Introduction to Individual Chapter 11 Cases: Part 2 (Negotiating a Plan; Plan Drafting; Disclosure Statements, Plan Confirmation and the Absolute Priority Rule)

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INTRODUCTION TO INDIVIDUAL CHAPTER 11 CASES:

CRAMDOWN UNDER A PLAN OF REORGANIZATION; EARLY DISCHARGE; NEGOTIATION OF A PLAN OF REORGANIZATION

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I. Introduction

These materials discuss the process of cramdown and negotiation of a plan in Chapter 11 cases for individuals. Included in the discussion are issues pertaining to the basics of cramdown, plan objections by unsecured creditors, property of the estate and post-petition earnings, the best interest of creditors test, feasibility, and timing of the effective date of the discharge. (Treatment of a principal residence in the plan and the applicability of the absolute priority rule in individual Chapter 11 cases are covered in other presentations in this seminar.)

II. Cramdown Basics

The Bankruptcy Code permits a Chapter 11 debtor to force confirmation of a plan over the objections of non-consenting creditors, or to "cram down" the plan on them. When the requirements of Section 1129(b) are met, the plan can be crammed down on dissenting classes.

The prerequisites to a cram down are applicable to both individual and other Chapter 11 cases, and include these.

A. Satisfaction of All Requirements of Section 1129(a) Except Acceptance of All Classes (Section 1129(a)(8)).

The court cannot cram down a plan unless all of the requirements of Section 1129(a) are satisfied other than 1129(a)(8), which requires that each class either accept the plan or is not impaired under the plan. Section 1129(a) includes sixteen elements that must be satisfied, including new 1129(a)(15), imposing unique requirements on an individual debtor when an unsecured creditor objects. See *III. When an Unsecured Creditor Objects*, below.

B. Necessity of Request by Plan Proponent

The plan proponent must specifically request cramdown to have it available. 1129(b)(1)

C. Unfair Discrimination as to Dissenting Class

The plan cannot discriminate unfairly with respect to any class. The Bankruptcy Code does not define "unfair discrimination" and the courts are not unanimous on its meaning. One formulation considers (1) whether the discrimination is supported by a reasonable basis; (2) whether the debtor can confirm and consummate a plan without the discrimination; (3) whether the discrimination is proposed in good faith; and (4) the treatment of the classes discriminated against. Another formulation holds that a rebuttable presumption that a plan is unfairly discriminatory will arise when there is: (1) a dissenting class; (2) another class of the same priority; and (3) a difference in the plan's treatment of the two classes that results in either (a) a materially lower percentage recovery for the dissenting class (measured in terms of the net present value of all payments), or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution.

Generally, the courts consider the disparity of treatment in the plan and whether the Code justifies the disparity.

D. Fair and Equitable as to Non-Accepting Impaired Classes

Section 1129(b)(2) defines "fair and equitable." The concept has two fundamental components, the absolute priority rule, and the rule that a plan cannot pay a creditor more than it is owed.

The absolute priority rule precludes any class lower than the class which is crammed down from receiving anything of value under the plan. Thus, if unsecured creditors are crammed down, owners of the debtor cannot retain their ownership interest.

The absolute priority rule as applicable to individual Chapter 11 debtors is discussed in other materials prepared for this Seminar.

E. Applicable Interest Rate

The Sixth Circuit Court of Appeals interpreted *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), determining the interest rate in Chapter 13 cramdowns, in *In re American Home Patient, Inc.*, 420 F.3d 359 (6th Cir. 2005). The Sixth Circuit held that a secured claim being crammed down in a Chapter 11 plan must be paid at an interest rate determined according to the prevailing market rate, assuming that there is an efficient market to set that rate. Where no such market exists, then the bankruptcy court should use the formula approach described in *Till*, which requires the use of some current baseline index (normally the current prime rate of interest) as establishing the time value of money,

adjusted upward for default risk. See *In re Griswold Building, LLC*, 420 B.R. 666 (Bankr. E.D. Mich. 2009), using the Till formula in a contested Chapter 11confirmation.

F. Protection of Exempt Property

Section 1129(c) provides that a plan proposed by anyone other than the debtor may not include exempt property, absent the debtor's consent.

III. Objections by Unsecured Creditors.

A. In 2005 BACPCA added a new subsection 15 to 1129:

1129(a) The court shall confirm a plan only if all of the following requirements are met:..
(15) In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the 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.

B. The debtor has two choices. One, he can pay the objecting unsecured creditor in full. But then he must pay all unsecured creditors in full under the unfair discrimination requirement. See II C "Unfair Discrimination as to Dissenting Class," above. Two, he can pay all unsecured creditors not less than the amount of

his "projected disposable income" as defined in 1325(b)(2)2 for the longer of 5 years or the period of the plan.

C. "Projected disposable income" is nowhere defined. But note *Hamilton v. Lanning,* 130 S.Ct. 2464 (2010), holding that "projected disposable income" under Section 1325(b)(1) is determined under the "forward-looking" approach, taking into account income or expenses that are "known or virtually certain at the time of confirmation."

D. Section 1325(b)(2) says that disposable income is monthly income less amounts reasonably necessary for maintenance or support of debtor or defendant.

E. But Section 1129(a)(15) does NOT incorporate 1325(b)(3), which says that if debtor's income exceeds the applicable median for his state, then the debtor's expenses are determined in accordance with the means test of 707(b)(2)(A) and (B), the so-called "means test." It is, therefore, up to the court to determine the "projected disposable income...received during the 5-year period..." The Committee Note to Official Form 22B, used to determine current monthly income, confirms this conclusion:

> 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...

F. At least two courts have held that the calculation is not controlled by the means test deductions. *In re Roedemeier*, 374 BR 264 (Bankr. D. Kan. 2007); *In re Gray*, 2009 WL 2475017 (Bankr. N.D.W.Va. 2009).

IV. Post-Petition Earnings

A. BACPCA in 2005 for the first time included an individual debtor's post-petition earnings in property of the estate in Section 1115 (similar to Section 1306):

1115. Property of the estate:

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

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

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

(b) Except as provided in section 1104 or a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.

B. BACPCA in 2005 also added a provision requiring the debtor to devote future income as necessary to fund the plan.

§ 1123. Contents of plan:

(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall—

(8) in a case in which the debtor is an individual, provide for the payment to creditors under the plan of all or such portion of earnings from personal services performed by the debtor after the commencement of the case or other future income of the debtor as is necessary for the execution of the plan.

C. Note that Section 1115(a) references "earnings from services" while Section 1123 refers to "earnings from *personal* services." Any difference?

D. Under Section 115(b), the debtor remains in possession of all property of the estate, including post-petition earnings. But once a trustee is appointed, Section 521(a)(4) requires the debtor to turn over all property of the estate, including earnings, to the trustee. Does the Trustee then approve a budget for the debtor and his family to live on?

E. Section 1123(a)(8) makes Chapter 11 for individual debtors consistent with Chapter 13 in requiring the debtor to use future income to fund a plan. But there are two significant limitations on that obligation. One, the debtor must use *either* "earnings from personal services" *or* "other future income." So a debtor could confirm a plan funded by the sale of property and not have an obligation to use any earnings from personal services. Second, the earnings must be devoted only to the extant "necessary for execution of the plan," there is no requirement to devote *all* earnings.

