Individual Chapter 11s

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RECENT DECISIONS REGARDING INDIVIDUAL CHAPTER 11 CASES

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BAPCPA AND THE THIRTEENTH AMENDMENT

In late 2012, New Mexico's bankruptcy court again indicated the parties before it should be "prepared to address the consequences and ramifications of the appointment of a chapter 11 trustee" in regards to the Thirteenth Amendment. In re Hyatt, 479 B.R. 880, 898, 898 n.19 (Bankr. D.N.M. 2012).

By comparison, in 2013 the Ninth Circuit affirmed Marciano v. Fahs (In re Marciano), 459 B.R. 27 (9th Cir. BAP 2011), aff'd 708 F.3d 1123 (9th Cir. 2013), but, unlike the BAP opinion it affirmed, the Ninth Circuit opinion does not mention the Thirteenth Amendment

PROPERTY OF THE INDIVIDUAL CHAPTER 11 DEBTOR'S ESTATE (Post BAPCPA)

On December 4, 2012, Utah's Supreme Court negatively answered the Tenth Circuit's certified question regarding whether a Utah statute that protects 75% of an individual's aggregate disposable earnings from garnishment, Utah Code Ann. §70C-7-103, creates an exemption in bankruptcy:

Section 103 does not create an exemption in bankruptcy. Instead, Section 103 limits garnishment of a debtor's disposable earnings under the narrow circumstance when a creditor seeks to enforce payment of a judgment based on a consumer credit agreement.

Gladwell v. Reinhart (In re Reinhart), 291 P.3d 228, 230 (Utah 2012).

On December 21, 2012, the Bankruptcy Court for the Northern District of Texas documented, and provided an apt synopsis of, the four-way split regarding the effect of plan confirmation on property of a Chapter 13 estate. In re Hymond, 2012 WL 6692196 (Bankr. N.D. Tex. Dec. 21, 2012). The court adopted, and noted the overall predominance of, the "reconciliation approach" Id. at *2-4.

When it comes to how a Chapter 11 debtor should pay his ordinary living expenses, on June 5, 2013, the Bankruptcy Court for the Central District of California relied upon Goldstein to conclude a debtor should be able to pay ordinary living expenses without prior court approval:

> Rather than struggle to invent out of whole cloth a procedure and standard for approving requests by chapter 11 debtors for authority to spend property of the estate for the payment of post-petition living expenses, the court should give section 363(c)(1) the same interpretation in chapter 11 cases as it has always been understood to have in chapter 13 cases. That is, the court should recognize that section 363(c)(1) authorizes a debtor in possession to use property of the estate to pay post-petition living expenses without prior court approval, so long as the amounts to be disbursed qualify as 'ordinary course' expenses. An individual

> chapter 11 debtor needs to pay his living expenses in order to continue generating revenues for the estate. Thus, the payment of ordinary course living expenses should be treated as being within the debtor'' ordinary course of business for the purpose of interpreting section 363(c)(1).

In re Seely, 2013 WL 2456359, *4-5 (Bankr. C.D. Cal. June 5, 2013).

The issue of whether debtor counsel's retainer is property of the estate has also developed since May of 2012. First, Arizona's District Court affirmed In re Glimcher, which held that a security retainer given to counsel for a Chapter 7 debtor could not be spent on post-petition services without debtor counsel being retained by the Chapter 7 trustee. In re Glimcher, 469 B.R. 835, 841-42 (Bankr. D. Ariz. 2012), aff'd, 2012 WL 5868972 (D. Ariz. Nov. 19, 2012).

On August 29, 2012, the Bankruptcy Court for the Western District of Wisconsin demonstrated how different the result can be for debtor counsel who collects a flat fee rather than a retainer. Applying Wisconsin law, the court analyzed the fee paid to counsel, concluded it was a true "flat fee" rather than a retainer, and held such a flat fee was not estate property. The court further held that the trustee could not avoid the prepetition flat fee payment to counsel under 11 U.S.C. § 548 because the fee amount was reasonably calculated to compensate counsel for adversary proceedings that were likely to occur. White v. Coyne, Schultz, Becker & Bauer, S.C. (In re Pawlak), 483 B.R. 169, 177-78 (Bankr. W.D. Wis. 2012).

CRAMDOWN (Post BAPCPA)

Abrogation of Absolute Priority Rule

The most active issue continues to be whether BAPCPA's amendment to 11 U.S.C. § 1129(b)(2)(B)(ii) abrogates the absolute priority rule for individual Chapter 11 debtors.

Cases holding BAPCPA abrogated the absolute priority rule lost one and gained two. Basically, one case adopting a broad interpretation of 11 U.S.C. § 1129(b)(2)(B)(ii) is no longer good law in its circuit. On January 15, 2013, the Tenth Circuit disagreed with In re Roedemeier, 374 B.R. 264 (Bankr. D. Kan. 2007), in Dill Oil Co. v. Stephens (In re Stephens), 704 F.3d 1279, 1286 (10th Cir. 2013).

On the other hand, two new cases apply the broad view. In late 2012, Oregon's bankruptcy court decided it was bound by, and applied, the Ninth Circuit BAP's Friedman opinion to reverse an earlier contrary determination. In re Tucker, 479 B.R. 873, 876 (Bankr. D. Or. 2012). On April 12, 2013, the Bankruptcy Court for the Western District of Arkansas adopted a broad interpretation of its own accord. In re O'Neal, 490 B.R. 837 (Bankr. W.D. Ark. 2013).

In re Tucker, it should be noted, followed Friedman narrowly. According to Tucker, reading Friedman to eliminate anything more than the absolute priority rule is incorrect. "[E]limination of the absolute priority rule in individual chapter 11 cases removes a significant barrier, but does not relieve the plan proponent from its burden of proving fair and equitable treatment of dissenting classes." In re Tucker, 479 B.R. at 878.

There has also been much activity among cases adopting the "narrow view". First and foremost, there are two new circuit court cases, from the Tenth and Fifth Circuits, refusing to abrogate the absolute priority rule. In re Stephens, 704 F.3d 1279, 1285 (10th Cir. 2013); In re Lively, 717 F.3d 406 (5th Cir. 2013). There is also one new bankruptcy court opinion adopting the narrow view. In re Lee Min Ho Chen, 482 B.R. 473 (Bankr. D.P.R. 2012).

Narrow view cases, however, also lost a member. Specifically, In re Tucker, 2011 WL 5926757 (Bankr. D. Ore. Nov. 28, 2011), was abrogated by In re Friedman, 466 B.R. 471 (9th Cir. BAP 2012), as recognized in later proceedings, 479 B.R. 873(Bankr. D. Or. 2012).

Thus, as it stands, eighteen cases support a narrow interpretation – but one, In re Tucker, is no longer citable as good law. Seven cases support a broad interpretation – but one, In re Roedemeier, is also not good law.

TIMING OF DISCHARGE: MODIFICATION OF PLAN (Post BAPCPA)

Cause

A recent case has weighed in on what constitutes "cause" under new section 1141(d)(5)(A). According to In re Detweiler: "The court finds that substantial consummation may constitute cause but it is not the exclusive benchmark. Cause must be determined, as it always has been, upon the facts and circumstances of each case." 2012 WL 5935343 (Bankr. N.D. Ohio Nov. 27, 2012).

HOW BAPCPA CHANGED

CHAPTER 11 CASES FOR INDIVIDUALS

– OR –

NO, THIS IS NOT YOUR MOTHER'S CHAPTER 11 !!

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TABLE OF CASES

MISCELLANEOUS

INTRODUCTION

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23, was enacted on April 20, 2005.[1] It made substantial changes to the Bankruptcy Code[2] and other bankruptcy-related statutes. With certain exceptions, BAPCPA's provisions apply to cases filed on or after October 17, 2005.

BAPCPA fundamentally changed the rules that govern chapter 11 cases for individuals. The purpose of this paper is to provide a description of some of the principal changes and their impact.[3] We begin with a general review of the principal differences among chapters 7, 11 and 13 cases before BAPCPA. Then, we look at some of the principal changes wrought by BAPCPA in chapter 11 cases for individual debtors. In general, under BAPCPA, chapter 11 cases for individuals have much in common with chapter 13 cases. In conclusion, we note some of the remaining statutory differences between chapter 11 and chapter 13.

AN INDIVIDUAL DEBTOR'S BANKRUPTCY CHOICES PRIOR TO BAPCPA

Prior to BAPCPA, individual debtors who needed relief from their debts had a choice to file under chapter 7 or 11, and some could choose to file under chapter 13. Each chapter had different characteristics. In very general terms:

General Description of Chapter 7 Before BAPCPA

Chapter 7 was – and after BAPCPA remains – a liquidation. A court-appointed trustee takes control of the debtor's assets as of the petition date, although the debtor can exempt certain assets from property of the estate. While there are often disputes about the disposition of property with value greater than the amount of the debt it secures or the availability of the debtor's claimed exemptions, often secured creditors are permitted to foreclose on their collateral, while the trustee liquidates the remaining unencumbered, non-exempt property (if any). If there are funds available after paying the costs of liquidation (including the trustee's fee and the fees and expenses of the trustee's counsel), the trustee makes a distribution to creditors in the order of the priority of their claims; within each priority class, payment is pro rata. The debtor receives a discharge, which frees him or her from the obligation to pay prepetition debt, except nondischargeable debt. Nondischargeable debt generally consisted of certain tax and tax-related

1 The Bankruptcy Technical Corrections Act of 2010, Pub. L. No. 111-327, 124 Stat. 3556 ("Technical Corrections Act"), which was enacted on December 22, 2010, corrected technical mistakes in BAPCPA. As appropriate, references herein to BAPCPA or the "Code" (as defined below) are to BAPCPA or the Code as amended by the Bankruptcy Technical Corrections Act.

2 Unless otherwise stated, references herein to sections, subsections, etc. are to sections, subsections, etc. of the Bankruptcy Code ("Code"), 11 U.S.C. § 101 et seq.

3 This paper is not intended to be exhaustive and is no substitute for careful review and consideration of the statutory changes themselves.

claims, certain marital and support obligations, certain educational loans, tort claims based on malice and willfulness, and debts incurred through fraud.

