

Consumer Track:
Is Individual Chapter 11 Just
a Chapter 13 on Steroids?

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The Sub Rosa Subchapter: Individual Debtors in Chapter 11 after BAPCPA

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Abstract:

In reforming the bankruptcy laws in 2005, Congress added several provisions to the Bankruptcy Code regarding the use of chapter 11 by individuals. These changes radically alter the basic chapter 11 rules with respect to individuals; among the most significant change is that postfiling service income, previously allocated to the individual debtor alone (and not available to pay prefiling creditor claims), was made property of the estate available to pay prefiling creditor claims. This article surveys the changes made and their possible impact, and suggests that they are sufficiently radical to have warranted a separate subchapter of chapter 11.

***The Sub Rosa Subchapter:
Individual Debtors in Chapter 11 After BAPCPA***

by
Bruce A. Markell*

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I. INTRODUCTION

Individuals¹ and chapter 11 have a rocky history. It took a Supreme Court decision to confirm that they were eligible debtors under chapter 11.² And even when they were allowed to file, fights broke out over what property was theirs and what wasn't,³ and whether they could ever use the new value corollary to the absolute priority rule.⁴

This chafing is more than a mere annoyance. The number of individual chapter 11 cases is not small. Indeed, it far exceeds chapter 11 cases in which the debtor is a public company. By some counts, individual chapter 11 cases account for somewhere between 10-15%,⁵ and perhaps as much as 36%,⁶ of all chapter 11 bankruptcy cases.

¹The term "individual" is not defined in the Bankruptcy Code, or for that matter, in the Uniform Commercial Code, even though both Codes use the term extensively. When used in this article, I mean a flesh-and-blood, living human being, not some artificial juridical entity.

A good introductory examination of the new chapter 11 provisions for individuals is Sally S. Neely, *How BAPCPA Changes Chapter 11 for Individuals - or - No, This Is Not Your Mother's Chapter 11!!*, Materials prepared for New York University's Workshop on Bankruptcy and Business Reorganizations (Sept. 14-16, 2005). In addition, several other authors have begun to explore some of the more interesting ramifications of the changes discussed in this article. See, e.g., Robert J. Keach, *Dead Man Filing Redux: Is the New Individual Chapter Eleven Unconstitutional?*, 13 AM. BANKR. INST. L. REV. 483 (2005); Jack F. Williams & Jacob L. 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. BANKR. INST. L. REV. 701 (2005); G. Ray Warner, *Garnishment Restrictions and the Involuntary Chapter 11: Rethinking Kokoszka in a Means Test World*, 13 AM. BANKR. INST. L. REV. 733 (2005).

²*Toibb v. Radloff*, 501 U.S. 157 (1991).

³Compare *In re Herberman*, 122 B.R. 273 (Bankr. W.D. Tex. 1990) with *In re FitzSimmons*, 725 F.2d 1208 (9th Cir. 1984).

⁴Compare *In re Gosman*, 282 B.R. 45 (Bankr. S.D. Fla. 2002) (may not use homestead as "new value" contribution; exempt property must be devoted to creditors' claims in chapter 11 plan) with *In re Henderson*, 321 B.R. 550, 558-60 (Bankr. M.D. Fla. 2005) (may use exempt homestead as "new value" contribution) and *In re Henke*, 90 B.R. 451 (Bankr. D. Mont. 1988) (allowing an individual to contribute nonexempt property, income from a patent held in the name of the owner, for purposes of new value exception). See also Ralph A. Peeples, *Staying In: Chapter 11, Close Corporations and the Absolute Priority Rule*, 63 AM. BANKR. L.J. 65 (1989); Raymond T. Nimmer, *Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions*, 36 EMORY L.J. 1009, 1068-82 (1987).

⁵Ed Flynn, *Bankruptcy By the Numbers: Who Is Filing Chapter 11?*, AM. BANKR. INSTITUTE L.J. 30 (Feb. 1999).

⁶Elizabeth Warren & Jay L. Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 AM. BANKR. L.J. 303, 336-39 (1999).

This means that last year, which saw an all-time low of some 6,600 chapter 11 filings,⁷ that at least 660, and maybe as many as 2375, individuals filed chapter 11 during the twelve months ended September 2005. Compare this to the 80 public companies that filed during all of calendar 2005.⁸

As rocky as the relationship is, it is about to get rockier. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)⁹ contained a host of changes for individual debtors under chapter 11. Driven in large part by Congress's desire to impose a means test in chapter 7 individual cases, and the desire to have bankruptcy relief keyed to a lack of future income rather than to a lack of current assets, these amendments work fundamental changes in the way chapter 11 treats individuals.

This paper attempts to summarize BAPCPA's major changes for individuals in chapter 11. As a heuristic for this examination, the article suggests that Congress underplayed the scope and import of these changes by the manner in which they were incorporated into existing chapter 11. A better way to achieve the changes sought – and to avoid many policy and implementation errors – would have been to create a separate subchapter, modeling it on the way chapter 11 now treats railroad reorganizations or the way in which chapter 7 treats stockbrokers. Had that drafting choice been made, many of the drafting ambiguities and infelicities might have been caught. As it is, however, we are left with a motley sub rosa subchapter, which will generate wasted effort for lawyers and pain for debtors.

⁷ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, Table F-2, *U.S. Bankruptcy Courts, Business and Nonbusiness Bankruptcy Cases Commenced, by Chapter of the Bankruptcy Code, During the Twelve Month Period Ended Sep. 30, 2005*, available at:

http://www.uscourts.gov/Press_Releases/bankrupt_f2table_sep2005.xls (last visited March 14, 2006).

Compare this to the 21,484 chapter 11 filings in the twelve months ended September 30, 1987.

ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, Table F-2, *U.S. Bankruptcy Courts, Business and Nonbusiness Bankruptcy Cases Commenced, by Chapter of the Bankruptcy Code, During the Twelve Month Period Ended Sep. 30, 1987*, at 43, available at: <http://www.uscourts.gov/bnkrpctystats/FY1987-2003.pdf> (last visited March 14, 2006).

⁸Mark G. Douglas, *The Year in Bankruptcy: 2005*, published by the law firm Jones Day. http://jonesday.com/pubs/pubs_detail.aspx?pubID=S3119 (last visited March 14, 2006). The same report indicates that 2004 has only 92 public company filings. The height of public company filings was 2001, with over 250 such filings. Alan Deaton, *Large and Small Companies Exhibit Diverging Bankruptcy Trends*, FDIC DIVISION OF INSURANCE PAPER 02-01, at 1 (January 2002).

⁹Pub. L. No. 109-8, 119 Stat. 23 (2005).

II. THE CONCEPT OF A SUBCHAPTER

As the title of this article implies, my basic thesis is that BAPCPA created a new type of reorganization applicable only to individuals. One way to understand these provisions is to think of how the amendments might have been incorporated in contexts already understood and used. One such context is the “subchapter.”

A. *Legislative Drafting and the “Subchapter”*

As noted in the House Legislative Counsel’s *Manual on Drafting Style*:

To be a good tool, style should be defined clearly. It should be one of the steady, predictable elements that attorneys use to reduce chaos to order, and not one of the fluctuating factors that contribute to the chaos. A good uniform style is one that gives clearly defined, steady, and predictable guidance for the structure and expression of legislation.¹⁰

Currently, a subchapter is a designated segment lower than a chapter, but higher than a division.¹¹ Although not mandatory, such style guidelines indicates a subchapter is appropriate when the basic functions or structure of the chapter is still applicable, but variation is required because of common features or elements of a particular class of cases.

B. *Existing Subchapters*

This conception of a subchapter is already found in chapter 11. For example, although not many are familiar with subchapter IV of chapter 11, it governs the reorganization of railroads. This subchapter’s roots are the longest of any statutory provisions related to reorganizations. Based upon the 1933 addition of Section 77 to the Bankruptcy Act of 1898,¹² this subchapter retains the basic chapter 11 reorganization structure, but alters it in key ways to adapt the form to the needs of railroads. Among these alterations are the elimination of creditor committees, accomplished simply by stating, in the first section of the subchapter, that Section 1104 of the general chapter

¹⁰ THE OFFICE OF THE LEGISLATIVE COUNSEL, UNITED STATES HOUSE OF REPRESENTATIVES, HOUSE LEGISLATIVE COUNSEL’S MANUAL ON DRAFTING STYLE 7 (1995).

¹¹ LEGISLATIVE COMPUTER SYSTEMS, OFFICE OF THE CLERK, UNITED STATES HOUSE OF REPRESENTATIVES, DRAFTING LEGISLATIVE DOCUMENTS 63 (2004).

