Update on Individual Chapter 11 Cases

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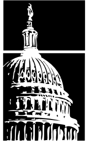

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ABI Consumer Winter Conference - Representing Individual Chapter 11 Debtors

By: John F. Sommerstein and William T. Stevens

Diversity of Debtors, the Unique Relief Afforded Individual Chapter11 Debtors and Strategies in Representation

Individual Chapter 11 Debtors come from many different situations, the causes are multi-faceted and the strategies myriad.

Examples of Individual Debtors filing for Chapter 11 relief:

- An individual guarantor of a corporation which has filed an affiliated Chapter 11 after a creditor commences collection;
- A taxing authority commences collection against an individual who had an operating or now defunct corporation for delinquent employee withholding taxes;
- Individuals who are over the jurisdictional Chapter 13 109(e) limit – typically debtors who own more than one piece of real estate;
- Individuals denied Loan modifications;
- Individuals who are *under or over* the Chapter 13 jurisdictional limit but prefer the Chapter 11 option because,
  (i) pre petition arrears are too high;
  (ii) the five (5) years cure period in Chapter 13 is insufficient;
  (iii) Chapter 11 does not have the so called "equal payment problem" of 1325(a)(5)(B)(iii)(I). (See In Re Hamilton, 401 BR 539, BAP, 1st Cir., (2009), denying confirmation of a balloon

payment Chapter 13 and In Re Lemieux, 347 BR 460 (2006), (Court denied confirmation of a plan where the debtor proposed to distribute property to a secured creditor in the form of unequal periodic payments). Also see In Re Flynn, 402 BR 437 (2009), (1st Circuit BAP remanded denial of confirmation to consider whether or not the creditor consented to the plan by not objecting); and

(iv) A more reasonable time to reorganize when multi family owners have vacancies and or need repairs to in order to propose a viable plan (See United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd, 484 U.S. 365 (1988). This point is extremely important for many debtors. It may be the *best and only* way to reorganize for many whom, prior to BAPCPA, could confirm a Chapter 13 "cram down" plan with a balloon payment to an undersecured mortgagee.

- Individuals who have filed a prior Chapter 7 case and cannot gain a Chapter 13 discharge for 4 years. (No corresponding Chapter 11 prohibition to Section 1328(f)). 11 U.S.C. § 1328(f) states:

> [T]he court shall not grant a discharge of all debts provided for in the [Chapter 13] plan or disallowed under section 502, if the debtor has received a discharge (1) in a case filed under Chapter 7, 11, or 12 of this title during the 4-year period preceding the date of the order for relief under this chapter….

Pre petition Strategies

- Securing appraisal before the filing in preparation for 506 Motion. Doing so also obviates the need to file Motion to Employ Appraiser, and gives a greater understanding of the potential cash collateral issues and plan strategy;
- Understanding adequate protection payments;
- Preparing for Cash Collateral Motions arising from collateral assignment of rents clauses in most multi family mortgages;
- Understanding and explaining Debtor in Possession accounts and Monthly operating reports.

Post Petition Strategies

- Filing Cash Collateral Motions with budgets;
- Filing Applications to Employ;
- Filing Application to Employ Appraiser and other professionals if necessary;
- Filing 506 Motions before filing plan helps speed case along and narrow issues vis-à-vis plan confirmation;
- Filing Bar Date Motions;
- Filing Disclosure Statements and Plans;
- Understanding classification and the voting requirements of Section 1126.

REPRESENTING INDIVIDUAL CHAPTER 11 DEBTORS

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REPRESENTING INDIVIDUAL CHAPTER 11 DEBTORS[1]

I. Introduction

Most sections of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8 (2005) ("BAPCPA") became effective on October 17, 2005. The new law made several changes that, according to some early decisions and commentators, were designed to make individual chapter 11 cases more like chapter 13s.[2]

But chapter 11 and chapter 13 retain structural distinctions. For example, in chapter 13, the automatic stay extends to co-debtors. *Cf.* 11 U.S.C. §§ 103 and 362(a) *with* § 1301. There is no co-debtor stay in chapter 11.

A trustee is automatically appointed to receive and to distribute plan payments in chapter 13. Not so in chapter 11. *Cf.* 11 U.S.C. § 1107 *with* § 1302 *and* § 1326.

A debtor must file a chapter 13 plan no later than 14 days after the petition date and make his first payment "not later than 30 days after . . . filing . . . the plan or the order for relief, whichever is earlier . . . ." Chapter 11 gives the non-small business debtor a 120 day exclusive period, which can be shortened or extended for "cause," but it mandates no specific plan filing deadline. *Cf.* 11 U.S.C. §§1321 *and* 1326 *and* Fed. R. Bankr. P. 3015(b) *with* 11 U.S.C. § 1121(b), (c) *and* (d).[3]

There is no disclosure statement requirement in chapter 13, eliminating one step in the confirmation process. *See* 11 U.S.C. §§ 1125(a) and 1325. And whereas classes of

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[1] By Eric K. Bradford, Esq. and Andrew G. Lizotte, Esq. John Sommerstein, Esq. and William Stevens, Esq. contributed to section II. Nothing in this outline expresses the views or policies of the United States Department of Justice. Eric K. Bradford thanks Trial Attorney Walter J. Theus, Jr. and Nan R. Eitel, Associate General Counsel for Chapter 11 Practice, both of the Executive Office for United States Trustees, for their suggestions and editing.

[2] *See e.g. In re Roedemeier*, 374 B.R. 264 (Bankr. D. Kan. 2007); *Matter of Johnson*, 402 B.R. 851, 852 – 853 (Bankr. N.D. Ind. 2009); Ralph Brubaker, "Individual Chapter 11 Debtors, BAPCPA and the Absolute Priority Rule," 30 Bankruptcy Law Letter (April, 2010).

[3] In a small business case, the debtor has a 180 day exclusive period and must file a disclosure statement and plan "not later than 300 days . . ." after the petition date. 11 U.S.C. § 1121(e)(2). Section 101(51(D) defines "small business debtor" as a "person engaged in commercial or business activities . . . and excluding a person whose primary activity is the business of owning or operating real estate or activities incidental thereto . . . that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the petition . . . in an amount of not more than $2,343,000 . . . ."

creditors may vote on whether to accept or to reject chapter 11 plans, creditors have no vote in chapter 13. They may only object. *Cf.* 11 U.S.C. §§1122, 1126 and 1129(a)(8) *with* § 1325).

The maximum term of a chapter 13 plan is five years. No such limitation exists in chapter 11. *Cf.* 11 U.S.C. § 1123 *with* § 1322(d)(1) *and* (2).[4]

Lastly, the absolute priority rule ("APR")[5] has never been a component of chapter 13. *Cf.* 11 U.S.C. § 1129(b)(2)(B)(ii) *with* § 1325(b)(1) (the "best efforts" test). BAPCPA added a best efforts test for individual chapter 11 debtors at 11 U.S.C. § 1129(a)(15), which may be invoked only by an unsecured creditor. *See infra* at section IV.

Recent decisions have split on whether (or to what extent) BAPCPA abrogated the APR by excepting post-petition property and earnings, which were added to the estate by new 11 U.S.C. § 1115, from amended 11 U.S.C. § 1129(b)(2)(B)(ii).[6]

B. This Outline

This outline provides an overview of chapter 11, as modified by the BAPCPA, for individual debtors, who own and wish to retain their interests in real estate.

Section II highlights circumstances suggesting that chapter 11 might be more appropriate for an individual than chapter 13.

Section III reviews selected operational issues, including compliance with the United States Trustee's operating guidelines, cash collateral and borrowing and employment and compensation of professionals.

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[4] *See Matter of Johnson*, 402 B.R. at 853 (reviewing some differences). *See In re Weber*, 209 B.R. 793, 798 – 799 (Bankr. D. Mass 1997) (same).

[5] The APR, codified at 11 U.S.C. § 1129(b)(2)(B)(ii), prohibits a debtor from receiving or retaining under the plan "on account of . . ." its junior claim or interest "any property . . . ," if an objecting class of unsecured creditors receives less than full payment. As applied to individual chapter 11 debtors, BAPCPA modified section 1129(b)(2(B)(ii) by excluding post-petition property, including wages, brought into the estate by new section 1115, from the APR, subject to the payment of post-petition domestic support obligations under section 1114. *See* section IV *infra.*

[6] *Compare In re Shat*, 424 B.R. 854 (Bankr. D. Nev. 2010) (holding that the APR no longer applies in individual chapter 11 cases) *with In re Gbadebo*, 431 B.R. 222, 228 (Bankr. N.D. Cal. 2010) (holding that BAPCPA abrogated the rule only as to post-petition assets incorporated into the estate by 11 U.S.C. § 1115). *Accord, In re Gelin*, 437 B.R. 435 (Bankr. M.D. Fla. 2010); *In re Mullins*, 435 B.R. 352 (Bankr. W.D. Va. 2010) and *In re Walsh*, 447 B.R. 45, 49 (Bankr. D. Mass 2011).