F. Since all post-petition property income and property acquired post-petition will be property of the estate, the debtor and his dependents will need to use property of the estate for all of the customary living expenses. But it is not clear that all of these expenses will qualify as administrative expenses under Section 503(b), i.e.,

expenses that are "actual, necessary costs and expenses of preserving the estate" or that are "in the ordinary course of business" under Section 363(c). See *In re Goldstein,* 383 B.R. 496 (Bankr. C.D. Cal. 2007) (joint individual Chapter 11 debtors could not use post-petition income to pay divorce counsel); *In re Harp*, 166 B.R. 740 (Bkrtcy.N.D.Ala.,1993) (contrasting interests of estate against interests of individual debtor and requiring approval of a budget for reasonable personal expenses).

V. Certain Property in a Cramdown

(a) BACPA in 2005 added a clause to Section 1129(b)(2)(B)(ii) permitting an individual debtor to retain certain property even if the debtor cram downs a plan:

> 1129(b)(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:...
>
> (B)With respect to a class of unsecured claims—
> (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>
> (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 requirements of subsection (a)(14) of this section.

(b) It is not entirely clear whether "property included in the estate under section 1115" includes only post-petition earnings or rather all property of the estate under Section 541. Section 1115 begins, "In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in Section 541," post-petition earnings.

VI. Best Interests of Creditors

A. Section 1129(a)(7)(B) requires each nonconsenting creditor to receive under the plan at least as much as it would receive if the debtor were liquidated under Chapter 7 on the effective date of the plan. However, in Chapter 7, post-petition earnings are not included in property of the estate available to creditors.

B. Presumably, therefore, in calculating the recovery under Chapter 7, post-petition income is not included.

C. Before 1994, the courts were split on whether the estate included post-petition earnings when a Chapter 13 was converted to Chapter 7. In 1994, Congress added Section 348(f), clarifying that post-petition property does not come into the estate on conversion to Chapter 7. But BACPCA did not add conversions form Chapter 11 to Chapter 7 to the rule under Section 348(f), perhaps leaving some doubt as to the outcome.

VII. Feasibility

A. The debtor must prove at confirmation that the confirmation of the plan is not likely to be followed by the need for further reorganization. Section 1129(a)(11).

B. However, creditors will have filed complaints objecting to discharge and dischargeability within 60 days of the conclusion of the meeting of creditors. Rules 4004 and 4007.

C. That litigation may not be concluded at the time of confirmation. But the outcome of the litigation may have a tremendous effect on the debtor's ability to effectuate his plan.

D. Confirmation might be delayed until the litigation is concluded. Can the debtor estimate the liability for purposes of confirmation under Section 502(c)?

VIII. Timing of the Discharge

A. Before BACPCA, the confirmation of a plan discharged individual debtors when the plan was confirmed. Section 1141(d)(1)(a).

B. BACPCA added Section 1141(d)(5), similar to Section 1328(a), providing that an individual debtor does not automatically receive a discharge until completion of all payments under the plan. Forms 9E and 9EAlt. (notice of meeting of creditors) have been amended to provide that, unless the court orders otherwise, an individual Chapter 11 debtor's discharge is not effective until all plan payments are completed.

1141. Effect of confirmation:

(d)(5) In a case in which the debtor is an individual—

(A) unless after notice and a hearing the court orders otherwise for cause, confirmation of the plan does not discharge any debt provided for in the plan until the court grants a discharge on completion of all payments under the plan;

(B) at any time after the confirmation of the plan, and after notice and a hearing, the court may grant a discharge to the debtor who has not completed payments under the plan if—

(i) the value, as of the effective date of the plan, of property actually distributed under the plan on account of each allowed unsecured claim is not less than the amount

that would have been paid on such claim if the estate of the debtor had been liquidated under chapter 7 on such date;

(ii) modification of the plan under section 1127 is not practicable; and

(iii) subparagraph (C) permits the court to discharge; and

(C) the court may grant a discharge if, after notice and a hearing held not more than 10 days before the date of the entry of the order granting the discharge, the court finds that there is no reasonable cause to believe that—

(i) section 522(q)(1) may be applicable to the debtor; and

(ii) there is pending any proceeding in which the debtor may be found guilty of a felony of the kind described in section 522(q)(1)(A) or liable for a debt of the kind described in section 522(q)(1)(B); and if the requirements of subparagraph (A) or (B) are met.

C. Under Section 1141(d)(5)(A), the court for "cause" may make the discharge effective on confirmation, but no definition of "cause" is provided. A number of courts have considered the issue of "cause:"

D. Of course, the plan may provide for early discharge, and if confirmed, that will determine the date of discharge. See *In re Clymer*, 2012 WL 125978 (Bankr. N.D. Ohio 2012) ("Debtor's confirmed plan does not provide for a discharge prior to completion and Debtors have not established cause for entry of the discharge before completion of payments.")

E. While Section 1141(d)(5)(B) specifies circumstances under which early discharge can be granted after confirmation, the courts have not viewed that as precluding granting early discharge for "cause" after confirmation under Section 1141(d)(5)(A). *In re Sheridan*, 391 B.R. 287, (Bankr. E.D. N.C. 2008) (when determining whether cause exists to enter the discharge early, court considers factors such as: 1) the likelihood that the debtors will make all of their plan

payments; and 2) assurances that creditors will receive the amount they have been promised even if the plan payments are not made); *In re Beyer*, 433 B.R. 884 (Bankr. M.D., Fla. 2009); *In re Necaise*, 443 B.R. 483 (Bankr. S.D. Miss. 2010). All courts that have considered the matter have found that the desire to cease the accrual of U.S. Trustee fees is not "cause" to enter the discharge earlier than plan payment completion. See *In re Belcher*, 410 B.R. 206 (Bankr. W.D. Va. 2009); *In re Ball*, 2008 WL 2223865 (Bankr. N.D. W. Va. 2008).

F. Cases will be open until all plan payments have been made which will impose on the debtor the obligation to pay UST quarterly fees and file operating reports. One court has permitted a case to be administratively closed to avoid that result, one has not. See *In re Necaaise, supra* (yes), and *In re Kerley*, 2011 WL 5330667 (Bankr. N.D. Ala. 2011) (no).

G. Because the discharge is not granted until completion of payments, debtors who default under a plan will be liable for the full pre-petition debt, unless the plan provides otherwise.

IX. Stay of Actions Post-Confirmation

A. The discharge injunction (Section 524(a)) will not become effective in the usual case on confirmation and thus will not protect the debtor from post-confirmation efforts to collect on pre-confirmation liabilities.

B. On the other hand, the automatic stay will remain in effect until the case is closed or the discharge is granted. Section 362(c).

C. Good practice is to include the necessary injunction in the plan.

X. Modification of Home Mortgages

A. Section 1123(b)(5) prohibits modification of the terms of a mortgage on the debtor's principal residence.

B. However, a plan can cure a default in a mortgage of a principal residence, as in Chapter 13. Compare Section 1123(b)(5), applicable to debtors under Chapter 11, with Section 1322(b)(5), applicable to debtors under Chapter 13.