¹²Section 77 provided for relief for railroad corporations. Act of March 3, 1933, ch. 204, § 77, 47 Stat. 1467, 1474 (1933).

does not apply.¹³ In addition, the subchapter also eliminates the “best interests” test of Section 1129(a)(7).¹⁴

The subchapter also adds as well as subtracts. Section 1171 of the subchapter supplements Section 507’s priority scheme with additional priorities, based upon practice in the equity receiverships that preceded Section 77’s enactment.¹⁵ There are also additional requirements for confirmation, including references to specific factors and a different test for feasibility¹⁶ and a specific direction to consider the public interest.¹⁷

Similar uses of the subchapter format appear in chapter 7. Subchapter III of that chapter has special provisions for stockbroker liquidations,¹⁸ while subchapter IV provides separately for the liquidation of commodity brokers¹⁹ and subchapter V contains provisions for the liquidation of clearing banks.²⁰ In each of these subchapters, the basic function of chapter 7 – liquidation – is preserved, but special treatment is given to certain types of creditors,²¹ or direction is given that other laws may control the ultimate liquidation.²²

Under this logic, Chapter 12, covering family farmers and fishermen, could and probably should have been a subchapter of chapter 13. As with subchapter IV of chapter 11 dealing with railroad reorganizations, chapter 12 makes only a few variations from the main provisions of chapter 13, but these variations are significant. A chapter 12 plan, for example, may modify a claim secured by the debtor’s principal

¹³11 U.S.C. § 1161.

¹⁴*Id.*

¹⁵11 U.S.C. § 1171.

¹⁶11 U.S.C. § 1173(a)(3).

¹⁷11 U.S.C. § 1173(a)(4).

¹⁸11 U.S.C. §§ 741-53.

¹⁹11 U.S.C. §§ 761-67.

²⁰11 U.S.C. §§ 781-84.

²¹ Holders of certain types of financial contracts in stockbroker liquidations, for example, receive preferential treatment not found in other sections of the Bankruptcy Code. *See, e.g.*, 11 U.S.C. § 741.

²² The Commodity Futures Trading Commission must get notice of all actions, and may appear and be heard, for example, in commodity broker liquidations. 11 U.S.C. § 762.

residence.²³ It is not limited to five years.²⁴ And, while there is the possibility of dispossessing the debtor as debtor in possession, there is also the possibility that the debtor may regain its position as estate fiduciary.²⁵ These changes do not run all in one direction; a chapter 13 discharge is broader than the chapter 12 discharge; for example, the chapter 12 debtor is subject to all of the nondischargeable claims found in Section 523.²⁶

The point here is that structure can aid function. Lawyers and judges can give better effect to a statute's purpose when that purpose is clarified by the structure used within the statute. Especially with respect to subchapters, Congress can signal its intent that similar, but not identical, treatment is necessary for certain classes of debtors. When Congress declines to use such signaling devices, however, lawyers and judges are left to wonder whether unspecified consequences are intended, or unanticipated.

III. THE CHANGES

A separate segmentation of chapter 11 for individuals would help, however, only if the changes made were sufficiently significant to justify the separate treatment. The claim that the new individual reorganization provisions effectively constitute such a subchapter – albeit a sub rosa one – ultimately turns on the effect of the Congress' changes. After first looking at the origins of these provisions, this article examines the amendments in some detail. It then compares the overall treatment effected by these changes to the treatment a chapter 13 case would provide.

A. *Origins and Legislative History – How Did We Get Here?*

Special provisions for individual chapter 11 debtors were first discussed by the Senate Judiciary Committee in 1999. At that time, in a markup to the then-current bankruptcy reform bill, Section 321 was added to read as follows:

SEC. 321. TREATMENT OF CERTAIN EARNINGS OF AN INDIVIDUAL DEBTOR WHO FILES A VOLUNTARY CASE UNDER CHAPTER 11.

Section 541(a)(6) of title 11, United States Code, is amended by inserting “(other than an individual debtor who, in

²³Compare 11 U.S.C. § 1222(b) with 11 U.S.C. § 1322(b)(2).

²⁴11 U.S.C. § 1222(b)(9).

²⁵11 U.S.C. § 1204(b).

²⁶Compare 11 U.S.C. § 1228(a) with 11 U.S.C. § 1328(a).

accordance with section 301, files a petition to commence a voluntary case under chapter 11)" after "individual debtor".²⁷

The section-by-section portion of the *Senate Report* accompanying the bill as ultimately reported simply stated that "[t]his section provides that post-petition income will become property of the bankruptcy estate in individual consumer cases under chapter 11."²⁸

The amendment did not go without comment. Senators Leahy, Kennedy, Feingold, and Schumer added the following in their Minority Views section of the *Senate Report*:

At the Judiciary Committee markup, Senator Grassley successfully introduced an amendment to include post-petition earnings for individual chapter 11 debtors as 'property of the estate.' This so-called 'super-rich' amendment, which would have been considered rather controversial had it been vetted among the bankruptcy community, is undoubtedly a significant change to bankruptcy law but is not the direct or most effective method of controlling higher income debtors and in any event is not responsive to our concerns regarding the disparate effects of the bill.²⁹

At the same time the Senate debated S. 625, the House was considering a companion bill, H.R. 833.³⁰ H.R. 833 passed the House on May 5, 1999,³¹ and was received in the Senate soon thereafter. The bill as received did not have any provisions for individual chapter 11 debtors.³² During its consideration by the Senate, however,

²⁷S. 625, 106th Cong., § 321 (as reported by S. Comm. on the Judiciary, May 11, 1999). The provision was not in the bill as introduced in the Senate. S. 625, 106th Cong. (as introduced in the Senate on March 16, 1999).

²⁸S. REP. NO. 106-49, at 33 (1999). The report indicates that the amendment was offered by Senator Grassley of Iowa, and that it passed by a vote of 12-5, with Senators Leahy, Kennedy, Biden, Kohl and Feingold voting nay. *Id.* at 17.

²⁹*Id.* at at 114 n.43.

³⁰H.R. 833, 106th Cong. (as introduced in the House, Feb. 24, 1999).

³¹The bill passed on May 5, 1999 by a 313-108 vote. 145 CONG. REC. H2771 (daily ed. May 5, 1999).

³²H.R. 833, 106th Cong. (as received in the Senate, May 12, 1999).

the Grassley amendment from S. 625 was inserted and, more importantly, expanded.³³ As a result, when the Senate ultimately passed H.R. 333, Section 321 contained not only a new Section 1115 regarding personal service income, but it also contained additional amendments that applied only to individuals. The list is short, but significant:

- Section 1123 was amended to require an individual's devotion of her postpetition service and other income as necessary to implement the plan;
- A "projected disposable income" test was added to Section 1129(a) as new paragraph (15);
- An individual's discharge was delayed until the completion of plan payments; and
- A new section on plan modification was inserted.³⁴

Congress passed the substance of H.R. 833 after the 2000 elections, but President Clinton then refused to sign the bill, and it was thus "pocket-vetoed."³⁵ Bankruptcy reform thus had to be reintroduced in the 107th Congress.

Reintroduction came soon: On January 31, 2001, H.R. 333 was introduced in the House.³⁶ This version contained the expanded version of Senator Grassley's Senate amendment that had passed both the House and the Senate a year earlier.³⁷ After some

³³The bill as passed by the Senate was nominally H.R. 833. Earlier, however, the Senate had struck the text of H.R. 833, and inserted the text of S. 625 in its place. 145 CONG. REC. S255 (daily ed. Feb. 2, 2000). The version inserted contained the Grassley amendment as expanded. See 145 CONG. REC. S407-08 (daily ed. Feb. 7, 2000).

³⁴H.R. 833, 106th Cong., § 321 (engrossed amendment as agreed to by Senate, Feb. 2, 2000).

³⁵For a detailed history, see Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485, 533-39 (2005).

³⁶H.R. 333, 107th Cong. (as introduced in the House, Jan. 31, 2001).

³⁷*Id.* § 321.

minor changes to the overall bill,³⁸ the House issued a report,³⁹ and promptly passed it.⁴⁰ The report contains the first extended discussion of the expansion of Senator Grassley's amendment.⁴¹

H.R. 333 ultimately went to conference in 2002. At conference, the House agreed to the Senate's text, and issued a conference report that contained a description of the expanded amendment, which is almost word-for-word the text used in the earlier House Report.⁴² This treatment, though somewhat extensive, is purely descriptive.⁴³ There is no discussion of the policy behind or purposes of these changes. And such silence was a hallmark of all successive versions of the bill, none of which altered the text of Section 321.

Thus, although not entirely free from doubt, it appears that the individual chapter 11 provisions were inserted as adjuncts to means testing to ensure no easy escape from chapter 7. As characterized by the Senate minority who opposed the provisions when they were first offered, the provisions were intended for the "super-rich." As enacted, however, these provisions do not just affect the "super-rich," and this article now turns to a detailed analysis of those provisions.

B. The Changes in Detail

Section 321 of BAPCPA carried forward several changes for individual chapter 11 debtors that had been discussed since 1999. They start with the original provision, which changed the nature of property of the estate.

1. Post-Petition Earnings From Services Are Property of the Estate – Section 1115

Section 321(a) of BAPCPA added Section 1115 to the Bankruptcy Code. This section defines property of the estate for each individual chapter 11 case. Section 1115's text is based upon and almost identical to existing Section 1306, which is applicable only

³⁸The bill was amended in committee to add what is now Section 1115(b), which allows the debtor to remain in possession of post-petition service income. See 146 CONG. REC. H548 (daily ed. March 1, 2001)

³⁹H.R. REP. NO. 107-3, 107th Cong., 1st Sess. (2001).