Section IV reviews selected confirmation issues, including classification, cramdown, the new "best efforts" test added by 11 U.S.C. § 1129(a)(15) and the widening split between courts on how BAPCPA affected the APR under 11 U.S.C. § 1129(B)(2)(B)(ii).

Section V presents suggested case closing procedures under 11 U.S.C. § 350 and Fed. R. Bankr. P. 3022 and post-confirmation issues.

II. Chapter 11 vs. Chapter 13

The following circumstances might influence whether chapter 11 is appropriate for an individual:

- their secured and/or unsecured debts exceed the chapter 13 ceilings established by 11 U.S.C. § 109(e) (which restricts chapter 13 to individuals having "noncontingent, liquidated, unsecured debts of less than $360,475 and noncontingent, liquidated, secured debts of less than $1,081,400 . . .") (adjusted under 11 U.S.C. § 104 and effective on April 1, 2010. *See* 75 Fed. Reg. 8748 (Feb. 27, 2010));

- their pre-petition mortgage arrears are too high and the five year cure period is too short;[7]

- they cannot satisfy the "equal monthly payment" requirement of 1325(a)(5)(B)(iii)(I), which was added by BAPCPA. *See In re Lemieux*, 347 BR 460 (2006) (denying confirmation of a chapter 13 plan, where the debtor proposed to make a final balloon payment to mortgagee). *Accord*, *Hamilton v. Wells Fargo* (*In re*

[7] In chapters 11 and 13, individual debtors may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence . . . ." 11 U.S.C. 1123(b)(5) and 1322(b)(2). *See Domestic Bank v. Mann (In re Mann)*, 249 B.R. 831 (B.A.P. 1st Cir. 2000) (holding that a debtor could strip off a wholly unsecured residential lien under a chapter 13 plan). *C/f In re Murphy*, 175 B.R. 134 (Bankr. D. Mass. 1994) interpreting 11 U.S.C. 1322(b)(2) and 1325(a)(5) and observing that "[e]ven if the debtor can modify a secured claim, absent consent of the secured claim holder or surrender of the collateral, a Chapter 13 debtor must do one of two things with a real estate secured claim: either pay the present value of the secured claim in full during the life of the plan or cure the default and maintain payments during the life of the plan . . . [E]ven after claim splitting, the debtor is stuck having either to pay a large real estate secured claim in full during the plan or to maintain payments consistent with the original loan agreement . . . ." (citation omitted). *See also* 11 U.S.C. § 1322(e).

Hamilton), 401 BR 539 (B.A.P. 1st Cir. 2009) (denying confirmation of a balloon payment chapter 13);[8]

- they need more time than afforded by chapter 13 to reorganize their affairs – *e.g.*, to reduce vacancies in rental properties and to make repairs; and

- they have received a discharge in a prior **a)** chapter 7 case "during the 4-year period . . ." prior to the petition date or **b)** chapter 13 case "during the 2-year period . . ." prior to the petition date. *See* 11 U.S.C. § 1328(f).

III. Selected Operational Issues

The United States Supreme Court affirmed in *Toib v. Radloff*, 501 U.S. 157 (1991), that individuals not engaged in business are eligible to reorganize under chapter 11. It observed, however, that "the greater expense and complexity of filing under Chapter 11 likely will dissuade most consumer debtors from seeking relief under this Chapter . . . ." *Id.* at 165.

The following highlights how operating in chapter 11 increases costs of administration.[9]

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[8] *See also In re Flynn*, 402 BR 437 (B.A.P. 1st Cir. 2009) (remanding order denying confirmation of plan to consider whether a mortgagee consented to the plan by not objecting).

[9] There is no impediment to an individual debtor's simultaneously being a small business debtor, assuming that he is "engaged in commercial or business activities . . . ." *See* 11 U.S.C. § 101(51(D) (defining "small business debtor"). But small business status imposes additional filing and reporting requirements under 11 U.S.C. § 1116, increasing costs of administration. The question is: what does an individual gain from being a "small business debtor" in exchange for the added compliance burdens and associated costs? Advantages might include a longer period – 300 days - within which to file a plan and disclosure statement (11 U.S.C. § 1121(e)) and freedom, upon a showing of "cause," from having a creditors' committee appointed (11 U.S.C. § 1102(3). But there are pitfalls. *See In re Sanchez*, 429 B.R. 393, 399 – 400 (Bankr. D.P.R. 2010) (denying reconsideration of order dismissing individual debtors' small business chapter 11 case, because they failed to their file disclosure statement and plan within the 300 day deadline established by 11 U.S.C. § 1129(e)). A debtor must claim small business status on his petition, which is submitted under penalty of perjury. Fed. R. Bankr. P. 1020 (stating that "the debtor shall state in the petition whether the debtor is a small business debtor . . . ." and authorizing the United States Trustee and parties in interest to object to the debtor's designation "not later than 30 days after the conclusion of any meeting of creditors held under § 341(a) of the Code . . . .)" *See In re Roots Rents, Inc.*, 420 B.R. 28**,** 34 – 35 (Bankr. D. Idaho, 2009) (dismissing small business debtor's chapter 11 case for failing to comply with plan confirmation deadline established by 11 U.S.C. § 1129(e) and denying

A. Compliance With U.S. Trustee OGRR

The United States Trustee has issued comprehensive, written Operating Guidelines and Reporting Requirements for Chapter 11 Cases ("OGRR") that all chapter 11 debtors, including individuals, must follow. 28 U.S.C. § 586(a)(3).

An analyst for the United States Trustee transmits the OGRR to the debtor's attorney soon after the petition date, along with letter scheduling an initial debtor interview ("IDI"). At the IDI, which is conducted before the section 341 meeting, the analyst reviews the OGRR with chapter 11 debtors and their counsel. 28 U.S.C. § 586(a)(3).

The OGRR require chapter 11 debtors to file monthly reports of their income and expenses, to provide evidence that they have insured all of their assets and operations, to close all pre-petition bank accounts and to use only debtor-in-possession bank accounts for all post-petition banking transactions.[10] 11 U.S.C. § 345. Chapter 11 debtors sign monthly operating reports under penalty of perjury.

The OGRR require debtors to provide the United States Trustee at the IDI with completed and executed chapter 11 questionnaires, proof that all of their assets are insured and copies of their most recent federal and state tax returns. Failure to provide proof of insurance, to attend the IDI and to comply with the United States Trustee's reasonable document requests might constitute "cause" for conversion or dismissal under 11 U.S.C. § 1112(b)(4)(C) and (H).[11] *See In re Van Eck*, 425 B.R. 54 (Bankr. D. Conn.

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the debtor's request to change its small business designation). Consideration of small business issues is beyond the scope of this outline.

[10] Unless the bankruptcy court orders otherwise for "cause," all chapter 11 debtors must open DIP accounts only at banks approved by the United States Trustee. 11 U.S.C. § 345(b). *See In re Service Merchandise Co., Inc.*, 240 B.R. 894 (Bankr. M.D. Tenn. 1999) (establishing a totality of the circumstances test to determine "cause"). These banks insure the full value of all DIP account deposits and independently report account balance information to the United States Trustee. Under the OGRR, debtors attach copies of their monthly DIP account bank statements to their monthly operating reports.

[11] Separately, section 109(h)(1), which was added by BAPCPA, among other things, requires an individual debtor, within 180 days prior to filing his/her petition under chapter 7, 11, 12 or 13, to obtain an individual or group briefing from an authorized (*i.e.* United States Trustee-approved) credit counseling agency as a pre-requisite to filing his/her bankruptcy petition. 11 U.S.C. § 109(h)(1); 11 U.S.C. § 521(b). A debtor who fails to obtain pre-petition credit counseling or to demonstrate "exigent circumstances" excusing performance is ineligible to file for bankruptcy under any chapter. 11 U.S.C. § 109(h)(1). *In re Fields*, 337 B.R. 173, 178 (Bankr. E.D. Tenn. 2005) (dismissing individual chapter 7 case for lack of pre-petition credit counseling); *In re Duplessis*, 2007 WL 118945 (Bankr. D. Mass. 2007) (denying motion for relief from dismissal order, because chapter 11 debtors failed to obtain pre-petition credit counseling).

2010) (granting United States Trustee's motion to dismiss individual debtor's chapter 11 case for "cause" under 1112(b)(4)(C) for failure to demonstrate that he had insured his real properties).