General Description of Chapter 11 Before BAPCPA

Chapter 11 was conceived as a vehicle for reorganizing business entities. However, the U.S. Supreme Court, in Toibb v. Radloff, 501 U.S. 157 (1991), determined that individuals – even those not engaged in business – could seek and obtain relief under chapter 11. By contrast to chapter 7, a chapter 11 debtor generally remains in possession and control of the property in his or her bankruptcy estate throughout the bankruptcy case. The culmination of a chapter 11 case is the confirmation of a plan that describes when, how and how much the debtor will pay his or her secured, priority and general unsecured creditors. The plan can reorganize the debtor's business or liquidate assets, or both. On confirmation, the individual chapter 11 debtor received a discharge from his or her prepetition debts (other than those that would be nondischargeable in chapter 7), but was obligated to make the payments and otherwise perform as provided in the plan.

There are numerous rules governing the chapter 11 plan process. For example, the plan must divide creditors into classes, with each class containing claims that are substantially similar; and claims in each class are to be treated the same way. Classes of claims are either "impaired" or "unimpaired." "Impaired" classes (i.e., those whose rights are modified by the plan) vote on the plan after receiving a disclosure statement that provides them with "adequate information" about the plan. A class votes in favor of the plan if creditors holding at least two-thirds in amount and more than one-half in number of claims voting accept the plan. If all of the impaired classes accept the plan and certain other requirements are met, then the plan will be confirmed, even if some creditors object. Among the other requirements are that the plan must (a) be proposed in good faith, (b) be feasible, and (c) satisfy the "best interests of creditors" test (i.e., each holder of a claim in an impaired class must receive not less than it would receive if the debtor were hypothetically liquidated under chapter 7). If not all of the impaired classes accept the plan, but the other requirements for confirmation are satisfied, then the plan may still be confirmed if the requirements for "cramdown" are met. A class of unsecured claims could be "crammed down" – i.e., the plan confirmed over their "no" vote – if the plan did not "discriminate unfairly" with respect to that class, and was "fair and equitable," which required that, at a minimum, each holder of a claim in that class (a) received or retained property of a value equal to the allowed amount of its claim or (b) the holder of any junior claim or interest received or retained no property under the plan. If neither of these requirements was met, there was also the possibility that a chapter 11 plan could be confirmed under the "new value corollary" articulated in Case v. Los Angeles Lumber Products Co, 308 U.S. 106, 121-22 (1939), which in general allows the debtor owner to receive or retain property under the plan if it makes a new, substantial,

and necessary contribution in money or money's worth that is reasonably equivalent to the interest received or retained. Under Bank of America v. 203 North LaSalle Street Partnership, 526 U.S. 434, 437 (1999), the adequacy of new value must be tested by some form of market valuation.

General Description of Chapter 13 Before BAPCPA

Some individuals have the option of filing for bankruptcy under chapter 13, which, unlike chapters 7 and 11, can be initiated only voluntarily. To be eligible for chapter 13, a debtor must be an "individual with regular income" (i.e., income that is sufficiently stable and regular to make payments under a chapter 13 plan). In addition, there is a debt limit: a chapter 13 debtor must owe, on the petition date, less than (a) $360,475 in noncontingent, liquidated, unsecured debts, and (b) $1,081,400 in noncontingent, liquidated, secured debts.[4] Unlike in chapters 7 and pre-BAPCPA chapter 11, the chapter 13 debtor's postpetition earnings and property acquired by the debtor postpetition are property of the chapter 13 debtor's estate. As is generally true in chapter 11, the chapter 13 debtor remains in possession and control of the property in his or her bankruptcy estate, although a "standing" chapter 13 trustee oversees the process. Like chapter 11, chapter 13 involves confirmation of a plan that specifies when, how and how much creditors will be paid. As in chapter 11, the chapter 13 plan classifies creditors into classes, and all creditors in a class must be treated alike. In addition, as in chapter 11, a chapter 13 plan must (a) be proposed in good faith, (b) be feasible, and (c) satisfy the "best interests of creditors" test. However, unlike in chapter 11, a chapter 13 debtor must file its plan within a very short time (i.e., 15 days) after filing for bankruptcy, there is no disclosure statement, and creditors do not vote on the plan. Rather, if an unsecured creditor objects to confirmation, the chapter 13 plan could not be confirmed unless (i) the dissenting creditor's claim would be paid in full or (ii) the debtor made his or her future projected "disposable income" for three years available to pay unsecured creditors under the plan; "disposable income" was income received by the debtor that was not necessary for the support and maintenance of the debtor or his or her dependents, for the payment of business expenses, or for certain charitable contributions. Generally, a chapter 13 debtor does not receive his or her discharge until the plan has been fully performed, although when granted after full performance, the chapter 13 discharge (known as the "super-discharge") covered most debts that are not dischargeable in chapter 7 and 11 cases (such as claims for fraud); only long term debts (e.g., a home mortgage), alimony, maintenance and support obligations, educational loans, debts for death or personal injury caused because the debtor was driving a motor vehicle while intoxicated, and claims for restitution or fines included in a criminal sentence were excluded.

Who Chose What Chapter Before BAPCPA

In very general terms, prior to BAPCPA, individuals who were prepared to give up

4 These amounts are subject to periodic cost-of-living adjustments under section 104, and were last adjusted on April 1, 2010.

all of their nonexempt property in order to obtain an immediate discharge and unfettered access to their postpetition earning potential filed under chapter 7. Qualified individuals who wanted to retain some of their nonexempt assets (often their homes) or obtain the "super-discharge" filed under chapter 13, the price for which was that they devoted their projected disposable income for three years – of which there could be little, if any – to the payment of their creditors.[5] Chapter 11 filings by individuals were not common. The complexity and expense of chapter 11, particularly proposing and confirming a chapter 11 plan, discouraged many potential individual chapter 11 debtors.

SOME EFFECTS OF BAPCPA

BAPCPA made profound changes in chapter 7 and chapter 13. Those changes were the focus of most of the Congressional and media attention during the many years the legislation was debated in Congress. We have all heard of the "means test," which is now used to determine presumptively whether a debtor whose debts are primarily consumer debts may remain in chapter 7 or will be forced to obtain relief in chapter 11 or chapter 13. You may even be aware that the income and expense standards of the "means test" have been imported into chapter 13 and are instrumental in determining "projected disposable income" in the context of confirming a chapter 13 plan, and that the chapter 13 "super-discharge" has been eroded. You may also be aware that BAPCPA imposes mandatory education requirements on individual debtors, and that lawyers who represent individuals in bankruptcy cases have significant new duties, limitations and liabilities. In fact, many BAPCPA amendments directed at individual debtors in chapter 7 and 13 also affect individual debtors in chapter 11.

You are also undoubtedly aware that BAPCPA made significant changes that affect chapter 11 business cases.[6] For example, the deadline to assume nonresidential real property leases cannot be extended beyond 210 days without the landlord's consent; plan exclusivity cannot be extended beyond 18 months; and the value of goods received by the debtor in the ordinary course of business within 20 days prior to filing will be an administrative claim.

BAPCPA also made very significant changes relating solely to chapter 11 cases for individual debtors.[7] Many of these changes import into chapter 11 concepts and rules from

5 In actuality, there were significant differences in filing rates among various jurisdictions throughout the United States that cannot be explained by the differences between the relief available in chapter 7 and chapter 13. These differences have been attributed to various causes, including cultural differences and differing familiarity of the bench and bar with chapter 13 in various judicial districts.

6 This paper does not deal with provisions of the Code that apply to a "small business debtor," as defined in section 101(51D). Those provisions apply regardless of whether the "small business debtor" is an individual.

7 Some have argued that the modifications made by BAPCPA to chapter 11 for individual debtors may, in some instances, be unconstitutional under the Thirteenth Amendment,

chapter 13. Thus:

which provides: "Neither slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States, or any place subject to their jurisdiction." A particularly nuanced and helpful analysis of this issue is provided by Professor Margaret Howard in her article, Bankruptcy Bondage, 2009 U. Ill. L. Rev. 191 (2009).

The court in Proudfoot Consulting Co. v. Gordon (In re Gordon), 465 B.R. 683 (Bankr. N.D. Ga. 2012), dealt with such constitutional issues in the context of a motion to convert to chapter 11 a chapter 7 case for an individual debtor with predominately business debt. The debtor was a consultant who voluntarily terminated his employment with one company (Proudfoot) and went to work for another, in violation of a restrictive covenant. Although litigation was still pending in federal district court, Proudfoot had a judgment against the debtor for over $300,000 and was garnishing the debtor's wages. This led the debtor to file a voluntary chapter 7 petition.

After the court denied Proudfoot's motion to dismiss the debtor's chapter 7 case, Proudfoot moved to convert the case to chapter 11 under section 707 (b). The debtor opposed Proudfoot's motion to convert on the ground, among others, that involuntary conversion of an individual debtor's chapter 7 case to chapter 11 violates the Thirteenth Amendment and the Anti-Peonage Act, 42 U.S.C. § 1994, based on certain aspects of chapter 11 after BAPCPA, including provisions that would treat his postpetition earnings as property of the estate that must be used as necessary for execution of a confirmed plan (new sections 1115 and new paragraph (8) of 1123(a)), that would require the amount of his projected disposable income to be paid under the plan (new subsection (15) of section 1129(a)), that would not allow him to voluntarily convert his case (section 1112(a)(3)), and that would permit a creditor to propose a plan (section 1121(c)). However, the court refused to consider these "'horribles,'" because none had occurred and would not occur without other decisions by the court. Id. at 698. Thus, issues relating to such possibilities were not ripe, nor did the debtor have standing to raise them. Rather, the court said, "[t]he only effect of converting the case . . . is that the Debtor's post-petition earnings become property of the estate, which means that, if he wishes to use those post-petition earnings for non-typical purposes, a request for approval to spend the money must be filed with the Bankruptcy Court and the use must be approved," and the debtor has to file monthly operating reports and pay the U.S. Trustee's fee. Id. at 697. These effects, the court determined, did not result in unconstitutional involuntary servitude or peonage. Noting that "involuntary servitude generally requires compulsion, either through physical coercion or legal sanction" (id. at 696), the court concluded:

> [T]he mere conversion of the case from Chapter 7 to Chapter 11 is not a type of physical or legal coercion constituting involuntary servitude. . . . [C]onversion does not require anything of the Debtor. Conversion does not require the Debtor to work for a particular employer, or in a particular job, or to work at all, nor does it require the Debtor to pay his creditors. Conversion simply places the Debtor in another chapter within the Bankruptcy Code, the protections of which the Debtor invoked by voluntarily filing his own petition to facilitate his discharge.