C. When Section 1123(b)(5) was enacted in 1994, the House Committee Report commented"

> This amendment conforms the treatment of residential mortgages in chapter 11 to that in chapter 13, preventing the modification of the rights of a holder of a claim secured only by a security interest in the debtor's principal residence. Since it is intended to apply only to home mortgages, it applies only when the debtor is an individual. It does not apply to a commercial property, or to any transaction in which the creditor acquired a lien on property other than real property used as a debtor's residence...

140 Cong. Rec. H10, 752, H10, 767 (daily ed. Oct. 4, 1994)

XI. Negotiating the Plan

A. The three most important aspects of negotiating a plan of reorganization, for the debtor, occur before the plan is ever filed or negotiated. First and foremost, can the debtor survive a Chapter 11, even if it is successful from a lawyer's point of view? Second, the debtor needs to have a clearly defined exit strategy before the case is filed. If you file, what do you want the plan to accomplish and can it legally do so? Third, if the creditors perceive that counsel for the debtor is unwilling to litigate, the debtor will have minimal leverage.

B. Consider the possibility of a pre-packaged plan. These can be difficult to accomplish if there is a large number of creditors. But if confirmed, they are quick, cheap, and wildly successful.

C. Then debtor's most important tool in negotiating a plan is the control provided by the debtor's exclusive right to propose a plan. Debtor's should not surrender this right and should be exceedingly wary of giving veto power to creditors.

D. There is unlikely to be much negotiation with priority creditors, including taxes and for individual debtors, children and former spouses to whom the debtor owes post-petition domestic support obligations pursuant to an order or judgment. Section 1129(a)(14). Priority creditors are entitled to have their claims paid in full.

E. As the debtor, assess your ability to confirm a plan over objections, i.e., to cram down.

(i) Can you muster the necessary evidence to support feasibility? Can you obtain and afford experts to support your projections and values?

(ii) Does the debtor have the skill and manpower to produce credible projections?

F. The yardstick for measuring what to negotiate for, and when to compromise, for both debtors and creditors, is what you can obtain in the courtroom (and at what cost). Debtors who demand plan provisions which are not legally confirmable lose credibility with both the court and creditors. Creditors who demand plan provisions plainly contrary to what any debtor can give will diminish their chances of cutting the best deal.

G. If you are a debtor, your most persuasive point is to stress that which the creditor can get in bankruptcy but not out, like access to all post-petition income.

H. If you are a creditor, remember that defeating the plan or dismissing the case does not put money in your pocket. It just gives you the opportunity to chase the individual who didn't pay you in the first place. Are you better off chasing a full loaf or getting paid the half-loaf promised in the plan?

I. For debtors, the confirmation of a plan is like a Chicago election, vote often and vote early. File your plan sooner rather than later, even if it is not fully negotiated. File amendments if you need to. Otherwise, the case will last forever (because all lawyers always take all the time they have) or fail of its own weight in legal fees (as you negotiate endlessly and try to draft your plan "by committee").

XII. Additional Resources

A. This article is comprehensive and very helpful on individual Chapter 11 cases. Neely, Sally, "HOW BACPA CHANGED CHAPTER 11 CASES FOR INDIVIDUALS OR NO, THIS IS NOT YOUR MOTHER'S CHAPTER 11!!," NCBJ/ABI Panels on Chapter 11 Cases for Individual Debtors (Tampa, Florida, 2011).

B. Attached is a chart comparing plan provisions of Chapter 11 and Chapter 13. This chart is a portion of the chart prepared by James Patrick Shea for "Individual Chapter 11 Case Strategies and Issues," American Bankruptcy Institute, Southwest Bankruptcy Conference (2010). My special thanks to James Patrick Shea and the ABI for allowing us to share this superb comparative chart with you.

The Plan		
Who May File a Plan and When it Must be Filed	In a small business case, only the debtor may propose a plan in the first 180 days of the case. Thereafter, any party may file a plan. All plans must be proposed by the 300th day. Bankruptcy Code § 1121 (e). In all other cases without trustees, only the debtor may file the plan in the first 120 days. If filed, the debtor has until the 180th day to solicit acceptances of the plan. If a trustee is appointed ~~and~~ no plan is filed in the first 120 days, or if the debtor fails to obtain the acceptance of the plan by thce 180th day, any party in interest may propose a plan Bankruptcy	Only the debtor may propose a plan § 1321. It must be filed within 15 days of the filing of the petition. Rule 3015(b).

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	Code § 1121(a), (c), & (d). These time periods can be extended for up to 18 months after petition date (to file a plan) and 20 months after petition date (for acceptances).	
Earliest Confirmation Date	A meeting of creditors may occur no earlier than 20 days and no later than 40 days after the order for relief. Bankruptcy Rule 2003(a). However, nothing in chapter 11 requires that the meeting occur or be completed prior to confirmation. If the debtor solicited prepetition acceptances to a "prepackaged" plan, the court may even dispense with the meeting Bankruptcy Code § 341 (e). 25 days notice of a hearing on disclosure statement and deadline to object to disclosure statement and 25 days' notice of a confirmation hearing and deadline to object to confirmation must be given. (Total process = 60 to 90 days). Rule 2002(b). If a small business debtor files a plan with the petition, if conditional approval is given to the disclosure statement on the 1st day of the case, and if objections may be raised at the confirmation hearing, the hearing could take place as early as the 25th day. Bankruptcy Code § 1129(e) requires that the plan of a small business debtor be confirmed no later than 45 days after the plan is filed.	A meeting of creditors may occur no earlier than 20 days and no later than 50 days after the order for relief Rule 2003(a). Parties must receive 20 days' notice of the meeting. Rule 2002(a)(1)/ 25 days' notice of a confirmation hearing and deadline to object to confirmation must be given Interim Rule 2002(b). Confirmation hearing may take place no earlier than 20 days and no later than 45 after meeting of creditors § 1324(b) Assuming: notice of the meeting served on the first day of the case; a meeting on the 20th day; notice of the confirmation hearing served on 15th day; and objections raised at the confirmation hearing, confirmation could occur as early as the 40th day.
Confirmation Standards		
Priority Debt	Must be paid in full Bankruptcy Code § 1129(a)(9). Tax priority claims may be paid in installments. If so, interest must be paid, the installments must be regular, and be over a period ending not later than 5 years after the order for relief Bankruptcy Code	Must be paid in full but if the plan has a term of 5 years and provides for the payment of all disposable income to creditors, the plan may provide for less than full payment of a domestic support obligation assigned to, owed directly to, or recoverable by, a governmental unit §§