⁴⁰146 CONG. REC. H600-01 (daily ed. March 1, 2001).

⁴¹H.R. REP. NO. 107-3, 107th Cong., 1st Sess. 53-54 (2001).

⁴²H.R. 107-617, 107th Cong., 2d Sess. 220-21 (2002).

⁴³*Id.*

in chapter 13 cases. Both sections supplement the estate with property that is excluded from the estate in an individual's chapter 7 case: post-petition earnings from services.

This expansion of property of the estate includes income from services performed postpetition, and ensures that this additional property, which usually is necessary to fund or otherwise implement a plan of reorganization,⁴⁴ is protected by the automatic stay.⁴⁵ This is even the case with respect to claimants who could pursue such property in a chapter 7 case, such as those holding postpetition claims.⁴⁶

This inclusion of postpetition service income, however, did not change other provisions in title 11 which rely on Section 541's definition of estate property, such as the "best interests" of creditors test found in chapter 11.⁴⁷ There is also no requirement that property coming into the estate due only to the operation of section 1115(a) be listed in the schedules. Obviously, such a requirement would be unworkable, since the debtor's schedules would have to be amended to reflect each paycheck or acquisition of property, as well as every expenditure.

While Section 1115(a) adds this additional property into the estate, Section 1115(b) confirms the debtor's presumptive right to remain in possession of that property, as well as all other property of the estate.⁴⁸ As in pre-BAPCPA chapter 13 cases, the right to remain in possession of this property of the estate is a major advantage for individual chapter 11 debtors, who would otherwise be required to turn over nonexempt property to the trustee in a chapter 7 case.⁴⁹

⁴⁴11 U.S.C. § 1123(a)(8) (requiring an individual chapter 11 debtor to include such income from postpetition services as is necessary to implement the plan).

⁴⁵The chapter 13 cases construing cognate language in Section 1306 establish this principle. *See, e.g., Security Bank of Marshalltown, Iowa v. Neiman*, 1 F.3d 687 (10th Cir. 1993) (chapter 13 estate continues to exist after confirmation of plan, so expenses to protect estate property were administrative expenses); *Carver v. Carver*, 954 F.2d 1573 (11th Cir. 1992) (debtor's wages were property of estate and therefore action to collect alimony from those wages was not a section 362(b)(2) exception to automatic stay); *Annese v. Kolenda (In re Kolenda)*, 212 B.R. 851 (W.D. Mich. 1997) (property acquired postpetition remains in estate after confirmation and is protected by automatic stay); *Clark v. United States (In re Clark)*, 207 B.R. 559 (Bankr. S.D. Ohio 1997) (all property of debtor was property of estate protected by automatic stay after confirmation of plan when order confirming the plan so provided).

⁴⁶*See* 11 U.S.C. § 362(a)(3), (4) (protecting property of the estate); *Carver v. Carver*, 954 F.2d 1573, 1577 (11th Cir. 1992) (postpetition income protected from support enforcement).

⁴⁷*See* 11 U.S.C. § 1129(a)(7).

⁴⁸*See also* 11 U.S.C. § 1107.

⁴⁹11 U.S.C. § 521(a)(4).

2. *Use of Section 1115 Property to Fund a Plan – Section 1123(a)(8)*

To ensure that a debtor devotes Section 1115 income to plan implementation and to creditor claims, Section 321(b) of BAPCPA added Section 1123(a)(8). This provision requires the individual chapter 11 debtor's plan to provide "all or such portion of earnings from personal services . . . or other future income . . . as is necessary for the execution of the plan."⁵⁰ This provision apparently ensures that an individual debtor will devote an amount equal to his or her personal service income to the plan, although for reasons explored later, it may not be sufficient to achieve that task.

3. *Disposable Income Requirement Imported From Chapter 13 – Section 1129(a)(15)*

Section 1129(a)(15), added by Section 321(c) of BAPCPA, requires individual chapter 11 debtors to either pay all allowed unsecured claims in full,⁵¹ or that the plan provide that the debtor will devote an amount equal to five years' worth of the debtor's projected disposable income to property to be distributed under the plan.⁵² As with the best interest of creditors test found in Section 1129(a)(7), standing to object on this ground is not class-based; it is irrelevant that the plan proponent obtained the consent of the class of unsecured creditors so long as there is one objecting unsecured creditor.

Central to the application of this paragraph is the concept of "projected disposable income," and the amounts of such disposable income that must be devoted to the implementation of the plan. "Disposable income" is a concept borrowed from chapter 13. Indeed, Section 1129(a)(15) itself refers to Section 1325(b)(2) for a definition of the concept.⁵³

Under Section 1129(a)(15), the plan must distribute property equal in value to the debtor's projected disposable income over the five-year period commencing with the date that the first payment is due under the plan. The confirmation requirement thus specifies the amount of all payments.

Although based on chapter 13 practice, this confirmation requirement differs from that practice in several respects. First, it differs as to time. Under chapter 13, a

⁵⁰11 U.S.C. § 1123(a)(8).

⁵¹11 U.S.C. § 1129(a)(15)(A).

⁵²11 U.S.C. § 1129(a)(15)(B).

⁵³Section 1129(a)(15)(B) specifically provides that "disposable income of the debtor" is used "as defined in section 1325(b)(2)."

debtor's plan must extend for three years (in some cases five years) unless the plan provides for payment in full of all unsecured claims sooner.⁵⁴ Section 1129(a)(15) does not specify a minimum period, but does specify that the value of the property to be distributed under the plan "is not less than the projected disposable income of the debtor . . . to be received during the 5-year period" commencing with the start of plan payments.⁵⁵ Thus, if property from any other source — such as loans or gifts, or from exempt property — is used to supplement the payments to unsecured creditors, the plan may be shorter than five years.⁵⁶

Chapter 13 also limits the maximum plan length to five years.⁵⁷ Section 1129(a)(15) explicitly permits longer plans by requiring a minimum amount of property be devoted to the plan, and by linking that amount to the debtor's projected disposable income for the five years following confirmation or for "the period for which the plan provides payments, whichever is longer."⁵⁸

Finally, Chapter 13 requires payments to begin within 30 days of the commencement of the case, regardless of whether the plan is confirmed,⁵⁹ and then measures the plan period from the first scheduled payment to unsecured creditors.⁶⁰ Under Section 1129(a)(15)(B), however, the minimum five year period commences on the "date that the first payment is due under the plan,"⁶¹ which usually will be after confirmation.

⁵⁴11 U.S.C. § 1325(b)(4).

⁵⁵11 U.S.C. § 1129(a)(15)(B).

⁵⁶This view is supported by Section 1123(a)(8), which requires an individual debtor's plan to include all postpetition earnings from services to the extent necessary to implement the plan, but does not specify any minimum period.

⁵⁷11 U.S.C. §§ 1322(d); 1325(b)(4)(A)(i)-(ii).

⁵⁸11 U.S.C. § 1129(a)(15)(B).

⁵⁹11 U.S.C. § 1326(a)(1). The plan must be filed within 15 days of the commencement of the case. FED. BANKR. R. PRO. 3015(b).

⁶⁰11 U.S.C. § 1325(b)(1)(B).

⁶¹11 U.S.C. § 1129(a)(15)(B).

4. *Delayed Entry of the Discharge Imported From Chapter 13 – Section 1141(d)(5)*

Section 321(d) of BAPCPA changed the date upon which an individual chapter 11 debtor receives his or her discharge. Before BAPCPA, all debtors received their discharge upon plan confirmation, regardless of whether all (or any) plan payments were made. Section 321(d) added Section 1141(d)(5) to chapter 11, which changes the discharge date. For cases covered by BAPCPA, the discharge is now issued “on completion of all payments under the plan.”⁶²

5. *Changes to Modification of Plans – Incorporating Section 1329(a) – sort of – into Section 1127(e)*

The delay of the discharge for individuals makes the terms of modification more important; if assumptions made at confirmation prove erroneous, modification will be necessary in order to issue a discharge. Section 321(e) of BAPCPA addressed this issue by adding Section 1127(e) to the Code. This new section allows individual debtors (along with trustees and unsecured creditors) to modify the plan to increase or reduce payments, or to increase or reduce any repayment periods under the plan, so long as other confirmation requirements are met.⁶³

6. *Additional Confirmation Requirements – 11 U.S.C. § 1129(a)(14) and BAPCPA § 1228(b)*

In addition to the changes made by Section 321 of BAPCPA, other significant changes were made to the confirmation requirements imposed on individual debtors. Chapter 11 debtors will now have to ensure that their post-petition domestic support obligations⁶⁴ are current as of confirmation.⁶⁵ In addition, in an uncodified portion of BAPCPA, Congress required individual debtors to prove that they have provided all tax information that was requested pre-confirmation.⁶⁶

C. *Chapter 11 and Chapter 13 Compared*

⁶²11 U.S.C. § 1141(d)(5)(A). This is a provision that permits an earlier discharge in certain circumstances, and is discussed *infra* at Section IV.B.2.c.