Id. at 699-700. The court also held that "a party has no constitutional right to a discharge" under chapter 7. Id. at 700. Rather, "[a] party has a statutory right to file bankruptcy, but . . . only pursuant to the terms of the statute." *Id.*

By contrast, in In re Lobera, 454 B.R. 824, 855 n.33 (Bankr. D.N.M. Mar. 16, 2011), after

(1) Under new section 1115, the estate of an individual chapter 11 debtor

refusing to dismiss the chapter 7 case of a doctor whose debts were primarily business debts, the court also refused to convert the case to chapter 11, noting that Congress, by enacting BAPCPA and, thus, "allowing creditors to force conversation of a Chapter 7 debtor's case to Chapter 11, coupled with an inability to voluntarily reconvert or dismiss and the inclusion of the debtor's post-petition income, . . . may have created the setting for a constitutional challenge."

The court in In re Clemente, 409 B.R. 288 (Bankr. D.N.J. 2009), considered a different situation. There, the debtor, a cardiovascular surgeon, filed a voluntary chapter 11 case. He was in the midst of a divorce, and was ordered to make domestic support payments. "As the Debtor's bankruptcy case advanced, however, Dr. Clemente was untimely with those payments. Needless to say, remnants from the matrimonial case powdered [sic] their way over the bankruptcy case, thereby impinging negotiations and ultimately the reorganization process." Id. at 290. Also, because of the debtor's inability accurately to account for and separate his personal from his business expenses, a trustee was appointed. "The appointment of the Chapter 11 trustee came during Dr. Clemente's attempt to garner approval of his disclosure statement and confirm his proposed plan of reorganization," which was resisted by various creditors, including his former wife. Id. "In a manifest stratagem to attain leverage in settlement negotiations and his reorganization efforts, the Debtor moved to convert his case from Chapter 11 to Chapter 7." Id.

The constitutional issue arose because the debtor could not automatically convert to chapter 7 under section 1112(a) because he was no longer a debtor in possession. "Moreover, pursuant to § 1115(a)(2) and § 541, Dr. Clemente's post-petition earnings remained property of the estate for use in funding his reorganization plan." Id. As the court colorfully observed, the debtor "was between the Charybdis of § 1115 and the Scylla of § 1112, with possible constitutional implications" of indentured servitude in violation of the Thirteenth Amendment. Id. The court described the situation as follows:

> Dr. Clemente is no longer the debtor in possession; a Chapter 11 trustee has been appointed, which nullifies the Debtor's standing to bring the conversion motion. Alternatively, the Court cannot dismiss this case, because dismissal certainly is not in the best interest of the creditors or the estate. Thus, at this point, Dr. Clemente is confined in bankruptcy until either his Chapter 11 trustee decides to move for conversion (unlikely) or his plan of reorganization is confirmed (difficult due to the numerous points in objection). Dr. Clemente is squeezed further by the application of § 1115. Dr. Clemente is compelled to use his post-petition earnings from individual services to fund his Chapter 11 plan, with no available route of escape. Notably, in light of Dr. Clemente's substantial unsecured debt, he cannot qualify as a debtor under Chapter 13 pursuant to the debt limits imposed under § 109(e). Chapter 11 is his only option, and if unable to convert to a liquidation proceeding under Chapter 7, he would be forced to work for his creditors in breach of his freedoms guaranteed by the Thirteenth Amendment.

Id. at 293.

The court rejected the creditors' argument that there was no constitutional issue because the debtor had voluntarily commenced his chapter 11 case. However, rather than decide

will include postpetition earnings and property acquired by the debtor postpetition. Section 1115 is virtually identical to section 1306 (which was not changed by BAPCPA).

(2) Under new paragraph (8) of section 1123(a), a plan for an individual debtor is to provide for the payment to creditors of postpetition earnings or other future income of the debtor as is necessary for execution of the plan. In chapter 13, the debtor's post-confirmation earnings have always been the principal source of payment under a plan.

(3) Under new paragraph (15) of section 1129(a), a plan for an individual debtor cannot be confirmed over the objection of an unsecured creditor unless (a) the plan provides for distribution to the creditor of the value of the allowed amount of its 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 for at least the next five years. Section 1129(a)(15) is very similar to section 1325(b)(1) (as amended by BAPCPA), and incorporates the "disposable income" definition set forth in section 1325(b)(2) (as amended by BAPCPA).

(4) Under new paragraph (5) of section 1141(d), discharge of an individual chapter 11 debtor is delayed until the payments provided for in the plan have been completed, unless the court permits an earlier discharge. Section 1141(d)(5) is similar to section 1328(a), (b) & (h) (as amended by BAPCPA).

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whether in the debtor's situation the operative provisions of chapter 11 violated the Thirteenth Amendment, the court opted to deem the debtor's motion to convert to be a request, first, to terminate the chapter 11 trustee under section 1105 for the limited purpose of converting the case to chapter 7 and, then, to convert the case to chapter 7. The court then granted that motion, sua sponte, if need be. Thus, "the Court . . . supplied the Debtor with an available escape from a possible state of peonage." Id. at 295. This result was in the best interest of the estate and creditors because "this matter will not be further delayed insofar as the constitutional question is no longer at issue." Id. at 296.

In Misuraca v. U.S. Trustee, 2009 WL 1212471 (D. Ariz. May 4, 2009), the district court denied the chapter 13 debtor's motion for stay pending appeal of the bankruptcy court's dismissal of his chapter 13 case for abuse. The debtor/appellant argued that dismissal of his chapter 13 case would give him no choice other than to file for relief under chapter 11 and that, based on language in Toibb v. Radloff, 501 U.S. at 165-66, involuntary proceedings in chapter 11 would be unconstitutional. The court denied the motion because "this issue is not ripe." 2009 WL 1212471, at *1. Similarly, in Marciano v. Fahs (In re Marciano), 459 B.R. 27, 39-40 (B.A.P. 9th Cir. 2011), the debtor asserted that section 303(a) was unconstitutional in violation of the Thirteenth Amendment insofar as it authorized the filing of an involuntary chapter 11 petition against an individual debtor. "The bankruptcy court ruled that unless and until an order for relief was entered in the case, the constitutional issue . . . was not ripe," and the Bankruptcy Appellate Panel affirmed.

(5) Under new subsection (e) of section 1127, a confirmed chapter 11 plan for an individual debtor may be modified, even after substantial consummation, to increase or reduce payments on claims of a particular class, or extend or reduce the time period for such payments, or alter the amount of distribution to a creditor that has received payments other than under the plan. Section 1127(e) is substantially similar to section 1329(a) (prior to BAPCPA).

In addition, new clause in section 1129(b)(2)(B)(ii) modifies the cramdown rules. It permits an individual debtor – as an alternative to providing each holder of a claim in a dissenting class of unsecured claims with property of a value equal to the allowed amount of its claim – to retain property included in his or her bankruptcy estate under section 1115, if he or she does not otherwise receive or retain any other interest in property under the plan.[8]

PRINCIPAL CHANGES MADE BY BAPCPA TO CHAPTER 11 CASES FOR INDIVIDUALS

Property of the Individual Chapter 11 Debtor's Estate

Pre-BAPCPA

Section 541(a)(6), which applies in chapter 11,[9] provides that a debtor's bankruptcy estate includes, among other things, "[p]roceeds, product, offspring, rents or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case" (emphasis added). While not without controversy, courts pretty consistently held that an individual chapter 11 debtor's postpetition earnings were not property of his or her bankruptcy estate. See Toibb v. Radloff, 501 U.S. at 165-66 ("there is

8 In his article entitled The Sub Rosa Subchapter: Individual Debtors in Chapter 11 After BAPCPA, 2007 U. Ill. L. Rev. 67, 73-79, Bruce A. Markell (now Bankruptcy Judge Markell) describes the legislative history of the provisions in BAPCPA regarding individual chapter 11 debtors. Judge Markell also discusses this legislative history in his opinion in In re Shat, 424 B.R. 854, 859-61 (Bankr. D. Nev. 2010). In short, the formal legislative history of BAPCPA contains "no discussion of the policy behind, or purposes of" the individual debtor amendments to chapter 11. Id. at 861. From his analysis, however, Judge Markell concludes that

> [A]lthough not entirely free from doubt, it appears that Congress inserted the individual chapter 11 provisions to ensure no easy escape from means testing. The template for this effort was to adopt and adapt as much of chapter 13 as possible with respect to individual debtors in chapter 11.
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> . . . What remains is a sort of hybrid chapter 13, in which many provisions of chapter 13 sit uneasily in chapter 11.

Id. at 862.

9 See 11 U.S.C. § 103(a) (chapter 5 applies in cases under chapter 11).

no comparable provision in Chapter 11 [like section 1306(a)(2)] requiring a debtor to pay future wages to a creditor").[10] Debate ensued in chapter 11 cases over the meaning of "earnings from services performed by an individual debtor" – particularly when the individual debtor operated a business as a sole proprietorship. One approach was articulated in In re FitzSimmons, 725 F.2d 1208 (9th Cir. 1984), which involved a lawyer who operated his law practice as a sole proprietorship. The Ninth Circuit established the following test:

> [W]e hold that § 541(a)(6) excepts from the proceeds of the estate only those earnings generated by services personally performed by the individual debtor. FitzSimmons is thus entitled to monies generated by his law practice only to the extent that they are attributable to personal services that he himself performs. To the extent that the law practice's earnings are attributable not to FitzSimmons' personal services but to the business' invested capital, accounts receivable, good will, employment contracts with the firm's staff, client relationships, fee agreements, or the like, the earnings of the law practice accrue to the estate.

Id. at 1211.