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	§ 1129(a)(9)(C). Nontax priority claims must be paid on the effective date unless the class accepts deferred cash payments. When paid deferred cash payments, interest must be paid Bankruptcy Code § 1129(a)(9)(B) Debtor must be current on all post-petition domestic support obligations in order to confirm plan. Section 1129(a)(14).	507(a)(1)(B), 1322(a)(4). § 1322(a)(2) does not require that interest be paid on priority claims when they are paid in installments. No restrictions on the debtor's ability to pay over the length of the plan.
Voting	Creditors with impaired claims may vote. A class of claims accepts the plan when 1/2 in number and 2/3 in amount of the claims voting accept the plan Bankruptcy Code §§ 1124. 1126, 1129(a)(8).	Creditors may not vote.
Absolute Priority Rule	If at least one impaired class of claims accepts the plan, it may be confirmed over the rejection of a class of unsecured claims if all claim holders in the rejecting class will be paid in full, or if no holder of a claim or interest junior to the rejecting class will receive or retain anything on account of such claim or interest. Bankruptcy Code § 1129(b)(1)(B)(I)-(ii). Bankruptcy Code § 1129(b)(2)(B)(ii) carves out an exception to the absolute priority rule permitting individual chapter 11 debtors to retain post-petition earnings except to the extent necessary to pay post-petition domestic support obligations.	Because creditors may not vote, there is no absolute priority rule.
Best interests	Unless the claim holder makes an election under Bankruptcy Code § 1111(b), a chapter 11 plan must provide to each holder of a claim in an impaired class not less than the present value of the amount that would be paid on such claim if the estate were liquidated under chapter 7 § 1129(a)(7).	A chapter 13 plan must provide to each allowed unsecured claim not less than the present value of the amount that would be paid on such claim if the estate were liquidated under chapter 7 § 1325(a)(4).
Best Efforts	If the holder of an allowed unsecured claim objects to confirmation, the plan must either pay unsecured claims in full, or the value of the property distributed	If the holder of an .allowed unsecured claim or the trustee objects to confirmation, the plan must either pay the unsecured claims in full, or all projected disposable income must

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	under the plan must be no less than the projected disposable income of the debtor. Bankruptcy Code § 1129(a)(15). Disposable income must be projected over the longer of the 5-year period following the first plan payment, or the entire period the plan provides for payments. Bankruptcy Code § 1129(a)(15). To project disposable income, the debtor's actual expenses, provided they are reasonably necessary for the maintenance or livelihood of the debtor, are deducted from current monthly income. The "presumed expenses" deducted from current monthly income under Bankruptcy Code § 1325(a)(3) are not applicable Bankruptcy Code §§ 1129(a)(15)(B) &1325(b)(2).	be applied to make payments to unsecured creditors § 1325(b)(1). Disposable income projected over 3 years must be devoted to the payment of unsecured creditors if the debtor's annualized current monthly income is less than median family income. If it is more, the commitment period increases to 5 years. §§ 1322(d), 1325(b)(1)(B) &(b)(4). The method of projecting disposable income hinges on whether the debtor's annualized current monthly income is greater than median family income. If greater, the expenses deductible from debtor, current monthly income are limited by the presumed expenses used in the means test § 707(b)(2), 1325(a)(3) If less than or equal to median family income, actual expenses that are reasonably necessary for the maintenance or livelihood of the debtor are deductible from current monthly income as under § 1129(a)(15)(8) § 1325(b)(2).
Treatment of Certain Claims		
Home Mortgages	The plan may provide for the cure of any arrears on a home mortgage. Bankruptcy Code § 1123(a)(5)(G), (b)&(d). "Curing" a default is distinct from modification of a claim *In re Lennington*, 288 B.R. 802 (Bankr N.D. III 2003). Unmatured, unaccelerated claims secured only by the debtor's home cannot be modified. Bankruptcy Code § 1123(b)(5). The exception to the anti-modification rule in chapter 13, Bankruptcy Code § 1322(c), is not applicable in chapter 11. As a result, it does not appear that a matured or accelerated home loan can be extended unless such is permitted by	The plan may provide for the cure of any arrears on a home mortgage. § 1322(b)(3). Unmatured, unaccelerated claims secured only by the debtor's home cannot be modified. § 1322(b)(2). § 1322(c) permits chapter 13 debtors to cure defaults under a home mortgage unless and until the home is sold at a foreclosure sale. Also, notwithstanding the maturity of a home loan, the plan may provide for payment of the home loan through the plan pursuant to § 1325(a)(5)(8).

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	applicable nonbankruptcy law.	
Other Secured Claims	Unlike chapter 13, nothing in chapter 11 prevents an individual debtor from stripping down an undersecured claim into its secured and unsecured parts, and treating each part as a separate and distinct claim. Bankruptcy Code § 1129(b)(1)(A). Periodic payments to secured creditors need not be in equal installments. But see secured tax claims below.	Plan may not bifurcate certain undersecured claims into secured and unsecured constituent parts. § 1325(a)(9). This prohibition extends to claims secured by purchase money debt incurred within 910 days of thepetition and secured by motor vehicles acquired for the personal use of the debtor or incurred during the 1-year period preceding the petition and secured by any other thing at value. If a secured claim is being paid through the plan in periodic payments, "such payments shall be in equal installments." § 1325(a)(5)(B)(iii)(I).
Secured Tax Claims	Secured tax claims that would otherwise be priority tax claims under Bankruptcy Code § 507(a)(8) were they not secured must be paid regular installments over a period ending 5 years after the order for relief and "in a manner not less favorable than the most favored nonpriority unsecured claim provided for by the plan." Bankruptcy Code § 1129(a)(9)(D).	No similar limitation.
Long Term Debt	There is no limitation on the maximum duration of a chapter 11 plan. Consequently, it is possible to provide in the plan for the conversion of short-term debt to long-term debt. However, unless court orders otherwise, an individual chapter 11 debtor is not entitled to a discharge until the "completion of all payments under the plan." Bankruptcy Code § 1141(d)(5)(A). Second, if an unsecured creditor objects, Bankruptcy Code § 1129(a)(15)(B) requires an individual chapter 11 debtor to commit all projected disposable income "during the period for which the plan provides payments."	The only debt that may be treated as long-term debt is a debt that matures after the completion of the plan and is not modified by the chapter 13 plan. (Cure permissible) Provided a chapter 13 plan seeks only to cure an arrearage, long-term debt may continue beyond the length of the plan. § 1322(b)(3) & (5).

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	CHAPTER 11	CHAPTER 13
Duration of Plan		
Minimum Length	There is no mandatory minimum chapter 11 plan length. However, if the holder of an allowed unsecured claim objects to a plan that does not pay unsecured claims in full, "the value of the property distributed under the plan [must be] 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." Bankruptcy Code § 1129(a)(15)(B).	There is no mandatory minimum chapter 13 plan length. But if the plan does not provide for payment of unsecured claims in full and if the trustee or an unsecured creditor objects, the play must run 3 to 5 years depending on whether annualized current monthly income exceeds state median family income §§ 1322(d), 1325(b)(4)(A)(ii).
Maximum Length	Chapter 11 does not limit the length of chapter 11 plans. However, if an unsecured creditor objects, Bankruptcy Code § 1129(a)(15)(B) requires an individual chapter 11 debtor to commit all projected disposable income for 5 years or, if longer, "during the period for which the plan provides payments." Also, unless the court orders otherwise, no discharge will be issued until the "completion of all payments under the plan." Bankruptcy Code § 1141(d)(5)(A).	Absent good cause, a plan cannot require payments for more than 3 years if annualized current monthly income is less than the state median family income. § 1322(d)(2). If there is good cause to exceed 3 years, the plan's length may not exceed 5 years. § 1322(d)(1)(C). If annualized current monthly income is equal to or more than median family Income, a chapter 13 plan may not require payments for more than 5 years § 1322(d)(1).
Modification of Plan		
Pre-Confirmation	Only the proponent of the plan may modify it prior to confirmation. Bankruptcy Code § 1127(a).	Only the debtor may modify the plan prior to confirmation. § 1323(a).
Post-Confirmation	If the debtor is an individual, after confirmation of the plan, and whether or not the plan has been substantially consummated, the debtor, any trustee, the United States Trustee, or the holder of an unsecured claim may propose a modification. This right ends when the plan payments have been completed. Bankruptcy Code § 1121(e).	After confirmation, the debtor, the trustee, or the holder of an unsecured claim may propose a modification. This right ends when the plan payments have been completed. § 1329(a).