The United States Trustee conducts chapter 11 section 341 meetings no earlier than 21 days and no later than 40 days after the order for relief. 11 U.S.C. § 341; Fed. R. Bankr. P. 2003.

At the 341 meeting, the United States Trustee attorney assigned to the case will ask for photo identification (11 U.S.C. § 521(h)) and confirm all information at the IDI, including whether debtors have closed all pre-petition bank accounts, have opened their DIP accounts, are using cash collateral without prior court authorization and have insured their assets.

Deficiencies may prompt appropriate action under 11 U.S.C. § 1112(b)(4).

B. Cash Collateral and Borrowing

Individual debtors need access to cash to pay personal and business expenses.

i. Cash Collateral

As noted above, BAPCPA added new section 1115, which applies to individual chapter 11 debtors. Subsection (a)(1) includes in the estate "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 case under chapter 7, 12, or 13, whichever occurs first . . . ."[12]

Subsection (a)(2) breaks with past practice. It includes in the estate "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 . . . ."

Nothing in 11 U.S.C. § 363 requires individual chapter 11 debtors to obtain court authorization to pay ordinary course living and other expenses from their earned income. *See* 11 U.S.C. § 363(c); schedules "I" and "J." Proposed post-confirmation expenses are relevant under 11 U.S.C. § 1129(a)(15), however. *See* section IV, *infra*.

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[12] One commentator suggests that this subsection "would seem to be at least partially duplicative of sections 541(a)(6) and (7), which already added 'proceeds, products, offspring, rents or profits of property of the estate' and '[a]ny interest in property that the estate acquires after commencement of the case . . . ." 7 *Collier on Bankruptcy* ¶ 1129.04[3][d] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed. rev. 2011).

Section 363(c)(2) authorizes debtors to use cash collateral, including rents,[13] that is subject to a creditor's interest in order to conduct post-petition operations with the creditor's consent or, after notice and hearing, with court authorization. Absent creditor assent or court approval, debtors must segregate and account for cash collateral. 11 U.S.C. § 363(c)(4).

The court may condition debtors' using cash collateral "as is necessary to provide adequate protection of such interest . . . ." 11 U.S.C. § 361 and § 363(e). *See generally In re Cross Baking Co., Inc.*, 818 F.2d 1027 (1st Cir. 1987) (creditor who informally authorized debtor to use its cash collateral could not avail itself, after the fact, with the protections afforded by section 363). Adequate protection - designed to prevent diminution in the value of the creditor's collateral - may include periodic cash payments, replacement liens or an administrative priority expense claim equaling the diminution in value of the creditor=s interest in cash collateral. *See In re Marine Optical, Inc.*, 10 B.R. 893 (B.A.P. 1st Cir. 1981); *In re Ralar Distributers, Inc.*, 182 B.R. 81 (D. Mass. 1995); 11 U.S.C. § 507(b) (providing a super-priority administrative claim under 11 U.S.C. § 507(a)(2) for diminution exceeding adequate protection).[14]

Local courts vary on their practice regarding the management of rents. At least two Massachusetts judges require that chapter 11 debtors establish separate DIP accounts for each rental property.

Rents from each property, and budgeted expenses attributable to it, are deposited into and disbursed from only its account. These same judges prohibit co-mingling of rental and earned income, requiring that debtors maintain at least one account for personal income and expenses, with reconciliations in monthly operating reports for all transfers between accounts, if any.

While nothing in the Code or the Rules requires debtors to adopt these practices, they are reasonable and promote transparency.

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[13] Section 363(a) broadly defines "cash collateral" as "cash . . . or cash equivalents . . . ," including "proceeds, products offspring, rents, or profits of property . . . subject to a [creditor's pre-petition] security interest . . . ." *See Prudential Ins. v. Boston Harbor Marina Co.*, 159 B.R. 616, 618 (D. Mass. 1993).

[14] *See also United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 372 - 373 (1988) (holding that an undersecured mortgagee was entitled to adequate protection on the value of its secured claim, as determined under 11 U.S.C. § 506(a), in determining whether "cause" exists to grant stay relief under 11 U.S.C. § 362(d)(1)).

ii. Post-Petition Borrowing

In contrast to section 363, section 364 permits chapter 11 debtors to obtain credit by offering "an escalating series of inducements[15] which the debtor in possession may offer while attempting to obtain credit for use in the reorganization . . . ." *In re Glover, Inc.*, 43 B.R. 322, 324 (Bankr. D.N.M. 1984). *Compare* 11 U.S.C. § 363(c) *with* § 364(b), (c) and (d).

iii. MLBR 4001-2

Fed. R. Bankr. P. 4001(b) and (c) and 9014 implement 11 U.S.C. § 363(c) and § 364. Debtors must request authorization to use cash collateral or to borrow funds in writing. Unauthorized use of cash collateral that is "substantially harmful to 1 or more creditors . . ." might constitute grounds for conversion or dismissal under 11 U.S.C. § 1112(b)(4)(D).

The court may authorize use of cash collateral on a preliminary basis, subject to a later hearing, if doing so will prevent irreparable harm. 11 U.S.C. § 363(c)(3). *See* 3 *Collier on Bankruptcy* ¶ 363.03[4][b].[16]

MLBR 4001-2(a) specifies information that debtors must provide in cash collateral and borrowing motions and stipulations, including the total amount of funds requested, how debtors intend to use the funds, a proposed budget for the period of use, the value of collateral and "any proposal for providing adequate protection . . . ." *Compare* MLBR 4001-2(a) *with* Fed. R. Bankr. P. 4001(b) and (c) (requiring less specific information and prescribing procedure).

Subject to court authorization and a conspicuous statement of variance under subsection "d," MLBR 4001-2(c) prohibits cash collateral and borrowing orders from including fourteen types of terms and conditions, including cross-collateralization

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[15] The inducements include a priority status claim equal to administrative expense - section 364(b); a super-priority status claim (priority over administrative expenses) - section 364(c)(1); a claim secured by a lien on otherwise unencumbered property - section 364(c)(2); a claim secured by a junior lien on encumbered property section 364(c)(3); or a claim secured by a senior or equal lien on encumbered property, assuming that the interest of the extant lienholder is adequately protected - section 364(d).

[16] Fed. R. Bankr. P. 6003, which was issued in 2007, prohibits the court from granting "first day" motions to employ professionals, to sell assets, to incur "all or part" of a pre-petition claim, except a cash collateral or borrowing motion, or to assume an executory contract or lease under 11 U.S.C. § 365 within 21 days of the petition date, "[e]xcept . . . to avoid immediate and irreparable harm . . . ." *See* 10 *Collier* at ¶ 6003.01[a] for examples of first day motions, including pre-petition wage, cash management and "critical vendor" motions. These may not be applicable in most individual chapter 11 cases.

clauses, concessions that bind "the debtor, the estate representative or other parties in interest . . ." as to the "validity, perfection, priority, enforceability or amount of the secured creditor's pre-petition lien or debt . . . ," provisions granting liens "on the estates claims arising under 506(c) . . ." and avoidance actions, waivers or releases of debtor or estate claims against the secured creditor and "[p]rovisions that grant automatic relief from stay upon the occurrence of any event . . . ." MLBR 4001-2(c)(1) – (14).

The United States Trustee recommends that, in addition to the meeting the requirements of MLBR 4001-2, all cash collateral and borrowing stipulations require debtors to file monthly budget to actual reconciliations.

C. Employment of Professionals

A chapter 11 debtor, as debtor in possession, assumes the rights, powers and duties of a trustee per 11 U.S.C. § 323(a) and § 1107(a) and, therefore, is a fiduciary of "the estate and its constituents," including creditors. *In re DN Associates*, 144 B.R. 195, 198 199 (Bankr. D. Me. 1992), *aff'd*, 3 F.3d 512, 514 - 515 (1st Cir. 1993); *see Commodity Futures Trading Com'n v. Weintraub*, 473 U.S. 343, 354 (1985); *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994).

Section 327(a) authorizes a debtor in possession, subject to court approval, to retain one or more professional persons to assist him in fulfilling his fiduciary duties, provided that the person: 1) does not represent an interest adverse to the estate; and 2) is disinterested.[17] *Rome v. Braunstein* at 57 -58.

The Code does not define "interest adverse," but courts have interpreted the term to mean:

> the possess[ion] or assert[tion] [of] mutually exclusive claims to the same economic interest, thus creating either an actual or potential dispute between rival claimants as to which . . . of them the disputed right or title to the interest in question attaches under valid and applicable law; or . . . [the possession of] a predisposition or interest under circumstances that render such a bias in favor of or against one of the entities.