A radically different approach was first articulated by the court in In re Herberman, 122 B.R. 273 (Bankr. W.D. Tex. 1990). The court in In re Harp, 166 B.R. 740 (Bankr. N.D. Ala. 1993), in which the debtor was a physician who partially owned and operated a radiology practice, adopted the Herberman approach, which it explained as follows:

> "Upon a voluntary Chapter 11 filing, a bankruptcy 'estate' is called into existence by the debtor. . . . An estate is a separate legal entity, created on (and by) the filing of a bankruptcy petition . . . . As such, an estate is more than just its property. It is an active legal enterprise, comprised of that property, to be sure, but also operating under the aegis of the Bankruptcy Code. . . . A Chapter 11 estate has an operating officer/trustee, who also serves as trustee for the estate. In the usual case, that operating officer is the debtor itself, as 'debtor-in-possession.' . . . .
>
> * * * *
>
> "There can be no "part" of a debtor that is not "in bankruptcy" during the pendency of a Chapter 11 proceeding. . . .
>
> "All the earnings of an enterprise during bankruptcy, regardless of the source, must of necessity be "an interest in property" acquired by the estate after commencement of the case, because the debtor's business is operated by the debtor-in-

10 While section 541(a) applies in cases under chapter 13, section 1306 specifically includes in property of 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, 11, or 12 of this title, whichever occurs first."

> possession, the trustee for the estate. All post-petition earnings of the enterprise logically fall neatly into Section 541(a)(7) as 'interest[s] in property acquired by the estate during the pendency of the bankruptcy. . . .'
>
> "This obvious conclusion causes no difficulty to anyone when the earnings of the enterprise in question are generated by a corporation in bankruptcy (e.g., Texaco), yet apparently offends the sensibilities of the courts when it is an individual in bankruptcy doing the earning."

Id. at 752-53 (quoting Herberman, 122 B.R. at 278-79) (emphasis added in Harp).

Fueled by the "fresh start" concept articulated and applied in Local Loan Co. v. Hunt, 292 U.S. 234 (1934),[11] and Segal v. Rochelle, 382 U.S. 375 (1966),[12] and influenced by the Thirteenth Amendment's proscription against involuntary servitude, the vast majority of courts opted in favor of a postpetition earnings exception in chapter 11. Variations on the FitzSimmons test when the individual debtor conducted business as a sole proprietorship became the majority rule. Thus, in general, any postpetition income generated by the business assets of a debtor's sole proprietorship (which were property of the estate) was property of the estate, but income relating to the postpetition services of the individual chapter 11 debtor was not property of the estate. Similarly, a distinction was made between interests in property that the estate acquired postpetition – which were property of the estate under section 541(a)(7) – and interests in property that the debtor acquired postpetition – which were not property of the estate unless they were actually "proceeds, product, offspring," etc. of property of the estate under section 541(a)(6) or were captured by section 547(a)(5).[13]

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11 In Local Loan v. Hunt, 292 U.S. at 245, the Supreme Court refused to allow a wage assignment to survive the debtor's discharge because the debtor's fresh start would be frustrated if he were forced to pay prepetition debt with future earnings.

12 In Segal v. Rochelle, 283 U.S. at 380, the Supreme Court held that postpetition earnings were property of the estate if they were "sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupts' ability to make an unencumbered fresh start that it should be regarded as 'property' [of the estate]."

13 Section 541(a)(5) provides that the following is property of the estate:

> Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date (A) by bequest, devise or inheritance; (B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or (C) as beneficiary of a life insurance policy or of a death benefit plan.

Post-BAPCPA

BAPCPA profoundly changed this analysis. Section 1115, added by BAPCPA, is virtually identical to section 1306 (which was not amended by BAPCPA). Section 1115 provides:

> (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.

As a result of new section 1115, as the courts in Herberman and Harp argued pre-BAPCPA in the sole proprietorship context, any earnings of[14] and property acquired by the

14 It is unclear whether or in what circumstances federal or state restrictions on wage garnishment would apply to exempt postpetition earnings of a chapter 11 debtor. The Federal Consumer Credit Protection Act ("CCPA") includes restrictions on wage garnishment. See 15 U.S.C. §§ 1671 et seq. In essence, except for very low-income debtors, the CCPA insulates from garnishment 75 percent of an individual's take-home pay. See 15 U.S.C. §§ 1672-73. Some state statutes protect from levy earnings that cannot be taken by creditors under the CCPA. See e.g., Cal. Code Civ. P. § 706.050. In Kokoszka v. Belford, 417 U.S. 642 (1974), in the context of a Chapter VII case under the Bankruptcy Act (the predecessor of the Code), the U.S. Supreme Court held that (i) an income tax refund due because of over-withholding from the debtor's prepetition wages was property of the estate, and (ii) the refund was not protected by the CCPA's restriction on wage garnishment. In part, this was because the CCPA "sought to prevent consumers from entering bankruptcy in the first place. However, if, despite its protection, bankruptcy did occur, the debtor's protection and remedy remained under the Bankruptcy Act." Id. at 651. Nevertheless, the reasoning of the Supreme Court in Kokoszka may not apply in chapter 11 cases for individuals post-BAPCPA, at least under certain circumstances. See G. Ray Warner, Garnishment Restrictions and the Involuntary Chapter 11: Rethinking Kokoszka in a Means Test World, 13 Am. Bankr. Inst. L. Rev. 733 (2005).

In In re Mordkin, 2011 WL 612073 (Bankr. D.D.C. Feb. 11, 2011), the court raised the issue whether the restrictions on garnishment in D.C. Code § 16-572 (which is modeled on the CCPA) constituted an exemption that would apply in a chapter 7 case. In its Memorandum and Order to Show Cause, the court discussed the division of opinion among "courts from other jurisdictions interpreting similar state [garnishment] statutes." Id. at *1. Later, after considering

debtor postpetition is property of the estate whether the chapter 11 debtor is an individual or a corporation.[15]

This fundamental change will certainly involve the court, the U.S. Trustee and debtor's counsel in issues relating to the use of property of the estate for purposes other than maintenance, preservation and disposition of property of the estate for the benefit of creditors between the petition date and termination of the estate's interest in the property.[16] Because the the submissions of the parties and oral argument, the court held that the D.C. statute did not apply in bankruptcy because it was not an exemption statute and, being modeled on the CCPA, was not intended by Congress to apply in bankruptcy. See In re Mordkin, 452 B.R. 311 (Bankr. D.D.C. 2011). In Gladwell v. Reinhart (In re Reinhart), 2011 WL 1048246, at *2 (10th Cir. Mar. 22, 2011) (not for publication), the Tenth Circuit certified to the Utah Supreme Court the issue, among others, whether "Utah Code Ann. § 70C-7-103 create[s] an exemption in bankruptcy." Like the CCPA, the Utah statute generally protects from garnishment 75% of the aggregate disposable earnings of an individual for any pay period. The Utah Supreme Court accepted the certification on May 4, 2011, but to date has not issued its opinion. See Order of Acceptance in Gladwell v. Reinhart (In re Reinhart), Case No. 10-4075.

15 In In re Camacuari, 2011 WL 1299353 (Bankr. E.D. Va. Mar. 31, 2011), the court held that the proceeds of life insurance policies payable to the debtor because of her husband's postpetition death were property of the estate, not under section 541(a)(5)(C) (because his death occurred more than 180 days after the petition date), but under section 1115, pursuant to which "all property that [the debtor] acquires prior to the closing of the case becomes property of the estate." Id. at *1 (emphasis in original).

In In re Marcato, 2009 WL 1856578 (Bankr. M.D. Ala. June 29, 2009), the debtor was the beneficiary of a spendthrift trust created by her mother. The terms of the trust provided that the mother, who was also the original trustee, could use, sell or lease her residence, which was the res of the trust, for 10 years. After that time, the mother would have no rights with respect to the residence and the remainder beneficiaries, i.e., her children (including the debtor), would become the trustees. When the debtor filed her chapter 11 petition in 2005, the ten-year period had not run. However, it ended in December 2007, during the debtor's chapter 11 case. Her case was converted to chapter 7 in September 2008, and in November 2008, the residence was sold. The issue before the court was whether the debtor's share of the proceeds of the sale was part of her chapter 7 estate. The court determined that it was not because, even though under section 1115 property acquired by the debtor postpetition is property of the estate, the spendthrift trust continued in existence after the ten-year period and the trust property was, therefore, protected from claims of creditors. Even assuming that the proceeds of the sale were distributed when the residence was sold, that occurred after the debtor's chapter 11 case was converted to chapter 7. Therefore, section 1115 no longer applied, and property acquired by the debtor post-conversion (e.g., the proceeds of the sale of the residence) was not property of the estate under section 541.

16 As the court in California Franchise Tax Board v. Jones (In re Jones), 420 B.R. 506, 513-516 (B.A.P. 9th Cir. 2009), aff'd on other grounds, 657 F.3d 921 (9th Cir. 2011), observed, there is at least a four-way split of authority regarding the effect of confirmation of a chapter 13 plan on property of the estate. This is because section 1306 seems to include property of the debtor in property of the estate until "the case is closed, dismissed, or converted," while section 1327(b) and (c) provides that, upon confirmation, property of the estate is vested in the debtor, free and clear of creditor claims or interests, unless the plan or confirmation order provides otherwise.

debtor will have virtually no property or earnings that are not property of the estate, he or she and his or her dependents will have to consume property of the estate for living expenses and to make domestic support obligation payments, among other things. Yet, many of these expenses do not seem to qualify as administrative expense claims under section 503(b) (e.g., "actual, necessary costs and expenses of preserving the estate") or expenses "in the ordinary course of business" under section 363(c).[17] It may be that that the new disposable income test for confirmation set Sections 1115 and 1141(b) and (c), applicable to chapter 11 cases for individuals, exhibit the same apparent inconsistency. According to the court in Jones, absent contrary direction in the plan or confirmation order, (a) some courts hold that property of the estate persists until the case is closed, dismissed or converted; (b) some courts – apparently the majority – hold that only property obtained after confirmation, such as post-confirmation income, is estate property; (c) some courts hold that only property necessary to fulfill the plan is estate property; and (d) some courts, including the Bankruptcy Appellate Panel in Jones, hold that estate property terminates upon confirmation unless the plan provides otherwise. See id. The court in In re Powers, 435 B.R. 385, 389 (Bankr. N.D. Tex. 2010), identified yet another approach: the estate continues to exist after confirmation, consisting of all pre- and post-confirmation assets under section 1306, but the debtor is vested on confirmation with the right to future enjoyment of the assets of the estate as soon as he or she has completed his or her obligations under the plan and is entitled to a discharge. The approach courts take to the issue of estate assets post-confirmation can have significant implications regarding, among other things, the automatic stay, as was the case in Jones, and as to the ability of the debtor to have access to credit and use his or her property after confirmation of the chapter 11 plan. As the court in Jones pointed out, its approach gives the debtor the choice (subject to court approval) to "protect pre-petition creditors and the ability to complete a plan, versus . . . access to credit and use of property post-confirmation." 420 B.R. at 516.