⁶³11 U.S.C. § 1127(e).

⁶⁴See 11 U.S.C. § 101(14A).

⁶⁵11 U.S.C. § 1129(a)(14).

⁶⁶BAPCPA, § 1228(b).

There is a tendency to look at the changes to chapter 11, and assume that the only difference for individuals between chapter 13 and chapter 11 is the debt limitations. This might lead to the conclusion that the new chapter 11 provisions are really a subspecies of chapter 13. But that would be problematic. There are some significant differences between chapter 11 and chapter 13, as illustrated by the following:

- If the debtor could file under either chapter 11 or chapter 13, and is engaged in business, the small business provisions of chapter 11 will likely be applicable if a chapter 11 is filed, but not if a chapter 13 is filed.⁶⁷
- Chapter 11 has a more expensive filing fee: \$[1000/2750?] versus \$[150/235].⁶⁸
- There is no automatic co-debtor stay in chapter 11.⁶⁹
- Chapter 11 does not contain a statutory authorization for separate classification of debts upon which the debtor is co-liable.⁷⁰
- The valuation standard contained in Section 506(a)(2), requiring retail valuation, does not apply in chapter 11.
- Disposable income under chapter 11 need only be part of the “property to be distributed under the plan,”⁷¹ which presumably means some of it may be devoted to secured creditors and post-petition administrative claimants; in chapter 13, disposable income must be distributed for the benefit of *unsecured* creditors.⁷²
- The anti-cramdown provision added by Section 306(b) of BAPCPA to Section 1325(a), which prohibits bifurcation of certain purchase money secured claims if the secured creditor is undersecured, does not apply in chapter 11.

⁶⁷See 11 U.S.C. § 101(51C) (only cases under chapter 11 are eligible to be “small business cases.”).

⁶⁸See 28 U.S.C. § 1930(a). [Note: this will change by the time of the program; insert new filing fees then]

⁶⁹Cf. 11 U.S.C. § 1301.

⁷⁰Cf. 11 U.S.C. § 1322(b)(1) (extending such classification only to consumer debts).

⁷¹11 U.S.C. § 1123(a)(8).

⁷²Cf. 11 U.S.C. § 1325(b)(1)(B).

- The chapter 11 disposable income test found in Section 1129(a)(15) may not incorporate the IRS expense limits applicable to some chapter 13 debtors. Section 1129(a)(15) refers only to Section 1325(b)(2), which calculates disposable income with reference to the debtor's actual expenses, and not expressly to Section 1325(b)(3), which incorporates the IRS collection standards set out in Section 707(b)(2) for debtors whose income is above the applicable median income for their state.⁷³
- Creditors must be solicited and get to vote on a chapter 11 plan;⁷⁴ there is no creditor voting in chapter 13.
- The minimum plan length is calculated differently. For some cases, chapter 13 plans can be less than five years;⁷⁵ chapter 11 may require that the debtor devote at least five years' worth of disposable income to his or her plan.
- The maximum plan length differs. In chapter 13, no plan may last longer than five years;⁷⁶ chapter 11 plans may extend over a longer period of time.
- Payments under chapter 11 plans do not normally commence until after confirmation, which may be significantly later than the filing date; chapter 13 plans must be filed within 15 days of the filing date,⁷⁷ and chapter 13 debtors begin paying the designated plan amounts before plan confirmation.⁷⁸
- A chapter 13 debtor may discharge certain marital property settlements to the extent that they are covered in Section 523(a)(15), and chapter 13 debtors may discharge some forms of wilful and malicious injury that do not involve personal injury or death.⁷⁹

⁷³See Section IV.B.2.a *infra*.

⁷⁴See 11 U.S.C. §§ 1129(a)(8); 1125.

⁷⁵See 11 U.S.C. § 1325(d)(4).

⁷⁶*Id.*

⁷⁷ED. R. BANKR. P. 3015(b).

⁷⁸11 U.S.C. § 1326(a).

⁷⁹See 11 U.S.C. § 1328(a)(1)-(4).

- If unable to complete a plan, a chapter 11 discharge for inability to complete a plan appears to be somewhat easier to obtain than a chapter 13 hardship discharge.⁸⁰
- Chapter 13 debtors must complete a course in financial education as a condition to receiving their discharge;⁸¹ no such education requirement is applicable to chapter 11 debtors.

IV. THE EFFECTS OF THE CHANGES: WOULD A SUBCHAPTER HAVE HELPED?

As Section 321 of BAPCPA provided for only five relatively small changes to chapter 11 for individuals, the claim that individuals deserve their own subchapter may seem to be much ado about nothing.⁸² But as the effects of these changes ripple through chapter 11, they cause significant changes in the way cases can and should be administered. These effects divide into three areas: administration before confirmation; confirmation; and post-confirmation.

A. *Issues During Administration, But Before Confirmation*

Critics complained about the what happens in the gap between filing the case and confirming a plan, the so-called administrative period.⁸³ Congress addressed some

⁸⁰Compare 11 U.S.C. § 1328(b)(1) (discharge allowed without completion of plan payments only if the debtor's failure to complete payments is "due to circumstances for which the debtor should be justly be held accountable") with 11 U.S.C. § 1141(d)(5)(B) (discharge allowed without completion of plan if modification of plan is not practicable).

⁸¹11 U.S.C. § 1328(g)(1).

⁸²See, e.g., Leif M. Clark, *Chapter 11: Does One Size Fit All?*, 4 AM. BANKR. INST. L. REV. 167 (1996) (concluding that one form of relief for all entities is appropriate if judges who administer the system are appropriately trained).

⁸³As Judge Edith Jones stated, "Chapter 11 is more an intensive-care ward (or mortuary) than a healing potion for sick businesses." Edith H. Jones, *Chapter 11: A Death Penalty for Debtor and Creditor Interests*, 77 CORNELL L. REV. 1088 (1992). See also *In re Maxim Indus., Inc.*, 22 B.R. 611, 613 (Bankr. D. Mass. 1982) ("Bankruptcy is perceived as a haven for wistfulness and the optimist's Valhalla where the atmosphere is conducive to fantasy and miraculous dreams of the phoenix arising from the ruins. Unfortunately, this Court is not held during the full moon, and while the rays of sunshine sometimes bring the warming rays of the sun, they more often also bring the bright light that makes transparent and evaporates the elaborate financial fantasies constructed of nothing more than the gossamer wings and of sophisticated tax legerdemain.").

of those concerns in BAPCPA by limiting the debtor's exclusivity,⁸⁴ and by generally encouraging judges to be active in the administration and swift progress of chapter 11 cases.⁸⁵ But BAPCPA's changes may have exacerbated these problems, and caused others.

1. *Personal Living Expenses*

In a chapter 13, debtors must file their plan within 15 days of commencing the case,⁸⁶ and begin payments under the proposed plan before confirmation.⁸⁷ By contrast, chapter 11 does not require a plan to be filed at all – it simply provides for conversion or dismissal if a confirmable plan is not filed within a reasonable time.⁸⁸ As a result, there often will be a significant time gap between the commencement of the case and the confirmation of a plan in a chapter 11 case.⁸⁹

But what about paying expenses necessary to get the debtor to confirmation? In particular, what about a debtor's personal living expenses? Recall that new Section 1115 brings into the estate all post-petition service income, but thereafter provides no real guidance as to how to spend that income preconfirmation. If it could just accumulate, that would be ideal, but few debtors could afford to work for a wage and then not pay any bills. If, however, those expenses are "actual, necessary costs and expenses of preserving the estate," such as maintenance payments on a principal asset, then they should qualify as administrative expenses,⁹⁰ and may be paid, presumably in the ordinary course.

⁸⁴11 U.S.C. §§ 1121(d)(2) (limiting extensions of the exclusivity periods to 18 and 20 months); 1121(e) (requiring small business debtors, with limited exceptions, to file a plan and disclosure statement within 300 days of the date of the order for relief).

⁸⁵*See, e.g.*, 11 U.S.C. § 105(d)(1).

⁸⁶ED. R. BANKR. PRO. 3015(b).

⁸⁷11 U.S.C. § 1326(a)(1) (requiring plan payments to commence at the earlier of 30 days after filing the plan or after the order for relief).

⁸⁸*See, e.g.*, 11 U.S.C. § 1112(b)(4)(J) (failure to file a plan with time fixed by court or code listed as a ground for conversion or dismissal).

⁸⁹The notable exception would be prepackaged chapter 11 plans, authorized in part by 11 U.S.C. § 341(e) and 11 U.S.C. § 1125(g).