THE ABSOLUTE PRIORITY RULE: DOES IT APPLY IN INDIVIDUAL CHAPTER 11 CASES?

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I. Introduction.

This is intended to provide a brief analysis of whether the absolute priority applies in individual Chapter 11 proceedings and a review of the trends of the courts that have decided the issue.

II. 11 U.S.C. § 1129(b)(2)(B)(ii).

A. Confirmation

To confirm a Chapter 11 plan of reorganization, all the requirements of 11 U.S.C. § 1129(a), must be met. One of these conditions is that each impaired class of creditors accepts the plan. 11 U.S.C. § 1129(a)(8)(A). However, pursuant to 11 U.S.C. § 1129(b), a Chapter 11 plan may be confirmed even if it does not comply with § 1129(a)(8)(A), by using its "cram down" provision "if the plan does not discriminate unfairly, and is fair and equitable" to the creditors who have not voted to accept the plan. 11 U.S.C. § 1129(b)(1). Section 1129 (b)(2) then sets out the requirements for a plan to be considered "fair and equitable."

Among the requirements in § 1129(b)(2) is the "absolute priority rule" found in § 1129(b)(2)(B)(ii), which provides in relevant part:

> For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:
>
> * * *
>
> (B) with respect to a class of unsecured claims –
>
> * * *
>
> (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 requirements of subsection (a)(14) of this section.***

§ 1129(b)(2)(B)(ii) (emphasis added). The basic premise of the absolute priority rule provides that if a proposed Chapter 11 plan allows "the debtor to retain property, any dissenting [class of] creditors must be paid in full in order for the plan to be 'crammed down.'" *In re Maharaj*, 681 F.3d 558, 562 (4th Cir. 2012) (citing *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202, 108 S. Ct. 963, 99 L. Ed. 2d 169 (1988)). Prior to the revisions under Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") in 2005, which added this italicized portion of the statute, it was well decided that the absolute priority rule applied to individual debtors in a Chapter 11. See *Norwest Bank Worthington v. Ahlers*, *supra*, 485 U.S. at 202. With the addition of the italicized portion, above, courts have begun to address whether the rule still applies to individual debtors. The debate about the language centers primarily on the phrase "property included under section 1115."

B. Property of the Estate under § 1115

BAPCPA also added § 1115 to the Bankruptcy Code, which reads:

§ 1115 Property of the Estate

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

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

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

(b) Except as provided in section 1104 or a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.

11 U.S.C. § 1115. Section 1115 creates more "property of the estate" in individual chapter 11 cases filed after BAPCPA than in similar cases filed prior to BAPCPA. 7 Collier on Bankruptcy ¶ 1129.04 (16th ed. 2009). As described by Collier:

> It achieves this by first specifying all property covered by section 541, and then by adding to that base one category of property previously excluded by section 541(a)(6): an individual's postpetition income from services.
>
> As a result, section 1129(b)(2)(B)(ii)'s phrase "included in the estate under section 1115" includes, at a minimum, such postpetition income from services. Whether it includes more depends on the meaning given "included" and the construction of section 1115.
>
> If "included" in section 1129(b)(2)(B)(ii) means only property which is added by section 1115, then it has a very narrow meaning: it refers only to postpetition income from services--and not to property originally specified in section 541. If, however, "included" anticipates that section 1115 supplants entirely section 541, and assumes that the property of the estate in an individual's chapter 11 case can only be found in section 1115, then it has a very broad meaning, essentially exempting individuals from the absolute priority rule as to unsecured creditors.

7 Collier on Bankruptcy ¶ 1129.04.

C. The split in authority over the interpretation of the relation between §§ 1115 and 1129.

Since the implementation of BAPCPA, due to various courts' interpretations of "included" in relation to §§ 1115 and 541, there has been a split in authority regarding whether the new language does away with the absolute priority rule in cases filed by individual debtors in Chapter 11, with only one court of appeals decision to date. *Maharaj*, *supra,* 681 F.3d 558. One district court, one bankruptcy appellate panel, and five bankruptcy courts have developed the "broad view," though through various reasoning, finding that "Congress intends to include the entirety of the bankruptcy estate as property that the individual debtor may retain, thus effectively abrogating the absolute priority rule in a Chapter 11 for individual debtors." *Id.* at 563; *See In re Friedman*, 46 B.R. 471 (9th Cir. BAP 2012); *SPCP Group, LLC v. Biggins*, 465

B.R. 316 (M.D. Fla. 2011); *In re Shat*, 424 B.R. 854 (Bankr. D. Nev. 2010); *In re Johnson*, 402 B.R. 851 (Bankr. N.D. Ind. 2009); *In re Tegeder*, 369 B.R. 477 (Bankr. D. Neb. 2007); *In re Roedemeier*, 374 B.R. 264 (Bankr. D. Kan. 2007); *In re Bullard*, 358 B.R. 541 (Bankr. D. Conn. 2007).

In contrast, the "narrow view," which finds that BAPCPA did not abrogate the absolute priority rule in its entirety, has been adopted by the Fourth Circuit Court of Appeals and at least fifteen bankruptcy courts. *Maharaj*, *supra,* 681 F.3d at 560; See *In re Ferguson*, 2012 Bankr. LEXIS 3061 (Bankr. D.S.C. July 6, 2012); *In re Arnold*, __ B.R. __, 2012 Bankr. LEXIS 2200, 2012 WL 1820877 (Bankr. C.D. Cal. May 17, 2012); *In re Tucker*, 2011 Bankr. LEXIS 4701, 2011 WL 5926757 (Bankr. D. Or. 2011); *In re Borton*, 2011 Bankr. LEXIS 4310, 2011 WL 5439285 (Bankr. D. Idaho 2011); *In re Lindsey*, 453 B.R. 886 (Bankr. E.D. Tenn. 2011); *In re Kamell*, 451 B.R. 505 (Bankr. C.D. Cal. 2011); *In re Draiman*, 450 B.R. 777 (Bankr. N.D. Ill. 2011); *In re Walsh*, 447 B.R. 45 (Bankr. D. Mass. 2011); *In re Stephens*, 445 B.R. 816 (Bankr. S.D. Tex. 2011); *In re Karlovich*, 456 B.R. 677 (Bankr. S.D. Cal. 2010); *In re Steedley*, 2010 Bankr. LEXIS 3113, 2010 WL 3528599 (Bankr. S.D. Ga. 2010); *In re Gelin*, 437 B.R. 435 (Bankr. M.D. Fla. 2010); *In re Mullins*, 435 B.R. 352 (Bankr. W.D. Va. 2010); *In re Gbadebo*, 431 B.R. 222 (Bankr. N.D. Cal. 2010); *In re Maharaj*, 449 B.R. 484 (Bankr. E.D. Va. 2009).