The court in Kimpel v. Meyrowitz (In re Meyrowitz), 2010 WL 5292066, at *4-*5 (Bankr. N.D. Tex. Dec. 20, 2010), recognized the applicability of this line of cases to a chapter 11 case for an individual. There the court adopted the "reconciliation approach," holding that, on confirmation, all current property of the estate vests in the debtor, but all future income is property of the estate. By contrast, the court in Baur v. Chase Home Finance, LLC (In re Baur), 433 B.R. 898, 899-900 (Bankr. M.D. Fla. 2010), also a chapter 11 case for an individual, employed the "termination approach," holding that, absent a contrary provision in the confirmed plan, postpetition property vested in the debtor, not the estate.

17 In In re Goldstein, 383 B.R. 496, 499 (Bankr. C.D. Cal. 2007), the court hypothesized that section 363(c), which permits a debtor who is authorized to operate his or her business to "use property of the estate in the ordinary course of business without notice or a hearing," may authorize an individual chapter 11 debtor "to buy bread and probably to purchase a ticket to travel to a court hearing."

In Gordon, the court noted that the immediately effect of converting a case for an individual debtor from chapter 7 to chapter 11 "is that the Debtor's post-petition earnings become property of the estate, which means that, if he wishes to use those post-petition earnings for non-typical purposes, a request for approval to spend the money must be filed with the Bankruptcy Court and the use must be approved." 465 B.R. at 697.

In U.S. v. Villalobos (In re Villalobos), 2011 WL 4485793 (B.A.P. 9th Cir. Aug. 19, 2011), the court reversed an order approving an individual chapter 11 debtor's budget nunc pro tunc to the petition date because the court failed to articulate either the legal rule it applied or any

forth in subsection (15) of section 1129(a) (discussed below under Good Faith), will serve as the guideline for pre-confirmation use of estate property for "personal" expenses, and that debtors should consider using section 363(b)(1) to obtain court approval of a budget to permit use of property of the estate "other than in the ordinary course of business."[18]

Section 1115 raises the related issue of how a chapter 11 debtor will pay his or her attorney for postpetition work that is for the debtor's personal benefit and, therefore, probably not compensable under section 330 as work done as counsel for the debtor in possession for the benefit of the estate or necessary for the administration of the case.[19] While section 330(a)(4)(B)

findings in support of its application. However, the Bankruptcy Appellate Panel provided little guidance to the bankruptcy court. It merely acknowledged that "personal expenses do not always neatly fall within the scope of 'actual, necessary' expenses under § 503(b)(1) or ordinary course of business expenses under § 363," and noted that "[a]t least two commentators have suggested [that] § 1129(a)(15)'s disposable income test is the proper test for approving pre-confirmation budgets and personal expenses of an individual chapter 11 debtor under § 363." Id. at *8.

18 Under the Bankruptcy Code prior to BAPCPA, one court steadfastly refused to impose any specific or general before-the-fact limits on an individual chapter 11 debtor's use of property of the estate for personal expenditures – even "$156,000 [per year] for the maintenance of club memberships, rent for his personal residences in Buffalo and Florida, charge card purchases, etc." In re Bradley, 185 B.R. 7, 11 (Bankr. W.D.N.Y. 1995); accord In re Murray, 216 B.R. 712 (Bankr. W.D.N.Y. 1998); In re Keenan, 195 B.R. 236 (Bankr. W.D.N.Y. 1996). Rather, that court indicated that creditors should employ the remedies specifically provided in the Code, such as seeking the appointment of a trustee or examiner, moving to convert or dismiss the case, or proposing their own plan.

By contrast, the court in In re Harp, 166 B.R. at 756 (emphasis in original), ordered the individual chapter 11 debtor, who was using property of the estate to pay personal expenses, to present to the court "a detailed budget of reasonable expenses for the Harp family . . . [including] total income less reasonable expenses listed in detail (including all recurring payees) and a net disposable income to be made payable to creditors."

19 A somewhat related question is to what extent a chapter 11 debtor who is an individual retains or loses the attorney-client privilege if his or her case is converted to chapter 7. The court in Bame v. Ramette (In re Bame), 251 B.R. 367 (Bankr. D. Minn. 2000), addressed this issue in the context of a subpoena issued by the chapter 7 trustee to a law firm that was retained, with court approval, to represent the debtor in possession in his pre-conversion chapter 11 case. The court held that, "as to communications regarding administration of the [chapter 11] estate, the estate . . . is the only party that can waive the privilege," and that power passed to the chapter 7 trustee. Id. at 374. However, to the extent the law firm provided advice to the debtor as an individual, the debtor retained the privilege.

> It is clear that under certain circumstances it is perfectly acceptable for the attorney for the DIP to represent the Debtor individually. The Bankruptcy Code imposes certain responsibilities on the debtor, while others are placed on the DIP. Thus, where the debtor is acting as the debtor rather than the DIP, such as in proposing a plan of reorganization, the attorney-client privilege belongs to the debtor individually, not to the estate. Indeed, the same may be true even

specifically authorizes the court to allow reasonable compensation to a chapter 12 or 13 individual debtor's counsel for representing the interests of the debtor in connection with the bankruptcy case, there is no such provision for chapter 11 debtor's counsel. Yet, an individual debtor – even one who is also debtor in possession – needs counsel to represent him or her in connection with, among other things, protecting exemptions under section 522 and defending discharge or dischargeability disputes.[20]

> if such individual advice was beyond the scope of [the law firm's] retention and even if the estate paid for such services.

Id. at 375-76. The debtor has the burden of proving that he was advised individually.

> To do so the Debtor must meet the following test: (1) the Debtor must show that he approached [the law firm] for the purpose of seeking legal advice; (2) he must demonstrate that when he approached [the law firm], he made it clear he was seeking legal advice in his individual rather than representative capacity; (3) he must demonstrate that [the law firm] saw fit to communicate with him in his individual capacity, knowing that a possible conflict could arise; (4) he must prove that his conversations with [the law firm] were confidential; and (5) he must show that the substance of his conversations with [the law firm] did not concern matters involving administration of the estate.

Id. at 375 n.5 (citing Doe v. United States (In re Grand Jury Subpoenas), 144 F.3d 653, 658-59 (10th Cir. 1998)).

20 In Goldstein, supra, a case involving a husband and wife who filed a joint chapter 11 petition, the court allowed each debtor to hire his or her own divorce counsel at the expense of their estates after finding that the services were "for the benefit of their two bankruptcy estates." The court noted that, because postpetition earnings were not property of the estate, "pre-BAPCPA case law took a restrictive view of the extent to which estate funds could be used to compensate divorce counsel," permitting "only professional services relating to the disposition of estate property" to be reimbursed from the bankruptcy estate, while "services relating to the marital dissolution" were not. 383 B.R. at 498. In Goldstein, the court made no such distinction, finding that the bankruptcy estates would be benefited because "[e]mploying special divorce counsel will assist the debtors in resolving their differences in their marital dissolution and in disentangling their domestic lives during the bankruptcy proceeding." Id. at 502.

By contrast, in In re Johnson, 433 B.R. 626 (Bankr. S.D. Tex. 2010), the court denied the chapter 11 debtor's motion to retain his divorce counsel as special counsel to represent the debtor in connection with his motion, filed in the bankruptcy court, to modify the terms of his divorce decree on the ground that his circumstances had changed significantly in the approximately nine months since his financial obligations under the divorce decree were finalized. The debtor argued that retention of counsel was in the best interest of his estate because creditors other than his former wife would benefit if the terms of his divorce were modified. Id. at 633. The court distinguished Goldstein on the ground that, in Goldstein, the debtors sought counsel to obtain a divorce in state court, while in Johnson, the debtor sought counsel to modify his divorce decree in the bankruptcy court. Id. at 637. Because the debtor argued that whether the modification should be allowed is a bankruptcy issue, the representation would not be disconnected from the bankruptcy case, but was central to it, and involved issues that general bankruptcy counsel should

The circumstances for chapter 11 debtor's counsel seem to be similar to the situation in Lamie v. U.S. Trustee, 540 U.S. 526 (2004). There, the issue was whether counsel for a corporate chapter 11 debtor that was formerly debtor in possession, could be compensated from the estate for work performed after the chapter 11 case was converted to chapter 7. The U.S. Supreme Court held that compensation from property of the estate in a chapter 7 case under section 330 is permitted only when counsel is retained under section 327 (i.e., by the trustee) or 1103 (i.e., by an official committee). By analogy, counsel for an individual chapter 11 debtor/ debtor in possession may not be eligible for compensation from the estate under section 330 for work relating to the debtor's personal interests.[21] The court so held in In re Dixon, 2010 WL

be and was equipped to handle. Id. at 637-38. Further, the court concluded that "the Debtor has failed to meet his burden of showing that his proposed retention of [special counsel] will benefit the estate, as opposed to the Debtor himself." Id. at 639. "[T]here is a dearth of evidence . . . outlining a concrete benefit to the estate," consisting only of "a cursory listing of the Debtor's obligations under the Divorce Decree and a statement that the Debtor's financial condition has changed since entry of the Divorce Decree." Id.