Id. at 58; *see In re Hot Tin Roof, Inc.*, 205 B.R. 1000, 1002 - 1003 (B.A.P. 1st Cir. 1997).

Section 101(14) defines "disinterested person" as one that:

[17] By contrast, bankruptcy attorneys representing chapter 13 debtors "are not bound . . ." by 11 U.S.C. § 327(a). *In re Holland*, 374 B.R. 409, 431 – 432 (Bankr. D. Mass. 2007). Insofar as chapter 13 debtors' attorneys are paid from estate assets (11 U.S.C. § 1306), their fees are reviewed under 11 U.S.C. § 330(a)(4)(B) for reasonableness, benefit and necessity. *Id*.

> (A) is not a creditor, an equity security holder, or an insider . . .
>
> (E) does not have an interest materially adverse to the interest of the estate or any class of creditors . . . by reason of any direct or indirect relationship to, connection with, or interest in, the debtor . . . or for any other reason.[18]

Fed. R. Bankr. P. 2014 implements 11 U.S.C. § 327(a). *In re Guard Force Management, Inc.*, 185 B.R. 656, 661 (Bankr. D. Mass. 1995). It requires that an employment application be in writing and state "specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection of the professional . . . any proposed arrangement for compensation and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee . . . ." Rule 2014 requires the proposed professional to file a separate "verified statement . . . setting forth the person's connections . . . ." *Id*.

Failure to make adequate disclosure might result in denial of fees and disgorgement. *See Rome v. Braunstein* at 58 (failure to disclose per section 327(a) and Fed. R. Bankr. P. 2014 resulted in denial of fees).

MLBR 2014-1(d) provides that a professional's employment "shall be deemed effective as of the date of the filing of the application. However, if such application is filed within fourteen (14) days from the later of case commencement or the date the professional commenced rendering services, court approval shall be deemed effective commencing the date that services were first rendered. Approval shall not be otherwise retroactive *absent extraordinary circumstances* . . . .") (emphasis added). *See* MLBR 2014-1(d).[19]

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[18] "[T]he twin requirements of disinterestedness and lack of adversity telescope into a single hallmark . . . that address[es] the appearance of impropriety as much as its substance, to remove the temptation and opportunity to do less than duty demands . . . the purpose of the . . . disinterested requirement . . . was to prevent even the appearance of a conflict irrespective of the integrity of the person or firm under consideration . . . a 'disinterested' person should be divested on any scintilla of personal interest which might be reflected in his decision concerning estate matters . . . ." *In re Martin*, 817 F.2d 175, 181 (1st Cir. 1987) (internal quotation marks and citations omitted).

[19] A debtor may seek court authorization to employ a professional *post facto* under 11 U.S.C. § 327(a) only if he meets a two-pronged test: 1) the professional's retention is necessary to the debtor's performing his fiduciary duties as trustee; and 2) there are "extraordinary circumstances to justify the application's untimeliness . . . ." *In re Jarvis*, 53 F.3d 416, 421 (1st Cir. 1995). "[A] mere showing of oversight does not constitute extraordinary circumstances . . . under the second prong of this test, regardless of whether

Section 329(a) and Fed. R. Bank. P. 2016(b) separately mandate that a proposed attorney file, within 15 days after the commencement of the case, a statement disclosing "the compensation paid or agreed to be paid . . . ." within the previous year "for services rendered or to be rendered in contemplation of or in connection with the case by such attorney and the source of compensation . . . ." *See In re Mills*, 170 B.R. 404, 409 (Bankr. D. Ariz. 1994). Disclosure of these payments facilitates the court's analysis of whether a professional will be inclined to act contrary to the interests of the estate, in violation of section 327(a). *See Matter of Kero-Sun, Inc.*, 58 B.R. 770, 778 (Bankr. D. Conn. 1986). *See also In re Lincoln North Associates, Ltd. Partnership*, 155 B.R. 804, 808 (Bankr. D. Mass. 1993) (court denied debtor's application to employ counsel, who had failed to make full and complete disclosure of the retainer that it had received without "inordinate prompting by the court . . . .").

D. Compensation of Professionals

Section 330(a) authorizes a bankruptcy court to pay a "a professional person employed under section 327 . . . reasonable compensation for actual and necessary services . . . ." 11 U.S.C. § 330(a)(1)(A). *See generally Lamie v. United States Trustee*, 540 U.S. 526, 538 - 539 (2004) (holding that a debtor's attorney could not be compensated from estate assets post-conversion, because he had not been employed by the chapter 7 trustee).[20] The court may authorize reimbursement of the professional's "actual" expenses if they are "necessary." 11 U.S.C. § 330(a)(1)(B).

The professional bears the burden of demonstrating his entitlement to fees and expenses under 11 U.S.C. § 330(a). If he fails to meet his burden of proof under 11 U.S.C. § 330(a), the bankruptcy court, with or without an objection from a party in interest, may award compensation "less than the amount of compensation that is requested . . . ." 11 U.S.C. § 330(a)(2). Section 330(a)(4) prohibits the bankruptcy court from awarding compensation for "unnecessary duplication of services . . . or . . . services that were not . . . reasonably likely to benefit the debtor's estate . . . or . . . necessary to the administration of the estate . . . ." 11 U.S.C. § 330(a)(4).

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the professional's services have benefited the estate . . . ." (internal quotations and citations omitted). *Id.*

[20]*Compare* 11 U.S.C. § 330(a) *with* § 328(a), which authorizes a debtor to employ professionals "on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis . . . ." Section 328(a) permits a bankruptcy court subsequently to award different compensation only if the pre-approved "terms and conditions of employment prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions . . . ." *Daniels v. Barron (In re Barron)*, 325 F.3d 690, 692 - 693 (5th Cir. 2003) (reversing and remanding fee order that reduced pre-approved compensation terms).

Section 331 authorizes professionals to seek interim compensation on the same basis as under section 330(a). *See* MLBR Appendix 6(b) (governing interim compensation procedures).

The First Circuit utilizes the "lodestar" method, which it adopted from non-bankruptcy, fee-shifting cases, to determine the reasonableness of requested bankruptcy professional fees under 11 U.S.C. § 330. *See In re Boston & Maine Corp. v. Moore*, 776 F.2d 2, 6 - 7 (1st Cir. 1985). Under this method, "the fee-setting court establishes a 'threshold point of reference' or the 'lodestar,' which is the number of hours reasonably spent by each [professional] multiplied by his reasonable hourly rate . . ." *Id.* Once the lodestar is determined, it may then be adjusted up or down to reflect the quality of the professional representation. *Id.*

In order to receive compensation under 11 U.S.C. § 330(a), a debtor's attorney must meet two tests. First he must be employed under 11 U.S.C. § 327(a). Second, regardless of the source of compensation, the bankruptcy court must grant a fee award. Failure to obtain prior court authorization to receive compensation, including from a retainer held by the professional, could result in denial of the fee application and disgorgement. *See Miller v. U.S. Trustee (In re Independent Engineering)*, 197 F.3d 13, 16 (1st Cir. 1999) (affirming orders directing debtor's counsel to disgorge all draws on a pre-petition security retainer that he had taken without court approval under 11 U.S.C. § 330(a) and denying his fee application)

IV. Confirmation And Cramdown

Assuming 1) a mortgagee holding an undersecured deficiency claim objects to confirmation, 2) that the mortgagee's claim controls the class of unsecured claims and 3) that that the plan otherwise complies with 11 U.S.C. § 1129(a), the debtor will be unable to confirm the plan, unless at least one class of impaired claims accepts under 11 U.S.C. § 1129(a)(10). Compliance with section 1129(a)(10) is a prerequisite to cramdown under 11 U.S.C. § 1129(b)(2)(B)(ii).[21] *See generally Beal Bank, S.S.C v. Waters Edge LP*, 248 B.R. 668, 678 (D. Mass.2000).

[21] "The policy underlying § 1129(a)(10) is that before embarking upon the tortuous path of cramdown and compelling the target of the cramdown to shoulder the risks of error [and related expenses] necessarily associated with a forced confirmation there must be some other properly classified group that is also hurt and nonetheless favors the plan . . . ." *In re Curtis Center, L.P.*, 195 B.R. 631, 637, 640 (Bankr. E.D. Pa. 1996) (holding that property tax claims entitled to priority under 11 U.S.C. § 507(a)(8) did not constitute a class under 11 U.S.C. § 1123(a)(3) and, therefore, could not serve as an impaired, accepting class and 1129(a)(10) (citations omitted).