D. Courts that favor the broad view.

The earlier interpretations had favored the broad view. *In re Johnson*, 402 B.R. 851 (Bankr. N.D. Ind. 2009) ; *Tegeder*, 369 B.R. 477 (Bankr. D. Neb. 2007); *In re Roedemeier*, 374 B.R. 264 (Bankr. D. Kan. 2007); *In re Bullard*, 358 B.R. 541 (Bankr. D. Conn. 2007). Many of these courts used a "plain meaning" analysis. The *Tegeder* Court opined:

> ...§ 1115 is clear that property of the estate in a case in which the debtor is an individual includes the property described in § 541 (which includes, but is not

> limited to, all legal or equitable interests of the debtor in property as of the commencement of the case), as well as post-petition property and earnings. Since § 1115 broadly defines property of the estate to include property specified in § 541, as well as property acquired post-petition, the absolute priority rule no longer applies to the individual debtors who retain property of the estate under § 1115.

Tegeder, 369 B.R. at 480. These plain meaning broad view courts have generally interpreted § 1115's use of the phrase "in addition to the property specified in section 541" to signify that § 1115 "absorbs and then supersedes section 541 for individual chapter 11 cases." 7 Collier on Bankruptcy ¶ 1129.04. This reading of the provision leads to the standpoint that section 1129(b)(2)(B)(ii)'s exception extends to *all* property of the estate. *Id.*

Other courts have reached the "board view" conclusion from a different approach. The *Shat* court, for instance, reviewed various amendments in BAPCPA that cause Chapter 11 cases to function like and follow Chapter 13, found that, although the plain meaning was ambiguous, Congress intended to abrogate the absolute priority rule for individual debtors. *Shat*, 424 B.R. at 863-68.

E. Courts that favor the narrow view.

More recently, however, the narrow view has the predominant view, and, as previously stated, the only Court of Appeals decision to date on this matter has supported this view. *Maharaj*, *supra*, 681 F.3d at 560. Similar to the broad view courts, the narrow view courts have differed in their reasoning supporting their opinions. Some of the opinions have found that the plain and unambiguous statutory language supports the retention of the absolute priority rule. *See, e.g.*, *Tucker*, 2011 Bankr. LEXIS 4701, 2011 WL 5926757 at *2; *Draiman*, 450 B.R. at 821; *Walsh*, 447 B.R. at 48-49; *Steedley*, 2010 WL 3528599 at *2; Mullins, 435 B.R. at 360; Karlovich, 456 B.R. at 681; *Borton*, 2011 Bankr. LEXIS 4310, 2011 WL 5439285 at *4. Others have found the language to be ambiguous, but have still adopted the narrow view. *See Gelin*,

437 B.R. at 441; *Kamell*, 451 B.R.at 509; *Lindsey*, 453 B.R. at 903. The *Lindsey* court, for example, found:

> Starting with the canons of statutory interpretation, it is axiomatic that the language of § 1129(b)(2)(B)(ii) and § 1115 is ambiguous, otherwise there would be no split of authority and the arguments in favor of each position so diverse. There is also no dispute that the legislative history for BAPCPA is sparse, at best, and provides no real assistance in this instance. Instead, the court agrees that the proper interpretation hinges on what Congress intended by the phrase "included in the estate under § 1115" added to § 1129(b)(2)(B)(ii).
>
> * * *
>
> ... the more logical reading of the phrase "included in the estate under section 1115" is the narrow one that Congress intended for only post-petition wages and debtors' after-acquired property to be excepted from the absolute priority rule.

Lindsey, 453 B.R. at 903. Yet, other courts have found that "if Congress had intended to abrogate the absolute priority rule for individual Chapter 11 debtors, it would have done so in a far less convoluted way, particularly in light of the well established place of the absolute priority rule in bankruptcy jurisprudence." *Maharaj*, 681 F.3d at 565-66 (citing *Kamell*, 451 B.R. at 509). While still other courts utilize a combination of the two approaches for their arguments that Congress' intent was to correlate Chapter 11 with Chapter 13 provisions. These courts generally believe that, "if that were Congress' intent, Congress would simply have amended the statutory debt ceilings for Chapter 13 cases set out in 11 U.S.C. § 109 (e), and either eliminate them all together or set them much higher." *Karlovich*, 456 B.R. at 682.

The Fourth Circuit Court of Appeals in *Maharaj* began its analysis by finding that the statutory language "is ambiguous because it susceptible to more than one reasonable interpretation." *Maharaj*, 681 at 568-69. Next, the court looked at Congressional intent when Congress enacted BAPCPA, and found that a narrow reading of the § 1115 does not render the statute trivial, but rather, in context, § 1115 adds property to the estate already established by § 541. *Id.* at 570. The court then considered statutory intent and with it, the doctrine against

implied repeal and found that Congress did not intend to abrogate the absolute priority rule. *Id.* at 572. ("Similarly, there is simply no clear indication from the language of either §§ 1129(b)(2)(B)(ii) or 1115 that Congress intended such a dramatic departure from pre-BAPCPA bankruptcy practice. Absent such a clear statement, we must refrain from adopting the 'broad view' and cannot conclude that the absolute priority rule has been abrogated for individual debtors in a Chapter 11 proceeding.") Lastly, the court considered and rejected the appellants' public policy arguments. *Id.* at 574-75.

III. The likely trend for the foreseeable future.

While the split in authority still remains, it appears that the trend from the more recent opinions, and higher court opinions, follows the narrow view. This has yet to be decided by the Sixth Circuit Court of Appeals, although the issue of it applicability is becoming a "hot topic" in individual Chapter 11 proceedings in the Eastern District of Michigan. The authors of this article know that the issue has been brought before the court in at least two recent cases: I*n re Grose* (E.D. Mich. Bankr. 11-69990) (Hon. Steven W. Rhodes) and *In re Marino* (E.D. Mich. Bankr. 11-55026) (Hon. Phillip J. Shefferly). The court in each agreed with the *Maharaj* decision and believed the broad view was the better view on the subject and found that the enactment of BACPA did not abrogate the absolute priority rule for individual debtors in a Chapter 11 proceeding.

THE ANTIMODIFICATION PROVISION OF 11 U.S.C. § 1123(b)(5)

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I. Introduction

This is intended to provide a brief overview of 11 U.S.C. §1123(b)(5) which states, in pertinent part, that a plan 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).*

II. History

Before the Bankruptcy Reform Act of 1994, Chapter 11 debtors could cram down a mortgage lien to the value of the collateral even though Chapter 13 debtors were prohibited from doing the same. The 1994 amendments added § 1123(b)(5) because Congress, in light of *Nobelman v. American Savings Bank*, 508 U.S. 324, 113 S.Ct. 2106, 124 L.Ed. 2d 228 (1993), wanted to extend the anti-modification provisions found in § 1322(b)(2) and provide the treatment of residential mortgages in Chapters 11 and 13. *H.R.E.P. No.* 103-835, at 46 (1994); *see also*, *In Re Daily*, 289 B.R. 707 (Bankr. C.D. Ill. 2003).

III. Generally

In Chapter 13, § 1322(b)(2) allows a debtor to propose a plan that modifies "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. § 1322(b)(2). *Nobelman v. American Savings Bank*, 508 U.S. at 328-29. Similarly, in Chapter 11 cases, § 1125(b)(5) allows debtors to modify the rights of holders of secured claims, but excepts from modification claims that are secured by a debtor's principal residence.[1] Also similar is § 1129(b), which contemplates the modification of lien rights of secured creditors in the context of plan confirmation.