21 In Lawrence Morrison, P.C. v. U.S. Trustee, 2010 WL 2653394 (E.D.N.Y. June 24, 2010), the issue before the court was whether counsel, who had been retained with court approval as counsel for the debtor in possession in an individual debtor chapter 11 case, could be compensated from property of the estate for work performed after a chapter 11 trustee was appointed. It was undisputed that debtor's counsel, who sought over $100,000 for the work he performed after appointment of the trustee, "played an instrumental role in achieving a global settlement" in the case and that the chapter 11 trustee and the creditors worked with him and appreciated and welcomed his contributions. Id. at *2 & *6. Nevertheless, the district court affirmed the bankruptcy court's denial of compensation, citing Lamie. The court held that Lamie applies not only when a chapter 11 case is converted to chapter 7, but also when a chapter 11 trustee is appointed, because the key under Lamie is whether the services were rendered to the debtor in possession, a role the debtor no longer played after either conversion or the appointment of a chapter 11 trustee. Id. at *5; accord, In re Miles, 2011 WL 1124245 (Bankr. N.D. Ga. Mar. 14, 2011). Debtor's counsel argued "that Lamie should not be applied to individual, as opposed to corporate, Chapter 11 debtors" because of the changes wrought by BAPCPA – which post-dated Lamie – particularly including postpetition earnings in the debtor's bankruptcy estate. The district court refused to consider this argument because it was first raised in the appellant's reply brief. 2010 WL 2653394, at *5. However, the court stated that, if it were to consider the argument, "it would be obligated to 'assume that Congress passed [the] subsequent law with full knowledge of the existing legal landscape.'" Id. (citation omitted). Moreover, the court said – without referring to section 1129(a)(15) – "even under BAPCPA, an individual debtor would regain access to earnings once the estate emerges from bankruptcy, and counsel would presumably be able to seek payment from the debtor at that time." Id.

The court in In re Schiff, 2010 WL 3219535 (Bankr. S.D.N.Y. Aug. 10, 2010), faced a similar situation. There, a trustee was appointed in a chapter 11 case for an individual because she had become incompetent to manage her financial affairs. Debtor's counsel continued to work because "the Trustee required and requested his services," which were "necessary and beneficial to the estate." Id. at *5. The debtor's later-appointed state guardian ad litem objected to allowance of debtor's counsel's fees for the period after appointment of the trustee. The court noted that Lamie

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(Bankr. N.D. Cal. Sept. 20, 2010). In this chapter 11 case for an individual, counsel for the debtor in possession defended the debtor's claim of exemption to which a creditor had objected. The court considered this a blatant conflict with the interests of the debtor's estate and denied counsel's request for fees.

It may be possible for debtor's counsel to use a prepetition retainer to pay for services performed postpetition for a chapter 11 debtor (as opposed to debtor in possession). However, the Fourth Circuit in the Lamie case below held that the unearned portion of debtor's counsel's retainer is property of the estate and could not be used to pay for post-conversion work. See U.S. Trustee v. Equipment Services, Inc. (In re Equipment Services, Inc.), 290 F.3d 739, 746-47 (4th Cir. 2002). The court explained:

> Retainer agreements can take various forms. For example, a retainer can be paid simply to ensure an attorney's availability to represent the client, whether or not services are ever performed. Or a retainer can be a prepayment for all future services to be performed, amounting to a flat fee. Under either one of these

and the language of the Code indicated that debtor's counsel's fees should be denied. However, the court did not reach the issue because the estate was solvent and the case was to be dismissed after all claims were paid. Therefore, the court ordered that debtor's counsel's post-trustee fees be paid from the surplus before remittance to the debtor.

In Warner v. Pease (In re Bay Voltex Corp.), 2008 WL 8444794 (B.A.P. 9th Cir. Oct. 9, 2008), aff'd, 2010 WL 1141517 (9th Cir. Mar. 24, 2010), Warner was retained as counsel by the debtor/debtor in possession with bankruptcy court approval. "The Employment Application provided that Warner's compensation 'would be such as the [bankruptcy] court would allow.'" Id. at *1. "The Fee Agreement provided [that] 'any fees or reimbursement of expenses claimed by [Warner] shall require prior approval of the bankruptcy court'" and that Bay Voltex would pay Warner's fees. Id. "The Employment Order provided that '[n]o fees shall be paid to Warner post-petition' without prior approval of the bankruptcy court." Id. at *2. After approximately one year in chapter 11, a trustee was appointed, but "Warner continued to represent Bay Voltex as its chapter 11 counsel." Id. In that capacity, he filed a plan and disclosure statement, which were not approved, and he opposed a settlement between the trustee and Pease, who was a principal of the debtor. When the bankruptcy court refused to award Warner fees for the period after the trustee was appointed based on Lamie, Warner sued Bay Voltex and Pease in state court for breach of contract and quantum meruit. Pease made a motion in the bankruptcy court asking it to interpret its order. Warner argued that Lamie did not prohibit him from seeking recovery of his attorneys' fees from Bay Voltex and Pease. The bankruptcy court decided to the contrary, finding "that, in initiating the state court action, Warner was in violation of the terms of his employment, as approved by the bankruptcy court." Id. at *4. The Bankruptcy Appellate Panel agreed. "The Fee Agreement, the Employment Application and the Employment Order uniformly provided that Warner would be paid only such fees for representation of Bay Voltex in its chapter 11 case as the bankruptcy court approved." Id. at *8. Because the bankruptcy court had not approved his fees, he could not recover them from any party. The Ninth Circuit agreed. 2010 WL 1141517 at *1.

> arrangements, the attorney acquires title to the retainer fee at the time he receives it, regardless of whether he thereafter performs legal services for the client. . . . On the other hand, if the relationship is a trust arrangement in which the attorney holds the retainer for the client as security for the payment of future fees, then the retainer so held, less any fees charged against it, constitutes the property of the client.

Id. at 746. The retainer in Equipment Services was the latter type. Therefore, it could not be used to pay the debtor's attorney's fees incurred after its chapter 11 case was converted to chapter 7.[22] Accord Redmond v. Lentz & Clark P.A. (In re Wagers), 514 F.3d 1021, 1024-29 (10th Cir. 2007); Morse v. Ropes & Gray, LLP (In re CK Liquidation Corp.), 343 B.R. 376, 383 (D. Mass. 2006), rev'g In re CK Liquidation Corp., 321 B.R. 10 (Bankr. D. Mass. 2005); In re Hill, 355 B.R. 260, 268 (Bankr. D. Ore. 2006), aff'd sub nom. Hill v. Camacho, 2007 WL 2120891 (D. Ore. July 24, 2007); see In re Glimcher, 469 B.R. 835, 841-42 (Bankr. D. Ariz. 2012) (security retainer provided prepetition to counsel for chapter 7 debtor was property of the bankruptcy estate and, because such counsel was not retained by the chapter 7 trustee, the retainer could not be used to pay for counsel's postpetition services even though they benefitted the estate and were requested by the trustee); In re Blackburn, 448 B.R. 28, 35-39 (Bankr. D. Idaho 2011) (security retainer provided prepetition to counsel for chapter 7 debtor to be used for defense of anticipated avoidance actions was property of estate that had to be turned over to trustee and could not be used to pay debtor's counsel even though counsel had perfected security interest or statutory lien in funds; court distinguished "classic or true retainers" and "advance payment retainers"). The characteristics of different types of retainers are matters of state law and there are different ethical obligations placed on attorneys in different states. See e.g., In re GOCO Realty Fund I, 151 B.R. 241, 250-51 (Bankr. N.D. Cal. 1993) ("Applying California law, there may be no difference in treatment [in bankruptcy] of a security retainer and an advance payment retainer," as opposed to an earned-on-receipt retainer; both an advance payment retainer and a security retainer require segregation of funds in a trust account and both must be available for refund to the client); cf.

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22 Certiorari was granted in Lamie only as to the issue whether section 330(a)(1) authorizes a court to award fees to a debtor's attorney (see 540 U.S. at 528), not as to whether the unearned portion of the attorney's retainer in that case was property of the estate. However, the Supreme Court in Lamie, in discussing the effect of its ruling on the bankruptcy system, observed:

> Section 330(a)(1) does not prevent a debtor from engaging counsel before a Chapter 7 conversion and paying reasonable compensation in advance to ensure that the filing is in order. Indeed, the Code anticipates those arrangements. See, e.g., § 329 (debtors' attorneys must disclose fees they receive from a debtor in the year prior to its bankruptcy filing and courts may order excessive payments returned to the estate.

540 U.S. at 537-58. This is often referred to as the "retainer exception" to Lamie.

In re Blixseth, 2011 WL 3503155 (Bankr. D. Mont. Aug. 10, 2011 (retainer payments made by chapter 11 debtor's acquaintances to her lawyer both pre- and post-petition were property of the estate under sections 541(a) and 1115(a) because, under applicable state law, they were gifts to the debtor that were held as security for the attorney's fees). Further, some bankruptcy courts have determined that earned-on-receipt or advance payment retainers are generally not permitted when representing a chapter 11 debtor in possession. See In re Danner, 2011 WL 2133768, at *3 (Bankr. D. Idaho May 26, 2011) ("The Court views [the advance payment retainer] to be the equivalent of a traditional security retainer which became property of the [chapter 11] bankruptcy estate on the petition date, despite Counsel's efforts to avoid such characterization and treatment by the title it chooses to bestow on the payment and by depositing those funds directly into its general account, rather than holding them in trust." (footnotes omitted)); In re Dividend Development Corp., 145 B.R. 651. 653-57 (Bankr. C.D. Cal. 1992) (earned-on-receipt retainer is not per se impermissible, but counsel must establish that the retainer is reasonable, which is very difficult to do); In re Hathaway Ranch Partnership, 116 B.R. 208, 217-18 (Bankr. C.D. Cal. 1990) ("advance fee payments, no matter how described, are property of the bankruptcy estate and not of the professional"); see also In re Montgomery Drilling Co., 121 B.R. 32, 37-38 (Bankr. E.D. Cal. 1990) (retainer, which according to the fee agreement was fully earned on payment, was treated as a security retainer). Therefore, counsel for a debtor and debtor in possession in an individual chapter 11 case should consult applicable state law and rules of professional conduct and the rulings of relevant bankruptcy courts when attempting to establish a prepayment mechanism to pay for postpetition work to be performed personally for the debtor, as opposed to the debtor in possession.[23]

Cramdown

Pre-BAPCPA

Individual chapter 11 debtors had great difficulty confirming plans when a class of general unsecured creditors had not accepted the plan. Under section 1129(b)(1), such a plan could be confirmed if all of the other requirements of section 1129(a) are satisfied[24] and "if the plan does not discriminate unfairly, and is fair and equitable" with respect to the rejecting class. Under section 1129(b)(2)(B), if the rejecting, impaired class was a class of unsecured claims, the "fair and equitable" test included the following alternative requirements:

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23 For a discussion of the problem in the context of chapter 7, see William F. Stone, Jr. and Bryan A. Stark, The Treatment of Attorneys' Fee Retainers in Chapter 7 Bankruptcy and the Problem of Denying Compensation to Debtors' Attorneys for Post-Petition Legal Services They Are Obliged to Render, 82 Am. Bankr. L.J. 551 (Fall 2008).