A. Voting, the Effect of Sections 506 and 1111 on Classification.

It is helpful here to review plan voting requirements and the impact of 11 U.S.C. § 506(a) and § 1111(b) on claim classification under section 1122.

i. Voting Requirements

Only holders of allowed claims or interests under section 502 may vote to accept or reject a plan. 11 U.S.C. § 1126(a); Fed. R. Bankr. P. 3018(a). A proof of claim is deemed allowed under section 502(a) unless a party in interest objects.

Notwithstanding an objection to a claim or interest, however, the court, after notice and hearing, may temporarily allow the claim or interest in an amount which the court deems proper for the purpose of accepting or rejecting the plan. Fed. R. Bankr. P. 3018(a). *In re Harmony Holdings, LLC*, 395 B.R. 350, 352 – 353 (Bankr. D.S.C. 2008).

A class of claims that is not impaired under the plan is conclusively presumed to have accepted the plan, and the plan proponent need not solicit the acceptance of that class. 11 U.S.C. § 1126(f).[22] A class that receives nothing under the plan is deemed to have rejected it. 11 U.S.C. § 1126(g). "Absent deemed acceptance under subsection (f) . . . or deemed rejection under subsection (g), a class must be permitted to participate in the balloting process to give effect to Section 1126(a) . . . ." *In re American Solar King Corp.*, 90 B.R. 808, 817 (Bankr. W.D. Tex. 1988).

A class of claims accepts a plan when more than one-half in number and at least two-thirds in amount of the claims actually casting ballots approve the plan. 11 U.S.C. § 1126(c).

ii. Deemed Acceptance by a Non-Voting Class

In specifying how a class may accept a plan, section 1126(c) arguably requires that a class take affirmative action – a vote – as a prerequisite to accepting. That is not how the Tenth Circuit Court of Appeals has interpreted section 1126.

In *Heins v. Ruti-Sweetwater, Inc., et al. (In re Ruti-Sweetwater, Inc.)*, 836 F.2d 1263, 1265 - 1266 (10th Cir. 1988), the debtors' plan authorized the sale of real property free and clear of attachment liens asserted by the appellants. None of the 103 classes of

[22] Section 1124 provides that "a class of claims or interests is impaired under a plan unless it . . . leaves unaltered the legal, equitable, and contractual rights to which such claim . . . entitles the holder of such claim . . . ; or . . . cures any default that occurred before or after the commencement of the case under this title; . . . reinstates the maturity of such claim ; . . . compensates the holder of such claim . . . for any damages . . . ; and . . . does not otherwise alter the legal, equitable, and contractual rights to which such claim . . . entitles the holder . . . ."

secured and unsecured creditors created by the plan, including the appellants, cast votes to accept or to reject. *Id.*

The bankruptcy court confirmed the plan and authorized the sale of the property, finding that, absent votes, all classes were "deemed" to have accepted. *Id.* Given deemed acceptance, the court did not need to evaluate the plan under the cramdown standards.

The court rejected the appellants' challenge of the sale at a post-confirmation hearing on the distribution of the sale proceeds. They then appealed the confirmation order.

The district court and the Tenth Circuit affirmed. *Id.*

The court noted that while "actual acceptance of a plan by at least one class of impaired claims is necessary for a bankruptcy court's confirmation of a plan under § 1129(a)(10) . . . ," section 1126(a) was permissive.[23] *Id*. at 1267. It contrasted section 1126(a) to its predecessor under the Bankruptcy Act of 1898, which presumed rejection if a creditor did not vote. *Id*.

The court found support for its analysis in subsections (f) and (g), which, as noted above, presume acceptance by classes of creditors whose claims are unimpaired and rejection by impaired classes who receive nothing under the plan. *Id*. It concluded "[s]ince the Heins did not object to the Plan at any time prior to its confirmation and because the Heins unilaterally opted not to vote on the confirmation of the Plan, the bankruptcy court did not err in presuming their acceptance of the Plan for purposes of § 1129(b) . . . ." *Id.* at 1267 – 1268.

Commentators and other courts have criticized *Ruti-Sweetwater*. 7 *Collier on Bankruptcy* ¶ 1126.04. ("*Ruti*-Sweetwater was not correctly decided and has been specifically rejected in subsequent decisions: The failure or inability of a creditor to vote on a plan is not the equivalent of the acceptance of the plan . . . .") (collecting cases).

Judge Feeney endorsed "deemed acceptance" without analysis in *SW Boston Hotel Venture, LLC et al*., __ B.R. __ 2011 WL 5520928 *9 (*citing Ruti-Sweetwater*). Research has surfaced no other Massachusetts cases on the issue.

iii. Sections 506(a) and 1111(b)(1)

Section 506(a) bifurcates the claim of an undersecured mortgagee into a secured claim equal to the value of the collateral and an unsecured claim for the deficiency. *See Timbers*, 484 U.S. at 372 - 373. *See also In re Winthrop Old Farm Nurseries, Inc.*, 50

[23] Section 1126(a) states that "[t]he holder of a claim or interest . . . *may* accept or reject a plan . . . ." (emphasis added).

F.3d 72, 75 (1995) (affirming plan confirmation order that valued debtor's primary asset at current fair value, because plan contemplated continued operation and not liquidation).

Section 1111(b)(1) automatically accords the unsecured portion of the claim recourse against the debtor, even if the mortgagee's loan documents originally gave it recourse only against its collateral. *Matter of Tampa Bay Associates, Ltd*., 864 F.2d 47, 49 – 50 (5th Cir. 1989). Under section 11 U.S.C. § 1111(b)(2), an undersecured mortgagee can elect to treat its entire deficiency claim as secured. "By making the § 1111(b) election, the secured creditor waives its deficiency claim and loses its right to vote in any class other than that of its allowed secured claim. By not making the election, the secured creditor chooses to treat its deficiency claim as unsecured and is entitled to vote that deficiency claim separately from its allowed secured claim . . . ." *In re Gato Realty Trust Corp.*, 183 B.R. 15, 19 – 20 (Bankr. D. Mass. 1995).

iii. Classification – Section 1122 and *Granada Wines*

Section 1122, which governs classification or claims in a plan, provides:

> (a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.
>
> (b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

In *Granada Wines, Inc. v. New England Teamsters and Trucking Industry Pension Fund*, 748 F.2d 11, 46 - 47 (1st Cir. 1984), the plan combined all unsecured claims, including one for pension fund withdrawal liability, into a single class. The plan proposed to pay the pension fund 50% less than other unsecured claims, however.

The bankruptcy court denied confirmation of the plan, finding that it unfairly discriminated against the pension fund claim. *In re Granada Wines, Inc*., 26 B.R. 131, 134 (Bankr. D. Mass. 1983), *affirmed* 748 F.2d at 11.[24] The district court affirmed.

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[24] The court, citing 11 U.S.C. § 1123(a)(4), and not § 1129(b)(1), rejected that the debtor's argument that the pension fund could be crammed down. The court held that "[t]he Pension Fund has a general unsecured claim and the debtor is not permitted to unfairly discriminate against a member of the unsecured class . . . ." *Id*. The issues of separate classification and potential gerrymandering under 11 U.S.C. § 1122 and § 1129(a)(10) are distinct from unfair discrimination under 11 U.S.C. § 1129(b)(1). *See In re Barney and Carey Co.*, 170 B.R. 17, 24 (Bankr. D. Mass 1994). Courts often combine the two in considering cramdown, however.

On appeal, the debtor argued that the pension fund claim could be crammed down and paid less as a separate class of claims under 11 U.S.C. § 1129(b)(2)(B)(ii), because, under applicable federal law, it was distinguishable from general unsecured claims. The court rejected this argument because "the limitation of liability under [federal law] affects only the allowable amount of the withdrawal claim, not its legal nature . . . ." *Id.* at 47. Citing pre-Code cases, the Court observed that

> The general rule regarding classification is that all creditors of equal rank with claims against the same property should be placed in the same class . . . Separate classifications for unsecured creditors are only justified where the legal character of their claims is such as to accord them a status different from the other unsecured creditors . . . .

Id. at 46 – 47 (internal citations and quotation marks omitted).

iv. The Split Between the Western and Eastern Divisions

With one exception, *Granada Wines* has been interpreted differently in the Western and Eastern Divisions of Massachusetts. This split might affect a debtor's ability to obtain an impaired, accepting class of claims under 11 U.S.C. § 1129(a)(10).