[1] The term "debtor's principal residence" is defined as a residential structure, including condominiums, co-ops, mobile homes or trailers. 11 U.S.C. § 101(13A)

To determine whether the claim is fully secured, partially secured, or wholly unsecured, collateral is valued under § 506(a). Even if the claim is partially secured, the creditor is still a "holder of a secured claim" whose rights are protected from modification. *Nobelman v. American Savings Bank*, 508 U.S. at 330-31. If valuation of the collateral determines that the claim is wholly unsecured, then, just like in Chapter 13, the claim may be modified.

There is, however, one exception to the anti-modification provision that is unique to Chapter 13. Section 1322(c)(2) provides, "in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to § 1325(a)(5) of this title." Courts have reasoned that the absence of a similar section in Chapter 11 is because a Chapter 13 plan cannot exceed 60 months, while a Chapter 11 does not have a similar limitation. See eg, *In re Silva*, 2010 Bankr. LEXIS 344 (Bankr. S.D. Fla. 2010).

IV. Conclusion

There appears to be a two step process for determining whether § 1123(b)(5) will protect a creditor from modification of its claim. The court must first determine whether the creditor holds a claim secured by the debtor's principal residence. The court must then determine whether the value for the creditor's claim is secured or wholly unsecured. See, *In re Zimmer*, 313 F.3d 1220, 1226 (9th Cir. 2002). If the claim is secured by the debtor's principal residence, and is supported by at least some equity, then it should be exempt from modification.

SECTION 1111(b) OF THE BANKRUPTCY CODE:
An extraordinary provision

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I. Introduction

Section 1111(b)(2) provides that an undersecured creditor in a Chapter 11 case can elect to have its claim treated as though it is fully secured despite § 506(a). "This outcome was considered by Congress to be so extraordinary that it required one of the most complicated (and controversial) provisions of Chapter 11 of the 1978 code – the § 1111(b) election." *First Union Mtg, Corp. v. Eubanks (In re Eubanks)*, 219, 468, n4 (B.A.P. 6th. Cir. 1998). Because of its complexities, § 1111(b) routinely causes confusion with bankruptcy practitioners new to Chapter 11. This material briefly reviews the Section and whether to make an election under § 1111(b)(2). As reference, § 1111 is reproduced in its entirety below:

Claims or interests

(a) A proof of claim or interest is deemed filed under section 501 of this title [11 USCS § 501] for any claim or interest that appears in the schedules filed under section 521(a)(1) or 1106(a)(2) of this title [11 USCS § 521(a)(1) or 1106(a)(2)], except a claim or interest that is scheduled as disputed, contingent, or unliquidated.

(b)

(1) (A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title [11 USCS § 502] the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless

(i) the class of which such claim is a part elects, by at least two-thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection; or

(ii) such holder does not have such recourse and such property is sold under section 363 of this title [11 USCS § 363] or is to be sold under the plan.

(B) A class of claims may not elect application of paragraph (2) of this subsection if—

(i) the interest on account of such claims of the holders of such claims in such property is of inconsequential value; or

> (ii) the holder of a claim of such class has recourse against the debtor on account of such claim and such property is sold under section 363 of this title [11 USCS § 363] or is to be sold under the plan.
>
> (2) If such an election is made, then notwithstanding section 506(a) of this title [11 USCS § 506(a)], such claim is a secured claim to the extent that such claim is allowed.

11 U.S.C. § 1111.

II. Section 1111(a)

Section 1111(a) regulates the claims process in Chapter 11 cases. Specifically, it allows uncontested claims and interests that are scheduled by the debtor to participate in the Chapter 11 case even if a proof of claim was not filed. This is a departure from the general rule that a creditor must file a proof of claim in order to participate in distributions from the bankruptcy estate. 1111-3 COLLIER BANKRUPTCY MANUAL, ¶ 1111.03 (3d ed. rev. 2007). Nevertheless, bankruptcy practitioners should still file a proof of claim for their creditor clients to ensure the claim is treated as timely filed if the case happens to convert to Chapter 7. *Id.*

III. Section 1111(b)

A. Generally

With certain exceptions, § 1111(b)(1)(A) provides that a claim, secured by a lien on property of the estate, shall have an allowed or disallowed claim under § 502 the same as if the holder of such claim had recourse against the debtor on account of such claim. It protects nonrecourse claims from unfair treatment in a plan of reorganization, yet it applies with equal effect to recourse claims.[1] And unlike in liquidation cases, a Chapter 11 reorganization case

[1] Debt for which a debtor is personally liable is commonly referred to as recourse debt. Non-recourse debt is generally debt that is secured by collateral but for which the debtor is not personally liable.

permits a nonrecourse creditor to have a deficiency claim if the value of the collateral is insufficient to satisfy the secured claim since it is "the existence of a 'lien' on estate property ... that triggers the recourse right under § 1111(b)(1), not the existence of value to secure it." *In re Atlanta West VI*, 91 B.R. 620, 624 (Bankr. N. D. GA 1988). Value in the collateral that is more than inconsequential, however, is necessary in order to make the § 1111(b)(2) election become fully secured. 1111-12 COLLIER BANKRUPTCY MANUAL, at ¶ 1111.03[B].

Because nonrecourse claims are given recourse rights, if the debtor wants to receive or retain any property under the plan, but is unable to pay the unsecured deficiency claims in full, or cannot successfully negotiate acceptance of the plan, the cram down powers of § 1129 can be used to gain confirmation if the dissenting interests are eliminated (eg., abandonment), or if the new value exception to the absolute priority rule is recognized by the court. 1111-13 COLLIER BANKRUPTCY MANUAL, at ¶ 1111.03[1][a]. This challenge generally means that undersecured non-recourse creditors have more power with which to negotiate better treatment in the plan. Additionally, these creditors may not be concerned with the valuation of their collateral as they might have been without this right. *Id.*

B. Exceptions to automatic conversion of nonrecourse claims

There are two exceptions to the automatic conversion of nonrecourse claims to recourse claims. The first is when the nonrecourse creditor elects to have its claim secured to the extent that such claim is allowed under § 1111(b)(2). The second is when the collateral is sold under § 363, or through plan, and provides the nonrecourse creditor with the ability to offset the amount of its claim against the purchase price of the property if the successful bidder at sale. 11 U.S.C. § 1111(b)(1)(A)(ii); see also, 1111-15 COLLIER BANKRUPTCY MANUAL, at ¶ 1111.03[2];

C. Time for making an election under § 1111(b)(2)

An election under § 1111(b)(2) is made at any time prior to the conclusion of the hearing on the disclosure statement, or within such later time as the court may fix." *FED R. BANKR. P. 3014.* "If the disclosure statement is conditionally approved pursuant to Rule 3017.1, and a final hearing on the disclosure statement is not held, the election ... may be made not later than the date fixed pursuant to Rule 3017.1(a)(2) or another date the court may fix." *Id.* Additionally, "[t]he election shall be in writing and signed unless made at the hearing on the disclosure statement." *Id.*