24 Section 1129(b)(1) permits cramdown if all of the requirements of section 1129(a) are satisfied except for the requirement, specified in subsection (a)(8), that each class either accepts the plan or is unimpaired.

> (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.

This test is often referred to as the "absolute priority rule." In essence, the absolute priority rule provides that a junior class of creditors or interest holders may not receive or retain any property on account of their claims or interests unless the claims or interests of an objecting senior class are satisfied in full.[25]

While arguments were made that section 1129(b)(2)(B) does not apply to individual debtors,[26] particularly consumer debtors, courts in reported cases uniformly rejected them. See, e.g., Unruh v. Rushville State Bank, 987 F.2d 1506, 1508 (10th Cir. 1993); MJPB, Inc. v. Fross (In re Fross), 1999 WL 26886, at *4-5 (B.A.P. 10th Cir. Jan. 15, 1999);[27] Van Buren Indus.

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25 In a recent case decided under the pre-BAPCPA Code, Alabama Department of Economic & Community Affairs v. Ball Healthcare-Dallas, LLC (In re Lett), 632 F.3d 1216, 1227-30 (11th Cir. 2011), the Eleventh Circuit held that, even though the appellant creditor did not object to the individual chapter 11 debtor's plan on absolute priority grounds, the issue was nonetheless preserved for consideration on appeal because the bankruptcy court had an independent duty to ensure that section 1129(b)(2)(B) was satisfied and did, in fact, have that issue presented to it by the debtor (albeit as a general proffer) and considered it. The Eleventh Circuit found support for its ruling in Everett v. Perez (In re Perez), 30 F.3d 1209, 1213-14 (9th Cir. 1994).

26 The court in In re East, 57 B.R. 14, 15 n.1 (Bankr. M.D. La. 1985), described a commonly-made argument as follows:

> Individuals who file Chapter 11 cases must necessarily retain a residual interest in their economic future since there is no effective way to alienate all future accessions to their net worth; therefore, . . . if this Court is correct that such retention is within the meaning of "property" not allowed to be retained under § 1129(b)(2)(B)(ii), then that sub-section must be unavailable to individuals. Consequently, . . . § 1129(b)(2)(B)(ii) would be meaningful only in corporate reorganizations where the equity claimants (the most junior class) could give up all of their rights to a senior class that is not paid in full.

A similar argument was also articulated in In re Davis, 262 B.R. 791, 794 (Bankr. D. Ariz. 2001).

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

27 In Fross, the court traced the history of the absolute priority rule to demonstrate

Investors v. Henderson (In re Henderson), 341 B.R. 783, 789 (M.D. Fla. 2006); In re East, 57 B.R. 14, 17-18 (Bankr. M.D. La. 1985). Therefore, assuming that the plan did not provide for payment in full of the allowed claims in the rejecting class under section 1129(b)(2)(B)(i), the issue was whether and how an individual chapter 11 debtor could satisfy section 1129(b)(2)(B)(ii) if he or she retained an interest in any property at all.

The U.S. Supreme Court in Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 207-08 (1988), made it clear that section 1129(b)(2)(B)(ii) would not be satisfied even if the property an individual debtor retained under the plan had "no value." While Ahlers involved a sole proprietorship – retention of a farm – with no "going concern" value (id.), subsequent cases applied its reasoning to the retention of "worthless" non-business assets as well. See, e.g., In re Yasparro, 100 B.R. 91, 95 (Bankr. M.D. Fla. 1989); East, supra. The court in East rejected the "no value" argument based on statutory language and common sense, as follows:

> First, § 1129(b)(2)(B)(ii) does not deal with "valuable" or "substantial" or even "positive value" property; that section provides that the plan cannot be crammed down if the junior interest receives or retains "any property." . . . Second, . . . the Court is skeptical of testimony that the Debtor's retained interest has negative value; the debtor would be well advised in such a situation to liquidate under Chapter 7 and to obtain a discharge of all debt. . . . Logically, the Debtor must perceive value in what he retains or he would not retain it. It is the difficulty and uncertainty of appraisal and valuation that provides the appearance of worthlessness.

57 B.R. at 18.[28]

In addition, there is a series of cases, overwhelmingly from bankruptcy courts in Florida – which has a very generous homestead exemption[29] – that held that section 1129(b)(2)(B)

that Congress intended section 1129(b)(2)(B) to apply to individual debtors. It explained that Congress amended Chapters XI, XII and XIII of the former Bankruptcy Act in 1952 for the specific purpose of removing the absolute priority rule from those chapters because, if it were applied, "'no individual debtor and, under chapter XI, no corporate debtor where the stock ownership is substantially identical with management could effectuate an arrangement except by payment of the claims of all creditors in full.'" 1999 WL 26886, at *5 (citing H.R. Rep. 2320, 82nd Cong., 2d Sess. 21, reprinted in 1952 U.S. Code Cong. & Admin. News (June 26, 1952)). When Chapters X and XI were combined into chapter 11 of the Code in 1978, Congress included in chapter 11 the modified absolute priority rule of section 1129(b)(2)(B). "This history compels the conclusion that Congress intended the absolute priority rule as stated in § 1129(b)(2)(B)(ii) to apply equally and in the same manner to individual debtors as it does to nonindividual debtors." 1999 WL 26886, at *5.

28 The court in In re Steedley, 2010 WL 3528599, at *3 (Bankr. S.D. Ga. Aug. 27, 2010), a post-BAPCPA case, indicated (without citation to authority) that the absolute priority rule of section 1129(b)(2)(B)(ii) could be satisfied if the debtor had no equity in the property. Contra, In re Lett, 2011 WL 2413484 (S.D. Ala. June 13, 2011) (also a post-BAPCPA case).

29 Currently, there are unlimited homestead exemptions in Florida, Iowa, Kansas, Texas and South Dakota.

(ii) was not satisfied even if the property the individual debtor retained under the plan consisted entirely of his or her exempt assets. See, e.g., In re Gosman, 282 B.R. 45 (Bankr. S.D. Fla. 2002); Yasparro, supra. Not all of these cases were from Florida, however;[30] the most thorough and persuasive argument in support of this position was made in an unpublished decision of the Tenth Circuit Bankruptcy Appellate Panel in Fross, 1999 WL 26886, at *6-11. Of course, there is also well-reasoned contrary authority. See, e.g., In re Egan, 142 B.R. 730, 733 (E.D. Pa. 1992) ("if debtors intend to retain only exempt property, then they are merely retaining that which is their absolute right to retain in any event, and they are not, properly speaking, receiving or retaining 'any interest that is junior to the interests' of any class of creditors"); see also In re Steedley, 2010 WL 3528599, at *3 (post-BAPCPA case); In re Bullard, 358 B.R. 541, 544-45 (Bankr. D. Conn. 2007) (post-BAPCPA case). In fact, in the only reported decision from an Article III court on this issue, Van Buren Industrial Investors v. Henderson (In re Henderson), 341 B.R. at 790, a Florida district court concluded that section 1129(b)(2)(B)(ii) does not include exempt property.[31]

Another possible approach to cramdown for an individual debtor who wished to retain property under the plan was to satisfy the "new value corollary" or "new value exception" to the absolute priority rule. This corollary derives from the U.S. Supreme Court's opinion in Case v. Los Angeles Lumber Products Co., in which the court (in dicta) stated:

> It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor . . . .
>
> [W]e believe that to accord 'the creditor 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 in money's worth, reasonably equivalent in view of all of the circumstances to the participation of the stockholder.

308 U.S. at 121-122. Essentially, the "new value corollary" allows a debtor to buy property that would otherwise have to be used to satisfy creditors' claims by making a "contribution" to the estate. To qualify under the "new value exception," the contribution must be (a) new, (b) in money or money's worth, (c) necessary to implement a feasible reorganization, and (d) reasonably equivalent to the interest being retained. See In re Woodbrook Assocs., 19 F.3d 312, 319-20 (7th Cir. 1994). Some courts add another requirement: that the contribution be substantial. See

30 E.g., in In re Ashton, 107 B.R. 670, 674 (Bankr. D.N.D. 1989), the court stated in dicta that "[t]here is no distinction between exempt and non-exempt property" in section 1129(b)(2)(B).

31 The bankruptcy court in In re Henderson, 321 B.R. 550 (Bankr. M.D. Fla. 2005), whose decision was affirmed by the district court, stated that issues as to the unfairness of the debtors' retention of $3.5 million of exempt property (including their unlimited homestead exemption) should be dealt with as a question of "good faith" under section 1129(a)(3).

Bonner Mall Partnership v. U.S. Bancorp Mortgage Co. (In re Bonner Mall Partnership), 2 F.3d 899, 908 (9th Cir. 1993), cert. granted, 510 U.S. 1039, vacatur denied and appeal dismissed as moot, 513 U.S. 18 (1994).[32]

For individual debtors, the Supreme Court's interpretation of the "new value exception" in Ahlers poses a significant barrier. In that case, the debtors' contribution to the plan was their "future labor, experience, and expertise," i.e., so-called "sweat equity." Ahlers, 485 U.S. at 204. The Supreme Court held that this did not satisfy the requirement that the contribution be "money or money's worth," saying:

> [R]espondents' promise of future services is intangible, inalienable, and, in all likelihood, unenforceable. It "has no place in the asset column of the balance sheet of the new [entity]." Unlike "money or money's worth," a promise of future services cannot be exchanged in any market for something of value to the creditors today. In fact, no decision of this Court or any Court of Appeals, other than the decision below, has ever found a promise to contribute future labor, management, or expertise sufficient to qualify for the Los Angeles Lumber exception to the absolute priority rule.