In general, the Western Division has found that separate classification of a mortgagee's undersecured, *recourse*, deficiency claim is acceptable under 11 U.S.C. § 1122, because its right to make an election under section 1111(b)(2) distinguished it from general unsecured creditors. The Eastern Division has disagreed. *Compare In re Bjolmes Realty Trust*, 134 B.R. 1000, 1003 - 1004 (Bankr. D. Mass. 1991) (holding that separate classification of an undersecured, *recourse* claim resulted in "no bad faith gerrymandering . . . .") (emphasis added) *with In re Barney and Carey Co.*, 170 B.R. at 17 (declining to follow *Bjolmes* and holding that "the ability to make the [1111(b)(2) election] is insufficient to permit separate classification of the undersecured portion of a *recourse* obligation . . . ," and that "the classification scheme was prompted only by the goal of creating a class of accepting claims . . . .") (emphasis added).[25]

The same split exits regarding separate classification of a mortgagee's undersecured, *non-recourse*, deficiency claim. *Compare Gato*, 183 B.R. at 19 – 20 (separate classification permissible) *with In re L.G. Salem Ltd. Partnership*, 140 B.R. 932, 935 (Bankr. D. Mass. 1992) (impermissible), although Judge Rosenthal sided with the Eastern Division in *In re National Northway Limited Partnership*, 279 B.R. 17, 27

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[25] Citing 11 U.S.C. § 1129(b)(1), *Barney and Carey* separately found that the debtor's plan was not confirmable, because it unfairly discriminated against holders of general unsecured claims by offering to pay them 15% in 90 days while paying recourse, undersecured deficiency creditors 100% over ten years. *Id.*

(Bankr. D. Mass. 2002) (holding that separate classification was impermissible and collecting cases).[26]

B. Cramdown – Section 1129(b)(1) and (2)

If a chapter 11 plan is accepted by less than all classes under 11 U.S.C. § 1129(a)(8), the court can nevertheless confirm it, so long as **1)** at least one impaired class of creditors accepts and the plan under 11 U.S.C. § 1129(a)(10) and **2)** it complies with 11 U.S.C. § 1129(b)(1), *i.e.* the plan "does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted the plan . . . ." *Bank of America National Trust and Savings Association v. 203 North LaSalle Street Partnership*, 526 U.S. 434 (1999).

i. Secured Claims

Section 1129(b)(2)(A) provides that a plan is fair and equitable as to a class of secured claims if it provides either:

> 1. that the secured creditor will retain its lien on its collateral and that it will receive "deferred cash payments totaling at least the allowed amount of" its secured claim "as of the effective date of the plan . . . ;" or
>
> 2. that the secured creditor's liens will attach to the proceeds of any sale of its collateral, subject to the creditor's right to credit bid under 11 U.S.C. § 363(k); or
>
> 3. that it will receive "the indubitable equivalent . . . ." of its claim.

Option 1 essentially entails paying the secured creditor the present value of its secured claim over time – *i.e.* a stream of payments equaling the value of its secured claim, with interest. *See Till v. SCS Credit Corp.*, 541 U.S. 465, 478 479 (2004) (adopting a "formula" approach under 11 U.S.C. § 1325(a)(5) that provided a secured creditor the value of its secured claim over the plan term, with interest based on a riskless rate, adjusted for risk).[27] *Accord, In re SW Boston Hotel Venture, LLC et al.*, __ B.R. __

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[26] *See Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture (Matter of Greystone III Joint Venture)*, 995 F.2d 1274, 1279 (5th Cir. 1991) *(en banc)*, *cert. denied* 506 U.S. 821 (1992) (reversing order confirming plan that had separately classified mortgagee's nonrecourse deficiency claim. The court stated that the lower courts had not adhered to the "one clear rule . . . on § 1122 classification: though shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan . . . .").

[27] An undersecured creditor making its section 1111(b)(2) election "foregoes its unsecured deficiency claim . . . ." *Weinstein v. First Fed. Bank of Calif. (In re Weinstein)*, 227 B.R. 284, 293 (B.A.P. 9th Cir. 1998). Its allowed secured claim is equal

2011 WL 5520928 *11 and *16 (Bankr. D. Mass. 2011) (confirming plan over mortgagee's objection and finding that a risk adjusted rate of 4.25% provided the mortgagee "with deferred cash payments equal to the allowed amount of its [secured] claim as of the effective date with the retention of its liens and the indubitable equivalent of its [secured] claim . . . .).[28]

Option 2 is self-explanatory.[29]

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to its total claim, not the value of the collateral. "[T]he present value of the electing creditor's stream of payments need only equal the present value of the collateral, which is the same amount that must be received by the nonelecting creditor, but the sum of the payments must be in an amount equal at least the creditor's total claim . . . ." *Id*. at 294. *See Dewsnup v. Timm*, 502 U.S. 410, 430, n. 3 (1992) (observing that "the present value of such payments [to the § 1112(b)(2) elector] (sic) need only equal the value of the secured creditor's interest in its collateral . . . .") (citations omitted).

[28] In *SW*, the objecting mortgagee did not assert an undersecured deficiency claim. *Id*. at 20 - 21. The court found that the APR was not implicated, because neither of the two classes of unsecured claims, who were to be paid in full, with interest – holders of general unsecured claims (Class 7) and an administrative convenience class (Class 8) – rejected. The court permitted the debtors to place in Class 7 insiders holding subrogation claims for amounts advanced under letters of credit that the mortgagee had called. *Id*. at 4. The plan paid the insiders nothing, but they received 100% of the equity in the reorganized debtor. *Id*. The court found that this treatment neither violated the APR nor "harm[ed] [the mortgagee or any other creditors who are being paid 100% of their allowed claims plus interest . . . ." *Id*. at 21. *Compare with* 11 U.S.C. § 1123(a)(4) (requiring the same treatment for constituent members of the same class, "unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest . . . ."

[29] On December 12, 2011, the United States Supreme Court granted certiorari to resolve a split between the Third, Fifth and Seventh Circuit Courts of Appeals on whether a cramdown plan could force an undersecured creditor to accept one of the 3 options for "fair and equitable treatment" and eliminate protections provided by another. In *RadLAX Gateway Hotel LLC v. Amalgamated Bank*, . --- S.Ct. ----, 2011 WL 3499633 (December 12, 2011) (granting certiorari), the court agreed to decide whether a plan, which required an undersecured lender to accept the proceeds of its auctioned collateral as the "indubitable equivalent" of its secured claim under 11 U.S.C. § 1129(b)(2)(A)(iii), met the "fair and equitable" test. The plan prohibited the lender from credit bidding under 11 U.S.C. § 1129(b)(2)(A)(ii), which incorporates § 363(k). *RadLAX Gateway Hotel LLC v. Amalgamated Bank*, 11-166l.

The Seventh Circuit had affirmed orders denying confirmation, because, in preventing credit bidding, the plan deprived the lender "of a crucial check against undervaluation of its collateral . . ." at the auction sale. *River Road Hotel Partners, LLC et al. v. Amalgamated Bank*, 651 F3d 642, 651 (7th Cir, 2011). Interpreting the plain language of subsection 1129(b)(2)(A)(ii) and (iii), the court also found that elevating the undefined "indubitable equivalent" standard of subsection (iii) over subsection (ii)'s specific credit

Option 3 might include deeding the property back to the lender in satisfaction of its secured claim. *See Sandy Ridge Dev. Corp. v. Louisiana Nat. Bank (Matter of Sandy Ridge Dev. Corp.*), 881 F.2d 1346 (5th Cir. 1989) (holding that plan conveying collateral to mortgagee in satisfaction of its secured claim satisfied the "indubitable equivalent" requirement of 11 U.S.C. § 1129(b)(1)).

ii. Unsecured Claims

Section 1129(b)(2)(B) provides that a plan is fair and equitable as to a class of unsecured claims if it provides holders of unsecured claims either:

> i. full payment as of the effective date of the plan; or
>
> ii. the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, *except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirement of subsection (a)(14) of this section* [post-petition domestic support obligations] . . . .

This section codifies the APR. *LaSalle*, 526 U.S. at 442. The italics show the amendment made by BAPCPA. *See infra* at subsection "C."

iii. The "New Value Corollary"

In order to avoid the effect of the APR and to preserve the interests of existing shareholders, corporate debtors have sought to invoke the "new value corollary" to the APR, which Justice Douglas outlined, in *dicta*, in a case decided under the Bankruptcy Act, *Case v. Los Angeles Lumber Products Co., Inc.*, 308 U.S. 106 (1939). He stated:

> It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor . . .

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bidding protection rendered the latter superfluous, violating accepted standards of statutory construction. *Id*. at 652 *Compare River Road with In re Pacific Lumber*, 584 F. 3d 229 (5th Cir. 2009) (affirming order confirming a plan that sold undersecured note holders' collateral without an auction but precluded them from credit bidding, finding that they would receive the "indubitable equivalent of their secured claim) *and In re Philadelphia Newspapers*, 599 F.3d 298, 310 (3d Cir. 2010) (affirming district court order approving bidding procedures as part of a plan that would sell undersecured lenders' collateral at public auction but preclude them credit bidding, finding that subsection (iii)'s "indubitable equivalent" language "unambiguously" excluded the right to credit bid under subsection (ii)).