D. Limitations on the ability to make an election under 1111(b)

According to § 1111(b)(1)(A)(i), it is the class of claimholders that elect treatment under § 1111(b)(2). The election is made if "at least two-thirds in amount and more than half in number" of secured claimholders vote for such treatment. 11 U.S.C. § 1111(b)(1)(A)(i).[2] There are two limitations on the ability of a class of secured claims to make an 1111(b) election. The first is when the collateral is "of inconsequential value". The second is if a creditor of the class has recourse and the property is to be sold under § 363 during the bankruptcy case, or is to be sold under the plan. See, *11 U.S.C. § 1111(b)(1)(B)(i)* and *(ii).*

[2] This is one example of how a class can impact the actions and treatment of an individual creditor of such class. It is, therefore, important to scrutinize the classification of claims in the plan. If claims that are not "substantially similar" are classified together, then there may be cause to object to such classification. For example, mortgages on different property are many times grouped in the same class; however, some courts hold that secured claims with different priority or with interests in different property are generally not substantially similar and should not be in the same class. *See eg., In re Commericail W. Fin Corp.,* 761 F.2d 1329 (9th Cir. 1985); F*ederal Home Loan Mortgage Corp. v. Bugg (In re Bugg)*, 172 B.R. 781 (E.D. Pa. 1994).

E. Calculating § 1111(b)(2)

Section 1129(b) provides three alternatives with which a debtor can cram down an impaired class for confirmation. The first involves providing deferred cash payments to such class. See, 11 U.S.C. § 1129(b)(2)(A)(i). The other two involve the sale of the collateral free and clear of liens, or providing the class with the "indubitable equivalent" of its claim. See, *11 U.S.C. §1129(b)(2)(A)*(ii) and (iii). Hence, it is necessary to analyze whether to make an election under elect § 1111(b)(2) in terms of a cash payment cram down.

In order to satisfy secured claims with deferred cash payments, the plan must provide that the holders of the class retain their individual liens to the extent of the allowed amount of such claims. This means that when an election under § 1111(b)(2) is made, the allowed secured claim is the total amount owed to the creditor. The plan must also provide each holder with deferred cash payments totaling at least the allowed amount of such claim, of a value as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property. *11 U.S.C. § 1129(b)(2)(A)(i).* This means that "the plan must provide for the holder to receive, on account of the allowed secured claims, payments, either present or deferred, of a principal face amount equal to the amount of the debt, and of a present value equal to the value of the collateral." 124 Cong. Rec. H 11102-H 11105, H 11114-H 11115 (Sept. 28, 1978).

The legislative history also provides an example, which is as follows:

> [I]f a creditor loaned $ 15,000,000 to a debtor secured by real property worth $ 18,000,000 and the value of the real property had dropped to $ 12,000,000 by the date when the debtor commenced a proceeding under chapter 11, the plan could be confirmed notwithstanding the dissent of the creditor as long as the lien remains on the collateral to secure a $ 15,000,000 debt, the face amount of present or extended payments to be made to the creditor under the plan is at least $ 15,000,000, and the present value of the present or deferred payments is not less than $ 12,000,000.

Id. The meaning of "'[p]resent value,' or the 'time of money,' [is that a] dollar received today is usually worth more than a dollar to be received in one year so that interest must be paid as compensation for delay in payment." James A. Pusateri, et al., *Section 1111(b) of the Bankruptcy Code: How Much Does the Debtor Have to Pay and When Should the Creditor Elect, 58 Am. Bankr. L. J. 129, 136-37* (Spring 1984).

The interest rate used for the calculation will vary according to jurisdiction. The Sixth Circuit Court of Appeals has held that the interest rate in this situation is the market rate if an "efficient market" exits. If an "efficient market" does not exist then the bankruptcy court should employ the formula approach endorsed by the [plurality in *Till v. SCS Credit Corp.*, 541 U.S. 465, 124 S. Ct. 1951, 158 L.Ed. 2d 787 (2004)]." *Bank of Montreal v. Official Committee of Unsecured Credtiors (In re American HomePatient, Inc.)*, 420 F.3d 559, 568, 693 (6th Cir. 2005).

The court in *In re Griswold Building, LLC, et al.,* 420 B.R. 666, 693 (Bankr. E. D. Mich. 2009), however, found that the term "efficient market" was not defined in either the *Till* or *American HomePatient* cases, and neither of them provided much guidance on the issue. To determine whether an "efficient market" existed, the court took expert testimony for the type of loans at issue and found one did not exist. It then assessed whether any adjustments for risk should be added to the national prime rate and determined the appropriate interest rate. *Id.*, 694-96.

These cases suggest that a court should first determine if an "efficient market" exists through expert testimony or some other evidentiary means. If one does not exist, the courts should employ the formula approach under *Till.*

F. Formulas and example

Because there are two payment requirements under § 1129(b)(2)(a), one requiring payments equal to the total claim, and the other requiring payments equal to the present value of the collateral, the debtor must pay the greater of the two to satisfy both. One can easily determine the appropriate treatment by simultaneously charting payments for various terms under each requirement and then choosing the greater of the two as the "required payment". See generally, Pusateri, et al., *Section 1111(b) of the Bankruptcy Code: How Much Does the Debtor Have to Pay and When Should the Creditor Elect*, 58 Am. Bankr. L.J. 129, 140 (Spring 1984). An example of this method is as follows:

1. Payments equal to the total claim.

The formula used to calculate payments that are equal to the total claim is: Total claim divided by total number of monthly payments equals monthly payment (TC/TMP=MP).

2. Payments equaling the present value.

The find payments equaling the present value, you must first determine the value of the collateral and the appropriate interest rate. Once those are ascertained, prepare a chart using information obtained through a mortgage repayment table (mortgage amortization calculation).

[CHART ON NEXT PAGE]

Total Claim: $100,000
Value of Collateral: $75,000
Interest Rate: 6%

Months	**Present ValuePayment ($75000 amortized at 6%)** Payment/Month	**Total Claim Payment ($100,000)** Payment/Month
12	$6454.98	$8333.33
24	$3324.05	$4166.67
36	$2281.65	$2777.78
48	$1761.38	$2083.34
60	$1449.96	$1666.67
72	$1242.97	$1388.89
84	$1095.64	$1190.48
96	$985.61	$1041.67
108	$900.43	$925.93
120	$832.65	$833.34
180	$777.53	$555.56

Looking at the above chart, if the claim is paid over 96 months, the debtor must pay $1041.67/month because it is the greater of the two choices found in the particular horizontal column. If the claim is paid over 180 months, the debtor must pay $777.53/month because it is the greater of the two choices in the particular horizontal column.

IV. Conclusion

Section 1111(b)(2) provides benefits to an undersecured creditor because it gives them the ability to retain future appreciation of its collateral or allows them to protect what value it has if a judicially determined value is erroneous. The burdens, however, are that the creditor will not receive payments on the unsecured portion of its claim or may lose voting leverage, or both. Practitioners should, therefore, review, among other things, the amount for distribution to unsecured creditors, whether the collateral is likely to appreciate in value, the ability to use § 1111(b)(2) as leverage for better treatment, or whether the valuation of the collateral is erroneous before making the election. Whatever the reason, the effect of the choice will, in most cases, have an impact on everyone involved with the case. It is, therefore, necessary to fully consider,

and understand, all available options so that a sound decision is made with respect to treatment in the plan and confirmation.