⁹⁰11 U.S.C. § 503(b)(1)(A). Taxes also will qualify as administrative expenses that may be paid in the ordinary course. *Id.* § 503(b)(1)(B)

But what about expenses that may not be necessary to preserve the estate, but which were part of the debtor's prepetition expenses? Many personal expenses of everyday folk are not "necessary" to preserve the "estate." Examples might include payments on a country club membership, a vacation, or even something as prosaic as the daily hit at Starbucks.⁹¹ There appears to be no statutory provision authorizing these types of payments.

These ordinary but not necessary expenses are handled in chapter 13 by Section 1325 which allows the debtor to include as a deduction against disposable income those costs which are reasonably necessary for the "maintenance or support of the debtor or a dependent of the debtor."⁹² Although new Section 1129(b)(15) cross-references Section 1325(b), Section 1129(a)(15) applies only to plan confirmation, and thus only to payments to be distributed under the confirmed plan, which typically will be after confirmation.⁹³ Indeed, if such expenses do not qualify as administrative expenses payable in full on confirmation, it appears that there may be no authorization for them, which means, at the extreme, that they could be recovered under Section 549.⁹⁴

2. Professional Expenses

Payment of the debtor's professionals also presents a concern with respect to the changes wrought by Section 1115. It is quite likely that the debtor's lawyer will have significant post-filing bills, and will need to know how (and will deserve) to be paid. This is not a problem in chapter 13, as there is explicit recognition of the ability of a professional for a chapter 13 debtor to receive reasonable compensation "for representing the interests of the debtor"⁹⁵

But no such provision exists for lawyers representing individual chapter 11 debtors. The chapter 11 debtor's lawyer would thus presumably be covered by *Lamie v.*

⁹¹At the extreme end, expenses for others which are not legally required, such as support for an elderly parent, are not strictly necessary to preserve the estate – but few outside of bankruptcy would quibble that a debtor should make such payments, and that the debtor should keep making them after filing.

⁹²11 U.S.C. § 1325(b)(2)(A)(i).

⁹³In addition, Section 1129(b)(15) will not apply if no creditor objects.

⁹⁴This might have a perverse effect on the best interests test, and on preplan disclosure; some court require the disclosure statement to outline the effect of avoidance power recoveries from insiders. *In re Sierra-Cal*, 210 B.R. 168 (Bankr. E.D. Cal. 1997).

⁹⁵11 U.S.C. § 330(a)(4)(B). This also applies to lawyers for chapter 12 debtors.

U.S. Trustee,⁹⁶ and could not receive compensation from the estate. The zone of noncompensation would cover advice as to exemptions, or advice on plan structuring if the plan allocates some of the estate for the debtor postconfirmation. And efforts to obtain sufficient funds prepetition to cover anticipated services may create causes of action under the avoiding actions, and thus raise questions of disinterestedness.⁹⁷

3. *Taxes and Support Payments*

After BAPCPA, keeping current on taxes and support payments is critical. An individual's failure to pay taxes or timely file tax returns may constitute cause for dismissal,⁹⁸ as may the failure to pay any domestic support obligation that comes due after the filing.⁹⁹ In addition, failure to keep these expenses current may preclude confirmation since both taxes and support payments are priority claims,¹⁰⁰ subject to a separate confirmation provision.¹⁰¹

B. *Confirmation Issues*

If the debtor is able to stay in chapter 11, and proposes a plan, there are several impediments, or uncertainties, regarding confirmation. These problems are dealt with as part of all confirmations under the heading of "all" confirmations, and as part of nonconsensual confirmations.

1. *All Confirmations*

BAPCPA added several paragraphs to Section 1129(a), which deals with consensual confirmation; that is, confirmation accompanied by the assent of all classes of claims.

⁹⁶540 U.S. 526 (2004).

⁹⁷ See *In re Equipment Services, Inc.*, 290 F.3d 739 (4th Cir. 2002); *In re CK Liquidation Corp.*, 321 B.R. 10 (Bankr. D. Mass. 2005); *In re Channel Master Holdings, Inc.*, 309 B.R. 855 (Bankr. D. Del. 2004). See also 3 COLLIER ON BANKRUPTCY ¶ 327.04[2][b] (15th rev. ed. 2006).

⁹⁸11 U.S.C. § 1112(b)(4)(I).

⁹⁹*Id.* § 1112(b)(4)(P).

¹⁰⁰

¹⁰¹11 U.S.C. § 507(a)(1) (domestic support obligations); 11 U.S.C. § 507(a)(8) (taxes); 11 U.S.C. § 1129(a)(9)(A) (postpetition taxes); 11 U.S.C. § 1129(a)(14) (postpetition domestic support obligations).

a. Best Interests Test and Service-Related Income

A central requirement of confirmation is the so-called “best interests” test; that is, the plan proponent must demonstrate that each and every nonconsenting, impaired creditor will receive more in reorganization than in liquidation.¹⁰² One nonobvious fallout of the BAPCPA amendments is that the intersection of Sections 1115 and 348 may render the “best interests” test immaterial in any case in which the debtor has significant postpetition income.

This odd result is dictated by the fact that, were a chapter 11 individual debtor to convert to chapter 7, Section 1115 would no longer be applicable.¹⁰³ All the postpetition income from services brought into the estate from and after filing would revert back to the debtor (and the debtor might even have a claim for a rebate) via the operation of Section 348, which tells courts that, in converted cases, the estate is deemed to have been created as of the filing date.¹⁰⁴ This would have the effect of recharacterizing all service income brought into the estate under Section 1115 as property of the debtor under Section 541(a)(6).

This was generally thought to be the result under chapter 13 as originally enacted.¹⁰⁵ Congress, however thought clarity was of sufficient importance to amend section 348 in 1994 to add subsection (f), which essentially clarifies that there is a reversion of postpetition service income to the debtor.¹⁰⁶ BAPCPA did not modify Section 348 to extend the same treatment to conversions from chapter 11 to chapter 7, so there remains some uncertainty over exactly how to calculate the value of the hypothetical chapter 7 estate. For this reason, the pre-BAPCPA cases examining the scope of Section 541(a)(6) in individual chapter 11 cases will retain vitality.¹⁰⁷

¹⁰²11 U.S.C. § 1129(a)(7).

¹⁰³One might quibble that the debtor would have to meet the means test of Section 707(b)(2) in order to convert, but that conclusion is not certain; Section 707(b)(1) would seem to extend the means test to “a case filed by an individual debtor *under this chapter . . .*” 11 U.S.C. § 707(b)(1) (emphasis supplied).

¹⁰⁴11 U.S.C. § 348(a).

¹⁰⁵See KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY § 315.1, at pp. 315-4 to 315-10 (3d ed. 2004).

¹⁰⁶*Id.* § 316.1. The main changes are found at 11 U.S.C. § 348(f)(1)(A).

¹⁰⁷See, e.g., *In re FitzSimmons*, 725 F.2d 1208 (9th Cir. 1984); *In re Harp*, 166 B.R. 740 (Bankr. N.D. Ala. 1993); *In re Herberman*, 122 B.R. 273 (Bankr. W.D. Tex. 1990).

b. Treatment of Privileged Creditors

Individuals also have to treat certain classes of creditors differently. Postpetition domestic support obligations have to be current to confirm a chapter 11 plan.¹⁰⁸ An uncodified provision of BAPCPA requires all “requested tax documents,” presumably all tax returns at a minimum, to be filed.¹⁰⁹ A minor concern exists in that BAPCPA did not modify Section 1122 to accommodate these necessary changes; in chapter 13, which borrows the classification standard from chapter 11, specifically allows the debtor to separately class favored classes of co-debtors.¹¹⁰

c. Good Faith

Good faith will change for individual chapter 11 debtors. Before BAPCPA, the focus in individual cases was the devotion of sufficient income to pay creditors.¹¹¹ Some courts had even adopted chapter 13’s disposable income test as an index of good faith.¹¹² But the change to Section 1123(a)(8), requiring the provision of an amount equal to at least five-years’ worth of projected disposal income to a plan, effectively requires debtors to devote all their service income to the plan, and thus undercuts the notion that good faith equates to the maximum provision of income. Thus, courts will have to shift their focus in individual cases to other, more traditional, indices of good faith.

d. Feasibility and Non-Dischargeable Debts

Every chapter 11 plan proponent must show that, under the plan, reorganization is not likely to be followed by the need to liquidate or reorganize further.¹¹³ This so-called “feasibility” requirement ensures that reorganization has a lasting quality.

¹⁰⁸11 U.S.C. § 1129(a)(14).

¹⁰⁹BAPCPA, § 1228(b).

¹¹⁰11 U.S.C. § 1322(b)(1). I acknowledge that similar changes were made with respect to the current status of domestic support obligations for chapter 13 plan confirmations, and also without modification of Section 1322.

¹¹¹*In re Kemp*, 134 B.R. 413 (Bankr. E.D. Cal. 1991); *In re Harman*, 141 B.R. 878 (Bankr. E.D. Pa. 1992); 7 COLLIER ON BANKRUPTCY ¶ 1129.03[3][a][iii][A] (15th ed. rev. 2006). See Neely, *supra* note 1, at 18-20.