> [W]e believe that to accord 'the creditor of his full right of priority against the corporate assets' where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder . . . .

Id. at 121 – 122.[30]

Over the period of a decade, the United States Supreme Court twice reserved ruling on whether the new value corollary survived the enactment of the Code. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 203 (1988); *LaSalle*, 526 U.S. at 451 - 452 (interpretation of the words "on account of" and edging toward acceptance, but not committing). In both of these cases, however, the Court ruled that the debtors had not complied with it.

In *Ahlers*, the Court held that the debtors, individual farmers, could not satisfy the new value corollary. It found that the debtors' "promise to contribute their [future] 'labor, experience, and expertise . . .'" did not constitute "money or money's worth . . . ." 485 U.S. at 203 - 204.

The Court also rejected their argument that they were retaining no "property" for purposes of the APR, where the farm had no "ongoing" value. "Even where debts far exceed the current value of assets, a debtor who retains his equity interest in the enterprise retains 'property . . . .'" *Id.* at 207 – 208.

In *LaSalle*, the Court rejected an attempt by partners to keep their interests in a partnership, because the plan, offered during the debtor's exclusive period, did not permit third parties, including creditors, the opportunity to bid for the retained equity interests. *LaSalle*, 526 U.S. at 451 – 452.

Pre-BAPCPA courts split on the issue of whether the APR applied to exempt property. *Compare In re Henderson*, 321 B.R. 550 (Bankr. M.D. Fla. 2005), *affirmed*, 341 B.R. at 790 (holding that insofar as exempt property was created by operation of section 522 and could not be used to fund a plan "proposed by an entity other than the debtor . . . unless the debtor consents . . ." under section 1123(c), it did not constitute estate property, and the APR did not apply)[31] *with In re Yasparro*, 100 B.R. 91 (Bankr.

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[30] Courts have summarized that in order to qualify under the new value corollary, the contribution must be "1) . . . new; (2) substantial; (3) money or money's worth; (4) necessary for reorganization; and (5) reasonably equivalent to the value or interest received . . . ." *In re Henderson*, 341 B.R. 783, 791 (Bankr. M.D. Fla. 2006) (affirming order confirming plan that allowed debtor to retain both exempt assets, for which he paid no new value, and non-exempt assets, for which he did so).

[31] *See Schwab v. Reilly*, __ U.S. __, 130 S.Ct. 2652, 2657 (2010) (holding that no party in interest needs to object to a debtor's claimed exempt interests in property, if they fall within the values prescribed by 11 U.S.C. § 522(d)).

M.D. Fla. 1989) (holding that insofar as section 1129(b)(2(B)(ii) made no distinction between exempt and nonexempt property, court denied cramdown of plan that permitted debtor to retain exempt assets) *and In re Gosman*, 282 B.R. 45 (S.D. Fla. 2002) (same).[32]

C. Did BAPCPA's Amendment to 1129(b)(2)(B)(ii) Abrogate the APR as to Individual Chapter 11 Debtors?

The courts have split on this issue.

The majority holds that BAPCPA did not eliminate the APR in individual chapter 11 cases as to pre-petition property of the estate.

i. Cases broadly interpreting amended section 1129(b)(2)(B)(ii)

BAPCPA added "*except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirement of subsection (a)(14) of this section* . . ." to 11 U.S.C. § 1129(b)(2)(B)(ii). As noted above, new section 1115(2) adds post-petition earnings from services to an individual debtor's estate.

Early cases applied a "broad" reading of amended section 1129(b)(2)(B)(ii) and found that it abrogated the APR in individual chapter 11 cases. In *In re Roedemeier*, 374 B.R. at 274, for example, the court reasoned that new section 1115 incorporated not only post-petition assets but also "all the property brought into the estate by § 541, most of which is property the debtor had before filing for bankruptcy . . . ."

It found support for this interpretation in multiple BAPCPA amendments, including the addition of sections that "were made to Chapter 11 . . . so that it could function for individual debtors much like Chapter 13 does . . . ," such as section 1123(a)(8), which requires debtors to use post-petition earnings "or other future income of the debtor *as is necessary* for the execution of the plan . . . ," 1129(a)(15), which

[32] Prior to the 2005, local bankruptcy courts confirmed plans proposed by individual debtors that violated the APR but offered new value. *See In re Shepcaro*, 144 B.R. 3, 4 (Bankr. D. Mass. 1992) (without distinguishing between exempt and nonexempt property, court confirmed plan, where debtor contributed $84,700 and retained "real estate and items of personal property valued at $338,732, but with an aggregate equity of only $8,649.85 over encumbrances . . . ."). *In re Beuchesne*, 209 B.R. 266, 270 - 271 (Bankr. D.N.H. 1997) (without distinguishing between exempt and nonexempt property, court confirmed plan that allowed debtor to retain business assets over objection of undersecured creditor, because non-debtor spouse contributed cash and a parking lot that would be liquidated, if needed, to make proposed plan payments). *See also In re O'Leary*, 183 B.R. 338 (Bankr. D. Mass. 1995) (denying approval of individual debtor's disclosure statement, because the plan violated the APR and was not confirmable).

requires that, if an unsecured creditor objects, "*the value* of property to be distributed under the plan is not less than . . ." the debtor's "projected disposable income . . . *as defined in section 1325(b)(2)* . . . to be received . . ." over the longer of five years or the plan term, section 1141(d)(5), which delays discharge until all plan payments are completed and section 1127(e), which permits modification of a confirmed plan "whether or not the plan has been substantially consummated . . . ." *Id*. at 275 – 276 (emphasis added).[33]

The court in *In re Johnson*, 402 B.R. at 853, noting that BAPCPA "made an individual debtor's Chapter 11 case look a lot more like Chapter 13 . . . ," held that "[a]n individual's plan does not need to satisfy the absolute priority rule . . . and, even though unsecured creditors will not be paid in full, can be confirmed over their objection so long as the plan satisfies the disposable income test of § 1325(b)(2) . . . ."

The court in *In re Shat*, 424 B.R. at 863, concluded that a "broad" interpretation of section 1129(b)(2)(B)(2) was required for two reasons. First, it found that the phrase "property included under section 1115 . . . ." was ambiguous. Second, it determined that the phrase "in addition to the property specified in section 541 . . ." in section 1115 meant "that Section 1115 absorbs and then supersedes Section 541 in individual chapter 11 cases . . . ." *Id.* at 865. Based on this interpretation and the additional revisions made by BAPCPA "to bring individual chapter 11s more in line with chapter 13 . . . ," the court found that BAPCPA had abrogated the APR for individual debtors as to all pre and post-petition property.

ii. Cases narrowly interpreting amended section 1129(b)(2)(B)(ii)

If the property "included in the estate under section 1115 . . . ." is limited to post-petition service income, then the "exception" to section 1129(b)(2)(B)(ii) is narrow and the APR rule still applies, but only to "pre-petition" property of the estate identified by 11 U.S.C. § 541(a). This is how the majority cases have decided the issue. *See In re Gbadebo*, 431 B.R. at 222. *Accord In re Gelin*, 437 B.R. at 435; *In re Mullins*, 435 B.R. at 352; *Walsh*, 447 B.R. 45, 49.[34]

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[33] *See also In re Tegeder*, 369 B.R. 477, 480 Bankr. D. Neb. 2007) (holding that the APR was "waived by permitting a debtor to retain property included in the estate under 1115 . . ." and that a broad reading of section 1115 "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 . . . ." In *In re Bullard*, 358 B.R. 541, 544 (Bankr. D. Conn. 2007), the court confirmed a plan over rejections by two classes of unsecured creditors, because the plan, which allowed the debtor to retain his post-petition income and car purchased post-petition, fell within the exception to the APR added by BAPCPA. Citing *Henderson*, the court added that debtor's retaining exempt property did not violate the APR, because it never applied to exempt property. *Id*. at 545.

[34] The following cases hold that BAPCPA did not abrogate the absolute priority rule and that it permits individual chapter 11 debtors to retain post-petition assets, and not

D. New Section 1129(a)(15)

BAPCPA added new section 1129(a)(15) to the list of the subsection "a" elements, now totaling 16 that an individual chapter 11 debtor must satisfy in order to confirm a plan.

Section 1129(a)(15) provides that if "the holder of an allowed unsecured claim objects to confirmation of the plan-

> (A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.

Section 1129(a)(15) parallels the "best efforts" test of section 1325(b). *See In re Ball*, 2008 WL 2223865, *3 (Bankr. N.D.W. Va. 2008). Subsection (B) does not require payments of income, however.