¹¹²*In re Weber*, 209 B.R. 793, 799 (Bankr. D. Mass. 1997). *But cf. In re Flor*, 166 B.R. 512 (Bankr. D. Conn. 1994) (rejecting chapter 13 analysis).

¹¹³11 U.S.C. § 1129(a)(11).

BAPCPA made this feasibility determination more difficult for the individual debtor. Even though BAPCPA changed chapter 11 to provide that an individual's discharge is delayed until completion of the plan, the deadline for filing nondischargeability complaints has not been extended. Given that complaints for fraud and other defalcations must be filed within 60 days of the conclusion of the first meeting of creditors under Section 341(a),¹¹⁴ creditors will be pressured to file a complaint before that time, or request an extension. Since the outcome of these adversary proceedings may make the difference between a 100% payment, and something less, no plan will be able to be confirmed without some showing that it is more likely than not that the debtor will prevail on the dischargeability claim, thus either forcing a fast and rough estimation of the debtor's chances in order to confirm a plan,¹¹⁵ or a postponement of the confirmation until such claims are known.¹¹⁶

2. *Non-Consensual Confirmations*

Chapter 11 brings with it the possibility of nonconsensual confirmation; that is, confirmation without the assent of all classes of claims. Due to the structure of Section 1129(b), however, a plan proponent must meet both the nonconsensual requirements, and all the consensual requirements (except, of course, for the requirement that all classes consent).¹¹⁷ Given the structure of the BAPCPA amendments, however, this class-based system of confirmation may no longer effectively apply to individuals.

a. **Projected Disposable Income**

A central feature of BAPCPA's amendments was the addition of Section 1129(a)(15). Even though this paragraph is found in the consensual confirmation requirements, it applies only if a "holder of an allowed unsecured claim objects to the confirmation of the plan"¹¹⁸ Thus, not only may every creditor press the "best interests" test of Section 1129(a)(7), every unsecured creditor may press Section 1129(a)(15)'s disposable income test.

¹¹⁴ ED. R. BANKR. P. 4007(c).

¹¹⁵A creative lawyer might attempt to use 11 U.S.C. § 502(e) to estimate the amount of the nondischargeable claim for purposes of confirmation, but that action itself will take time.

¹¹⁶If the debtor is also a small business debtor, however, the time within which to file and confirm a plan are substantially circumscribed. A small business debtor must file his or her plan within 300 days of filing, 11 U.S.C. § 1121(e), and must then confirm that plan within 45 days, 11 U.S.C. § 1129(e). There are only limited circumstances in which these deadlines may be extended. 11 U.S.C. § 1121(e)(3).

¹¹⁷11 U.S.C. § 1129(b)(1).

¹¹⁸11 U.S.C. § 1129(a)(15).

This test, borrowed almost verbatim from chapter 13, requires the debtor to devote an amount equal to five-years' worth of projected disposable income to the plan, with the five years measured by the date the plan is confirmed or plan payments start, whichever is later. This will be a playground for creative lawyers. One question that arises is whether Section 1129(a)(15) requires all actual service-related income to be devoted to the plan, or only an amount equal to the projected disposable income, determined as of confirmation. The issue might arise in the following case. Say that a debtor owns significant real estate, and the plan calls for its sale. Assume that the net proceeds from the sale exceed the debtor's projected salary (or consulting agreement payments) for the five year period. Has the debtor met this provision by offering up the property?

Finally, although the Advisory Committee on Bankruptcy Rules does not think so,¹¹⁹ it is not beyond cavil that Section 1129(a)(15)'s reference to Section 1325(b)(2) incorporates the means test expenses from Section 707(b). The argument here starts with the fact that Section 707(b)(2)'s expenses are incorporated into chapter 13 by Section 1325(b)(3), which admittedly is not specifically referred to in Section 1129(a)(15). But the lead in to Section 1325(b)(3) states that it is to be used to calculate the "[a]mounts reasonably necessary to be expended under [Section 1325(b)] (2)."

Could this mean that Section 1325(b)(3)'s reference to Section 1325(b)(2) follows any use or reference in the Code to Section 1325(b)(2)? In other words, does it follow, in much the same way that the rules of Section 102 apply to all words in title 11 without any reference back to Section 102, that any reference to Section 1325(b)(2) carries with it all sections that help define it?¹²⁰ Although the Rules Committee's interpretation will be entitled to deference, it is not the only way to read the statute, thus leaving more uncertainty over the scope of the section.

¹¹⁹See Committee Note to Forms 22A, 22B & 22C, at 6, available at http://www.uscourts.gov/rules/Revised_Rules_and_Forms/B22A-C-Note.pdf ("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.")

¹²⁰11 U.S.C. § 102. The counter argument is that Section 103 makes Section 102 applicable throughout the Code, while there is no similar section that makes any provision in chapter 13 generally applicable to chapter 11 cases.

b. Absolute Priority and Cram Down

Any nonconsensual plan of reorganization must be “fair and equitable,”¹²¹ which has generally been held to require compliance with, among other things, the absolute priority rule.¹²² How that rule applies to individuals, however, is a puzzle.

The applicability of the absolute priority rule to individuals and small businesses has always presented confusion. Before 1952, for example, individual debtors under chapter XI of the Bankruptcy Act had to propose plans that were “fair and equitable.” Congress deleted the “fair and equitable” requirement from Chapter XI in 1952.¹²³ As the accompanying *House Report* stated, “the fair and equitable rule, as interpreted in [Case] cannot be realistically applied in a Chapter XI [action] Were it so applied, . . . no corporate debtor where the stock ownership is substantially identical with management could effectuate an arrangement except by payment of the claims of all creditors in full.”¹²⁴ Currently, Chapter 12 and Chapter 13 debt adjustment plans do not need to be “fair and equitable” with respect to dissenting creditors which means, among other things, that plans confirmed under those chapters do not have to satisfy the absolute priority rule.¹²⁵

Even before BAPCPA, courts were in disarray regarding whether an individual debtor could cram down a plan over the dissent of a class of unsecured creditors.¹²⁶

¹²¹11 U.S.C. § 1129(b)(1).

¹²²Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106 (1939).

¹²³Pub. L. No. 82-456, § 35, 66 Stat. 420, 433 (1952).

¹²⁴H.R. REP. NO. 2320, 82d Cong., 2d Sess. 21 (1952); see also S. REP. NO. 1395, 82d Cong., 2d Sess. 11-12 (1952).

¹²⁵11 U.S.C. §§ 1225(b)(1), 1325(b)(1).

¹²⁶See, e.g., *Unruh v. Rushville State Bank*, 987 F.2d 1506, 1508 (10th Cir. 1993); *In re Davis*, 262 B.R. 791, 794 (Bankr. D. Ariz. 2001); *In re East*, 57 B.R. 14, 15 n.1 (Bankr. M.D. La. 1985). See also H. Gray Burks IV, *Application of the Absolute Priority Rule to Exemptible and Abandonable Property -- Is Cramdown Eliminated in Individual Chapter 11's?*, NORTON BANKR. L. ADVIS. 1, 1 (Jan. 1991).

As Sally Neely notes:

The debate over whether section 1129(b)(2)(B) applies to individual debtors has recently been fueled by the court of appeals decisions in *Security Farms v. General Teamsters Local 890* (*In re General Teamsters Local 890*), 265 F.3d 869 (9th Cir. 2001) (neither members nor parent labor union of not-for-profit local union held interests for purposes of section 1129(b)(2)(B)(ii)), and *In re Wabash Valley Power Ass'n*, 72 F.3d 1305 (7th Cir. 1995) (members could continue in control of rural electric cooperative without violating the absolute priority rule of section 1129(b)(2)(B)(ii)).

Neely, *supra* note 1, at 12.

While Section 1129(a)(15) requires the debtor to commit to the plan property that has a value of certain future income, the absolute priority rule looks to the allocation of prepetition assets. In a corporate reorganization, if there is not enough value to reach a junior class, such as the equity holders, that class is eliminated. Elimination of the “equity” class in an individual case, while not without historical precedent,¹²⁷ is something most every court would avoid.

This has caused some to believe that individual debtors cannot effect a nonconsensual confirmation.¹²⁸ Others, however, have noted that such confirmation can comply with absolute priority through the contribution of exempt assets, or through loans from family, friends or gullible third parties.¹²⁹ But even that aspect is open to some doubt.¹³⁰

c. What Assets May or Must Be Devoted to the Plan – Of the Amendment to 11 U.S.C. § 1129(b)(2)(B)(ii)

The BAPCPA amendments address this conundrum of individual cramdown in a roundabout way by changing the statutory example of compliance with absolute priority, found in Section 1129(b)(2)(B)(ii). Section 321 of BAPCPA added the following text to Section 1129(b)(2)(B)(ii), applicable only in the case of an individual debtor:

the debtor may retain property included in the estate under Section 1115, subject to the requirements of subsection (a)(14) of this section [related to the satisfaction of all postpetition domestic support obligations]¹³¹

¹²⁷See 2 WILLIAM BLACKSTONE, COMMENTARIES 472 (“[Under Roman law], creditors might cut the debtor’s body into pieces, and each of them take his proportionate share...”). See also Vern Countryman, *Bankruptcy and the Individual Debtor – and a Modest Proposal to Return to the Seventeenth Century*, 32 CATH. U.L. REV. 809, 810 (1983).

¹²⁸See note 4 *supra*.

¹²⁹*In re Henke*, 90 B.R. 451 (Bankr. D. Mont. 1988) (allowing an individual to contribute nonexempt property, income from a patent held in the name of the debtor, for purposes of new value exception).

¹³⁰Some cases have read the use of the term “property” in Section 1129(b)(2)(B)(ii) to include exempt property, which effectively blocks use of that property as a contribution by the debtor for which he or she would receive credit. See, e.g., *In re Gosman*, 282 B.R. 45 (Bankr. S.D. Fla. 2002); *In re Yasparro*, 100 B.R. 91, 99 (Bankr. M.D. Fla. 1989); *Contra: In re Henderson*, 321 B.R. 550, 558-60 (Bankr. M.D. Fla. 2005); *In re Egan*, 142 B.R. 730, 733 (E.D. Pa. 1992).

¹³¹11 U.S.C. § 1129(b)(2)(B)(ii).

The problem, however, is that this addition contains a somewhat ambiguous reference to “property included in the estate under Section 1115.” At first glance, this section might be read to allow a debtor, so long as he or she meets the projected income test of Section 1129(a)(15), to keep post-petition income from services. But this would be odd given the effect of Section 1123(a)(8), also added by BAPCPA. It would be the rare case in which a debtor would have any funds left over after pledging an amount equal to five years’ worth of projected income to the plan. This might mean that income from and after year five in a plan could be kept over the dissent of a class of unsecured creditors, but that also seems somewhat odd.

A further oddity is in the language of Section 1115 itself. That sections states that “property of the estate includes, in addition to the property specified in Section 541” all postpetition income from services.¹³² But does this locution bring all of the property snagged by Section 541 into the chapter 11 estate, such that a person could say that Section 1115, by incorporation, specifies all property of the estate in chapter 11 cases? If so, then the exception in Section 1129(b)(2)(B)(ii) just got a lot more interesting. Given the paucity of legislative history on this point, it is unclear what the intended scope of the section is. The reader is left with the miserly post-fifth-year income on one side, and the generous designation of all estate property on the other.

C. Post-Confirmation Issues

BAPCPA also modified the chapter 11 discharge for an individual. It is now delayed until completion of the payments under the plan.¹³³ This tracks chapter 13 in the main, but leaves some questions open as how to assimilate into the plan the inevitable changes that will occur postconfirmation.

1. Who May Modify

The first problem that will arise is who has standing to modify a confirmed plan. In chapter 13, the debtor, the trustee or a holder of an unsecured claim may seek to modify the plan.¹³⁴ Under new Section 1127(e), the same group would seem to be empowered to seek a change.¹³⁵ What is different is that the changes to chapter 11 did not pick up the changes made to Section 1329, which now allows modification to allow

¹³²11 U.S.C. § 1115.

¹³³11 U.S.C. § 1141(d)(5).

¹³⁴11 U.S.C. § 1329.

¹³⁵11 U.S.C. § 1127(e).

the debtor to pay necessarily health insurance premiums.¹³⁶ In addition, secured creditors are not given standing to seek modification, although they often bear the brunt of the long-term changes effected by chapter 11 plans.

2. *The “Hardship” Discharge*

Of more interest is the opportunity for a chapter 11 individual debtor to obtain a discharge before the completion of plan payments. Under chapter 13, such a discharge is possible, but it covers only unsecured debts not subject to nondischargeability under Section 523.¹³⁷ More importantly, the debtor must show that the “failure to complete [plan] payments is due to circumstances for which the debtor should not justly be held accountable”, and that “modification of the plan under section 1329 of this title is not practicable.”¹³⁸

The chapter 11 analogue to this provision omits two parts. First, it does not grant a lesser discharge; there is no exception for debts covered by Section 523(a).¹³⁹ Second, the provision drops the first part to the two conditions for discharge – that the debtor should not justly be held accountable for the failure to complete payments – but keeps the second, making the early discharge turn on whether modification is “not

¹³⁶BAPCPA added a fourth paragraph to Section 1329(a) which allows the modification of a chapter 13 plan to:

- (4) reduce amounts to be paid under the plan by the actual amount expended by the debtor to purchase health insurance for the debtor (and for any dependent of the debtor if such dependent does not otherwise have health insurance coverage) if the debtor documents the cost of such insurance and demonstrates that—
- (A) such expenses are reasonable and necessary;
 - (B) (i) if the debtor previously paid for health insurance, the amount is not materially larger than the cost the debtor previously paid or the cost necessary to maintain the lapsed policy; or
 - (ii) if the debtor did not have health insurance, the amount is not materially larger than the reasonable cost that would be incurred by a debtor who purchases health insurance, who has similar income, expenses, age, and health status, and who lives in the same geographical location with the same number of dependents who do not otherwise have health insurance coverage; and
 - (C) the amount is not otherwise allowed for purposes of determining disposable income under section 1325(b) of this title; and upon request of any party in interest, files proof that a health insurance policy was purchased.

¹³⁷11 U.S.C. § 1328(b).

¹³⁸11 U.S.C. § 1328(b)(1), (3).

¹³⁹This is likely not a drafting glitch. The scope of the discharge for individuals in chapter 11 has always been coextensive with the discharge in chapter 7, and thus the debts listed in Section 523(a) have always been nondischargeable in chapter 11. Only in chapter 13, with its former “super” discharge, would the issue have arisen.

practicable.”¹⁴⁰ At this point, it is unclear what sort of thinking was behind the omission – it cannot be that the view that chapter 11 confirmation is administratively easier than confirmation in chapter 13. For one thing, chapter 11 still requires disclosure to each impaired creditor and the opportunity for each such creditor to vote.¹⁴¹ Perhaps the thought was that before utilizing this section, the debtor would have to propose a plan that was not accepted, but given the relatively Draconian provisions for dismissal if one cannot confirm a plan, this would seem to require too much.

V. CONCLUSION

As examined in this article, BAPCPA amended chapter 11 in five places in ways that directly affect individuals. These few changes, however, have deep and long ripple effects. Post-BAPCPA administration and confirmation of an individual’s chapter 11 plan will significantly and substantially differ from the administration and confirmation of other chapter 11 plans. Indeed, given the interrelatedness of chapter 11’s provisions, the full extent of these changes may not be known for a long time.

Form should follow function. The significant changes to chapter 11 should have been reflected in the structure of the Bankruptcy Code. Congress had a ready and simple tool to reflect these changes: the subchapter. For its own reasons, however, Congress chose not to use this device. The failure to use this device is difficult to understand. Congress has made effective use of this device within the Bankruptcy Code, especially in the treatment of other subclasses of debtors such as railroad and stockbrokers.

The failure to use a common and simple drafting tool – the subchapter – to organize the new provisions will have the untoward effect of increasing the incubation period of understanding will extended for the thousands of potential chapter 11 individual debtors. Participants in the bankruptcy system deserved better.

¹⁴⁰11 U.S.C. § 1141(d)(5)(B)(ii). Both the chapter 13 and 11 early discharges require that the plan have paid at least liquidation value to unsecured creditors. 11 U.S.C. §§ 1328(b)(2); 1141(d)(5)(B)(i).

¹⁴¹Or it might. At first glance, Section 1127(f) would appear to make Sections 1121 through 1128 and 1129 applicable to all modifications. The qualifier to this provision, however, refers to “any modification under subsection (a).” Subsection (a), however, only applies to preconfirmation modification, thus leaving open the question of whether these sections apply to postconfirmation modifications.

IS INDIVIDUAL CHAPTER 11 JUST A CHAPTER 13 ON STEROIDS?

AMERICAN BANKRUPTCY INSTITUTE, SOUTHWEST BANKRUPTCY CONFERENCE, SEPTEMBER 2011

Topic	Chapter 13	Chapter 11
Eligibility	Regular monthly income Secured debt of \$1,081,400 Unsecured debt of about \$360,475	No regular income required No debt minimums or maximums
Filing Fee	\$274	\$1,039
Trustee	Chapter 13 cases have a Trustee Trustee has statutory duties per Section 1302 In a business Chapter 13, the Debtor, and not the Trustee, has certain powers under Section 363, and specifically 363(c), as well as Section 364 U.S. Trustee has little or no involvement in Chapter 13 cases	Chapter 11 cases typically do not have a Trustee. They have a Debtor in Possession (“DIP”) per Section 1101. A Trustee may be appointed based upon a motion filed pursuant to Section 1112. Constitutional issues have been raised where a Trustee is appointed and a Debtor is compelled to work to satisfy plan payments. Chapter 11 cases have an Initial Debtor Interview (“IDI”) with a Staff Attorney from the Office of the U.S. Trustee, prior to which tax returns and other financial information will be requested.