Only "the holder of an allowed unsecured claim" may object. It cannot do so by casting a ballot rejecting the plan, however. *See In re Washington*, 2010 WL 1417708, *2 - 3 (Bankr. N.D. Tex. 2010) (holding that rejecting ballot was insufficient to invoke section 1129(a)(15)). It must file an objection to confirmation. *Id.*, *citing In re Shat*, 424 B.R. at 857, n. 4.[35]

In defining "projected disposable income . . . to be received . . . ." over the longer of five years or the plan term in terms of 11 U.S.C. § 1325(b)(2), section 1129(a)(15) requires that the calculation of "value of property to be distributed under the plan . . ." is

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prepetition assets, if the plan does not provide for payment in full to unsecured creditors. *In re Karlovich*, 456 B.R. 677 (Bankr. S.D. Cal. 2010); *In re Lindsey*, 453 B.R. 886 (Bankr. E.D. Tenn. 2011); *In re Stephens*, 445 B.R. 816 (Bankr. S.D. Tex. 2011); *In re Maharaj*, 449 B.R. 484 (Bankr. E.D. Va. 2011); *In re Draiman*, 450 B.R. 777 (Bankr. N.D. Ill. 2011); *In re Kamell*, 451 B.R. 505 (Bankr. C.D. Cal. 2011); *In re Borton*, 2011 WL 5439285 (Bankr. D. Idaho November 9, 2011); *In re Tucker*, 2011 WL 5296757 (Bankr. D. Or. November 28, 2011).

[35] *Shat* noted that that "an objection [for purposes of section 1129(a)(15)] requires more – at a minimum, the objector must affirmatively take a position the proposed plan is objectionable on some legal ground . . . .")

ultimately determined by the court and not the means test standards of 11 U.S.C. § 707(b)(2) and 1325(b)(3).

The Committee Note to Form 22B, which an individual chapter 11 debtor uses to calculate current monthly income ("CMI") under 11 U.S.C. § 101(1)(A), confirms this. It states:

> 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) . . . .

(emphasis added).

Section 1325(b)(2) defines "disposable income" as "current monthly income received by the debtor less amounts reasonably necessary to be expended - (A)((i) for maintenance or support of the debtor or a dependent of the debtor . . . ." In turn, current monthly income is defined as average monthly income over the six month "look back" period of 11 U.S.C. § 101(10A). *See Hamilton v. Lanning*, 130 S.Ct. 2464, 2478 (2010) (adopting a "forward looking approach" and holding that in calculating "a debtor's projected disposable income, the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation . . . .").[36]

One decision sustained a creditor's objection under section 1129(a)(15) and eliminated "unreasonable and unnecessary" expenses on schedule "J." *In re Gray*, 2009 WL 2475017, *4, n.3 (Bankr. N.D. W. Va. 2009) (summarizing the formula under section 1325(b)(2) as "CMI (Form 22B) – Payroll Deductions (Schedule I) – reasonably necessary expenses (Schedule J) = monthly disposable income . . . ."

V. New Section 1141(d)(5) – Case Closing and Discharge

A. Effect of Confirmation

Interpreting section 1141(d) *as it existed prior to 2005*, a local district court observed that "confirmation of a Chapter 11 Plan: (1) discharges a nonliquidating debtor's pre-confirmation debts; (2) restructures creditors' claims as provided in the plan; (3) vests property of the estate in the debtor free and clear of all liens, except as provided in the Plan; (4) terminates the automatic stay of any act against estate property and binds

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[36] *See also In re Roedemeier*, 374 B.R. at 272 (referencing Form 22B and stating that section 1325(b)(3) and the IRS local and national standards were inapplicable in determining projected disposable income under 11 U.S.C. § 1129(a)(15)).

a debtor and its creditors. . . . The confirmed plan is essentially a new and binding contract between debtors and their preconfirmation creditors . . . ." *In re Space Building Corp.*, 206 B.R. 269, 272 – 273 (D. Mass. 1996) (citations and internal quotation marks omitted) (interpreting11 U.S.C. § 1141).[37]

B. Delayed Discharge Under BAPCPA

New section 1141(d)(5) delays discharge for chapter 11 debtors until they have completed plan payments, "unless after notice and a hearing the court orders otherwise for cause . . . ." *See In re Mendez*, __ B.R. __, 2011 WL 4459093 *2 (Bankr. D. Mass. 2011) (permitting chapter 11 debtor to close case administratively and to avoid the accrual of post-confirmation United States Trustee's quarterly fees).

Section 1141(d)(5) permits a debtor to obtain a discharge prior to completing the payments prescribed by the plan "at any time after confirmation . . . and after notice and a hearing . . . if . . ." the property distributed under the plan equals the amount that would have been paid on liquidation under chapter 7 and if modification is not "practicable . . . ." One court has noted that "it is unclear whether this also requires a showing of cause or hardship as does the similar provision in § 1328(b)(1) . . . ." *In re Burgueno*, 451 B.R. 1, 2 - 3 (Bankr. D. Ariz. 2011) (holding that confirmation of an individual chapter 11 debtor's plan did not discharge his personal liability for post-petition condominium association fees under 11 U.S.C. § 523(a)(16), *citing In re Ames*, 447 B.R. 680 (Bankr. D. Mass. 2011).

Discharge "operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any . . . debt [discharged under section 1141(d)] as a personal liability of the debtor . . . . 11 U.S.C. § 524(a)(2).

C. Case Closing – Section 350 and Rule 3022

After confirming a plan, a debtor remains obligated to pay United States Trustee's quarterly fees under 28 U.S.C. § 1930(a)(6) until "the Court converts or dismisses a case or, after confirmation of a Chapter 11 case, enters the final decree, an order declaring the case fully administered and ordering that it be closed . . . ." *In re 1095 Commonwealth Avenue Corp.*, 213 B.R. 794, 795 (Bankr. D. Mass. 1997) (denying corporate debtor's motion to be relieved of its obligation to pay United States Trustee post-confirmation, quarterly fees). Fees are "calculated according to a graduated scale based on the total

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[37] *See* 11 U.S.C. § 362(c), which provides that the automatic stay provided by 11 U.S.C. § 362(a) "continues until the earliest of . . . the time the case is closed . . . the time the case is dismissed . . . or . . . the time a discharge is granted or denied . . . ." *In re Lacy*, 304 B.R. 439, 446 (D. Col. 2004) (reversing order converting individual debtor's chapter 11 case under section 1112(b), where debtor had defaulted under confirmed plan, because all assets had vested in the debtor upon confirmation, the estate had ceased to exist and there was nothing for a chapter 7 trustee to liquidate).

sum of disbursements . . . ." *In re Celebrity Home Entertainment, Inc*., 210 F.3d 995, 998 (9th Cir. 2000).[38]

Individual debtors should consider moving to close their cases under 11 U.S.C. § 350, if the elements set forth in the Advisory Committee note to Fed. R. Bankr. P. 3022, which implements section 350, have been met. *See* Walter W. Theus, Jr., *Individual Chapter 11s: Case Closing Reconsidered*, 29 Am. Bankr. Inst. J., 1, 62 (Feb. 2010) (articulating the United States Trustee Program's policy on case closing). *See In re Mendez*, __ B.R. __, 2011 WL 4459093 (*citing* Theus).

The Advisory Committee note states:

> Entry of a final decree closing a chapter 11 case should not be delayed solely because the payments required by the plan have not been completed. Factors that the court should consider in determining whether the estate has been fully administered include (1) whether the order confirming the plan has become final, (2) whether deposits required by the plan have been distributed, (3) whether the property proposed by the plan to be transferred has been transferred, (4) whether the debtor or the successor of the debtor under the plan has assumed the business or the management of the property dealt with by the plan, (5) whether payments under the plan have commenced, and (6) whether all motions, contested matters, and adversary proceedings have been finally resolved . . . .

Closing the case under section 350, subject to reopening and requesting the entry of discharge once debtors complete plan payments, will obviate the accrual of quarterly fees. *See In re Johnson*, 402 B.R. at 856. *Accord*, *In re Necaise*, 2010 WL 3294692 (Bankr. D. Miss. 2010).

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[38] Disbursements for purposes of section 1930(a)(6) include pre and post-confirmation ordinary operating expenses and post-confirmation plan payments. *Walton v. Jamko, Inc. (In re Jamko, Inc.)*, 240 F.3d 1312, 1316 (11th Cir. 2001). *Accord, Robiner v. Danny's Markets, Inc. (In re Danny's Markets, Inc.*), 266 F.3d 523, 526 (6th Cir. 2001).