		There are U.S. Trustee Guidelines for Chapter 11 cases. Those guidelines include the requirement that the DIP open post-petition bank accounts (which contains the designation “Debtor In Possession” in the account title <u>and</u> on the checks) in a financial institution that is on the Department of Justice approved list and provide evidence that all pre-petition accounts have been closed.
Operating Reports	No obligation to file in wage-earner Chapter 13 May have to file in self-employed Chapter 13	Obligation to prepare and file monthly operating reports by the 20 th day of the following month, or be subject to a motion to dismiss. Can “administratively close” a chapter 11 case during the payment period to avoid the accrual of post-confirmation quarterly fees. Case is then reopened to obtain the Debtor’s discharge.
Commissions/Fees	The Chapter 13 Trustee is entitled to receive a commission of no more than five percent of disbursements, Section 326(b)	Quarterly fees are assessed quarterly, based upon disbursements. The minimum fee for quarterly disbursements up to \$14,999 is \$325. Fees are used to fund the U.S. Trustee program, which is self-funded.
Credit Counseling	Required to file Financial education course required to exit, Section 1328(g)(1)	Required to file No financial education required to exit
Co-Debtor Stay	Automatic	None, absent filing an adversary proceeding and satisfying Section 105 injunction standards

<p>Post-Petition Earnings Estate Property</p>	<p>Yes, Section 1306</p>	<p>Yes, Section 1115 -Compare Section 521(a)(4) -Section 1115(b) confirms Debtor’s right to remain in possession of property -See Section 1123(a)(8), plan to provide “all or such portion of earnings from personal services ... or other future income ... as is necessary for the execution of the Plan.” -But see, Section 1129(a)(7) “best interests” test</p>
<p>Personal Living and Ordinary Course Expenses</p>	<p>No lengthy case administration period</p> <p>Section 1325 allows deduction against PDI for costs reasonably necessary for “maintenance or support of the debtor or a dependent of debtor.”</p> <p>Section 330(a)(4)(B) allows employment for “representation of the debtor” in Chapters 12 and 13 (does not extend to Chapter 11)</p>	<p>Due to plan filing and confirmation requirements, there could be as much as six months’ case administration</p> <p>Section 1129(a)(15) (which references 1325(b)) applies to plan confirmation not case administration</p> <p>Risk, if not proper administrative expenses per Section 503(b)(1)(A), might be subject to recovery per Section 549</p> <p>Motion to approve personal living and ordinary course expenses? (Include a request to fund representation of debtor on matters that clearly will not benefit the estate?)</p>
<p>Employment and Compensation of Professionals</p>	<p>Debtor’s employment of counsel does not require court approval. Many jurisdictions have a “no look” Chapter 13 fee for attorneys, with fee applications required only</p>	<p>Employment of attorneys and other professionals requires court approval, Section 327.</p>

	if exceeded. Attorneys' fees and costs are paid through the plan.	Payment of professional fees and costs must be approved by the Court, Section 328. Interim compensation may be sought, with the first such request no sooner than 120 days from the petition date, and subsequent interim requests every 120 days thereafter, Section 331.
Separate Classification, Debts Debtor Co-Liable	Section 1322(b)(1), yes, for consumer debt	No
Valuation Standard	Section 506(a)(2) requiring retail valuation	Not applicable
Claim Bifurcation	Section 1325(a) prohibits bifurcation of certain purchase money secured claims if the secured creditor is undersecured	No such provision
Plan Filing Date	<p>Must be filed within 15 days of the filing date, Bankruptcy Rule 3015(b)</p> <p>Small Business Case provisions of Section 101(51D) do not apply</p>	<p>Small Business Case provisions do apply</p> <ul style="list-style-type: none"> -Commercial or business activities -total debt under \$2,190,000 (excluding insider debt) -No active committee <p>Section 1121(e)(1) 180 day exclusivity</p> <p>Section 1121(e)(2) plan and disclosure statement shall be filed no later than 300 days following entry of the Order for Relief</p> <p>Section 1129(e) Court "shall confirm a plan" that complies with applicable plan confirmation requirements within 45 days of the date on which</p>

		<p>plan is filed, unless extended per Section 1121(e)(3)</p> <p><u>Timing Traps</u>: very difficult to confirm plan within 45 days. <u>Practice Pointer</u>, use conditionally approved disclosure statement for balloting; don't separately file plan until within 45 days of confirmation hearing</p> <p>Section 1112(b)(4)(F), (J) failure to comply with time periods is "cause" to convert or dismiss</p> <p>Section 1121(e)(3) permits extension of time periods if debtor demonstrates "it is more likely than not" that the court will confirm "a plan" within a reasonable period of time, with order entered before existing deadline expires</p>
Plan Payments	<p>Section 1326, payments begin within 30 days of the commencement of the Case</p> <p>Plan period is measured from the first scheduled payment to unsecured creditors.</p>	<p>Payments begin on Plan Effective Date, which could be 150 days or more after the petition date.</p> <p><u>Practice Pointer</u>: Debtor's post-petition monthly budget should contain a monthly accrual of funds to pay professional fees for the Debtor's attorney and provide for any income in excess of approved expenses to be held to fund the plan.</p> <p>Section 1129(a)(15)(B), dollar amount limitation measured by five year period, not a five year payment period requirement. Could satisfy with one payment on the Plan Effective Date.</p>

<p>Projected Disposable Income (“PDI”)</p>	<p>Section 1325(b)(2) definition</p> <p>Section 1325(b)(1)(B), must be distributed for the benefit of unsecured claims</p> <p>Section 1325(b)(3) calculates PDI based upon the IRS expense limits applicable to some Debtors</p>	<p>Section 1129(a)(15) requires either payment of allowed unsecured claims in full or that the plan provide debtor will devote an amount equal to five years’ worth of the debtor’s PDI.</p> <p>Section 1123(a)(8) requires payment only be part of the “property to be distributed under the plan,” which may mean that some of it may be devoted to post-petition administrative claims and secured claims.</p> <p>Section 1129(a)(15) refers only to Section 1325(b)(2) which calculates disposable income with reference to the debtors actual expenses.</p>
<p>Plan Length</p>	<p>Must extend for three years (in some cases five), unless plan provides for payment in full of all unsecured claims sooner</p> <p>Maximum plan length of five years</p>	<p>No minimum time period; specifies that the value of the property to be distributed under the plan “is not less than the PDI of the debtor ... to be received during the five-year period” commencing with the start of plan payments.</p> <p>-If other property (gifts, exempt property, proceeds of sales or settlements, return of collateral) is used to supplement the payments, plan may be shorter than five years.</p> <p>-Example, paid in full on Plan Effective Date</p> <p>Section 1129(a)(15)(B), measurement of five years, or for “the period for which the plan provides payments, whichever is longer.”</p>

Creditor Votes	There is no creditor voting, but the Chapter 13 Trustee files recommendations regarding plan confirmation.	Sections 1125 and 1129(a)(8), Creditors must be solicited and are permitted to vote on a chapter 11 plan. Must have at least one accepting impaired class to resort to cram down, Section 1129(b)(1).
Chapter 11 Plan Confirmation Issues		<p>Section 1129(a)(7) “best interests” test, demonstrate nonconsenting, impaired creditors will receive more in reorganization than liquidation. Anomaly, if case converts to chapter 7, per Section 348, the estate is deemed to have been created on the filing date. This would recharacterize post-petition earnings as property of the Debtor per Section 541(a)(6) (and may give the Debtor a right to a refund).</p> <p>Section 1129(a)(14) requires domestic support obligations to be current to confirm plan.</p> <p>Section 1129(a)(3) good faith requirement, case law focused on whether individual debtor devoted sufficient income to pay creditors. Changes in Section 1123(a)(8) now expressly requires sufficient income. This may shift back to traditional indices of good faith.</p> <p>Section 1129(a)(15) adds a new basis for objection (see above). <u>See also</u>, Notes to Form 22B “chapter 11 form is the simplest of the three, since the means-test deductions of § 707(b)(2)</p>

		<p>are not employed in determining the extent of an individual chapter 11 debtor's disposable income."</p> <p>Section 1129(b), non-consensual confirmation or "cram down."</p> <p>Section 1129(b)(1), plan must be "fair and equitable," which has been held to require compliance with, among other things, the "absolute priority rule."</p>
Timing of Discharge	Section 1328, no discharge until completion of plan payments.	Section 1141(d)(5)(A), no discharge until completion of plan payments. Could be on the Effective Date, could be five years, could be more than five years.
"Superdischarge"	Sections 523(a)(15), 1328(1)(1)-(4), may discharge certain marital property settlements, as well as some forms of willful and malicious injury that do not involve personal injury or death.	Section 1141(d)(2), Chapter 11 does not discharge a Debtor from any debt excepted from discharge under Section 523. Thus, a narrower discharge than in chapter 13.
Hardship Discharge	Section 1329(b)(1), discharge allowed without completion of plan payments only if "due to circumstances for which the debtor should justly be held accountable"	Section 1141(d)(5)(B) discharge allowed without completion of plan if modification of plan is not practicable