Id. at 204 (citation omitted). Invoking Ahlers, the court in Yasparro, 100 B.R. at 98, held that a promissory note to be paid with the debtor's "future income as chief executive officer of a corporate jewelry distributor" was not "money or money's worth."

Courts have noted that, largely because of Ahlers, it was unlikely that an individual chapter 11 debtor could confirm a nonconsensual plan – at least one in which the debtor proposed to retain non-exempt property – unless he or she had some outside source that would make a sufficiently substantial gift to satisfy the requirements of the "new value exception." See, e.g., In re Cipparone, 175 B.R. 643, 645 (Bankr. E.D. Mich. 1994) (debtor's proposed infusion of future earnings and income tax refunds does not satisfy new value exception because they will not

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32 Los Angeles Lumber was decided in 1939 under section 77B of the Bankruptcy Act, well before the Code was enacted and section 1129(b)(2)(B) was codified. There are grounds to question whether the "new value corollary" articulated in Los Angeles Lumber survived enactment of the Code in 1978, given the other qualifications of the Los Angeles Lumber-era "absolute priority rule" that were incorporated into the Code at that time. The U.S. Supreme Court has carefully avoided deciding whether the "new value exception" retains vitality. See Bank of America v. 203 North LaSalle St. Partnership, 526 U.S. 434, 443 (1999); U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership, 513 U.S. 18, 20 n.1 (1994); Ahlers, 485 U.S. at 203 n.3. However, both the Seventh and Ninth Circuits have ruled that the doctrine remains viable. See Bank of America v. 203 N. LaSalle St. Partnership, 126 F.3d 955 (7th Cir. 1997), rev'd without deciding issue, 526 U.S. 434 (1999); Bonner Mall, 2 F.3d at 899. No court of appeals has actually held otherwise. See 7 Collier on Bankruptcy ¶ 1129.03[4][c] n.166 (Alan N. Resnick & Henry J. Sommer eds., 16th ed.) ("Collier").

"come from an 'outside source'").[33] As the court in East, 57 B.R. at 19, explained:

> [I]t might be that the injection of "outside capital" would allow cram down in an individual case. It is easier in a corporate context to consider the concept of the injection of outside capital; when an individual is involved, it is difficult to imagine the source of such funds: perhaps a relative or friend might make a gift; perhaps there are other sources. . . . It would appear, in most cases, that counsel is correct in concluding that 1129(b)(2)(B)(ii) is not available to individuals.

The court in In re Harman, 141 B.R. 878, 886 (Bankr. E.D. Pa. 1992), questioned whether the "new value corollary" is ever available to individual chapter 11 debtors who are not involved in business. The court noted that the principal purpose for the exception – to permit viable businesses to remain in existence for the benefit of their creditors, employees and the general economy, as well as their owners – is inapplicable to consumer cases.

Post-BAPCPA

BAPCPA further complicated the issues surrounding cramdown in individual debtor chapter 11 cases by amending section 1129(b)(2)(B)(ii) to add the following proviso at the end: "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." Thus, an individual chapter 11 debtor will be able to confirm a plan that has been rejected by a class of general unsecured creditors if all of the other requirements of section 1129 are satisfied,[34] even if the debtor retains the property that has been included in his or her bankruptcy estate under new section 1115 (subject to the requirements of section 1129(a)(14)).[35]

A few observations:

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33 In Henderson, 341 B.R. at 787, 790-91, the court held that the debtor satisfied the new value exception to the absolute priority rule because his wife, who was not a debtor, provided $525,000 to fund the plan so the debtor could retain non-exempt property, which was valued between $212,500 and $410,600.

34 See note 38, infra. N.B., BAPCPA added to section 1129(a) some new requirements for confirmation. Some of those are discussed below.

35 New section 1129(a)(14) provides that the court may not confirm a chapter 11 plan unless the debtor has paid all postpetition "domestic support obligations" (defined in new section 101(14A) (added by BAPCPA)) due under a judicial or administrative order or statute. It appears that the reference in section 1115 to subsection (a)(14) may be an error, and should be to subsection (a)(15). See In re Shat, 424 B.R. at 860 n.21; In re Lively, 466 B.R. 897, 900 n.3 (2011), certified for direct appeal to Fifth Circuit, 467 B.R. 884 (Bankr. S.D. Tex. 2012). However, this reference was not changed in the Technical Corrections Act (described in note 1, infra). Nonetheless, the court in SPCP Group, LLC v. Biggins, 465 B.R. 316, 320 n.3 (M.D. Fla. 2011), erroneously stated that "[t]his cross-reference to subsection (a)(14) has since been revised to cross-reference the current subsection (a)(15)."

Exempt Property

The new proviso does not expressly resolve the issue whether exempt property is or is not outside the scope of section 1129(b)(2)(B)(ii).[36]

Disagreement Regarding the Meaning of the New Exception in Section 1129(b)(2)(B)(ii)

There is dispute over the meaning of "property included in the estate under section 1115." Does it mean only property that is not property of the estate under section 541, but is added to property of the estate by section 1115, namely, only "property of the kind specified in section 541 that the debtor acquires after the commencement of the case" (emphasis added) and "earnings from services performed by the debtor after the commencement of the case" (collectively, "section 1115 property").[37] Or does it mean all property of the estate, thus effectively exempting individual chapter 11 debtors from the absolute priority rule?[38]

36 In two post-BAPCPA cases, In re Steedley, 2010 WL 3528599, at *3, and In re Bullard, 358 B.R. at 544-45, the bankruptcy courts followed Henderson, 321 B.R. at 559-60, and concluded that an individual chapter 11 debtor can retain exempt property and still cram down under section 1129(b)(2)(B)(ii). In both cases, however, the issue was not contested by any party in interest, but raised sua sponte by the court. In In re Maharaj, 449 B.R., 484, 493 n.4 (Bankr. E.D. Va. May 9, 2011), aff'd, 2012 WL 2153066 (4th Cir. June 14, 2012), the court said it was "inclined to hold that retention of exempt property does not violate the absolute priority rule," but did not decide the issue.

In Schwab v. Reilly, 130 S. Ct. 2652 (2010), the U.S. Supreme Court held that the chapter 7 trustee was not required to object to the debtor's claimed exemption of cooking equipment in the maximum value legally permitted in order to preserve the estate's right to sell the equipment for more than the maximum exempt amount and keep the proceeds above that amount. With respect to exemptions subject to a monetary limit – as opposed to in-kind exemptions of property without any cap on value – the Court held that "[i]f an interested party does not object to the claimed interest by the time the Rule 4003 period expired, title to the asset will remain with the estate pursuant to § 541, and the debtor will be guaranteed a payment in the dollar amount of the exemption." Id. at 2667. This approach may affect whether the reference to "property" in section 1129(b)(2)(B)(ii) includes exempt property.

37 In In re Sutton, 2012 WL 433480 (Bankr. E.D.N.C. Feb. 9, 2012), the individual debtor's chapter 11 plan provided that he would retain $60,000 in postpetition earnings he had accumulated pre-confirmation. The court noted that this would not run afoul of section 1129(b)(2)(B)(2)(ii) because the earnings were section 1115 property. See id. at *5. Nevertheless, the court denied confirmation because "the Debtor failed to prove by a preponderance of the evidence" that the plan did not violate section 1129(b)(1) by unfairly discriminating against a non-consenting unsecured creditor class. Id. at *7.

38 Regardless of the correct interpretation of section 1129(b)(2)(B)(ii), an individual chapter 11 debtor will still be subject to the general cramdown requirement in section 1129(b)(1) that "the plan does not discriminate unfairly, and is fair and equitable" with respect to the non-consenting class, and to all of the other requirements for confirmation, including the "best interests of creditors" test of section 1129(a)(7), the "good faith" test of section 1129(a)(3), the "feasibility"

Reported Cases Holding That the New Exception in Section 1129(b)(2)(B)(ii) Abrogates the Absolute Priority Rule in Cases for Individual Debtors

The courts in the first three reported opinions that addressed this issue determined that, under section 1129(b)(2)(B)(ii) as amended, individual chapter 11 debtors are exempt from the absolute priority rule.[39] See In re Shat, 424 B.R. at 862-68 (Bankr. D. Nev. 2010); In re Roedemeier, 374 B.R. 264, 274-76 (Bankr. D. Kan. 2007); In re Tegeder, 369 B.R. 477, 480 (Bankr. D. Neb. 2007).[40] Thereafter, two additional reported opinions also adopted this "broad" view. See SPCP Group, LLC v. Biggins, 465 B.R. 316 (M.D. Fla. 2011), and In re Friedman, 466 B.R. 471 (B.A.P. 9th Cir. 2012).[41]

In Tegeder, "Debtors own[ed] and operat[ed] two businesses and most of their debt [was] business debt." Id. at 478. Under their plan, they would retain all of their prepetition and postpetition assets, while projecting payment to unsecured creditors of approximately 95% of their claims during the last three years of a ten-year plan. The general unsecured creditor class rejected the plan; the only three ballots that were cast voted against it. Without supplementary analysis, the court concluded that, "[s]ince § 1115 broadly defines property of the estate to include property specified in § 541, as well as property acquired post-petition and earnings from services performed post-petition, the absolute priority rule no longer applies to individual debtors . . . ." Id. at 480. The court also concluded that the plan was otherwise fair and equitable.

In Roedemeier, a dentist proposed in his plan to retain his dental business, operated through a limited liability company, from which he would be paid a salary that he projected would permit him to pay $6,000 per year for five years to his general unsecured creditors,

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test of section 1129(a)(11), and the new disposable income requirement of section 1129(a)(15) (discussed below under Good Faith). In re Murray, 2012 WL 1066730 (Bankr. E.D.N.C. Mar. 28, 2012), In re Puff, 2012 WL 994007 (Bankr. N.D. Iowa Mar. 23, 2012), In re Hockenberry, 457 B.R. 646 (Bankr. S.D. Ohio), and In re Draiman, 450 B.R. 777 (Bankr. N.D. Ill. 2011), are examples of recent cases in which the court denied confirmation of an individual chapter 11 debtor's plan for, among other reasons, failure to satisfy the "best interests" test of section 1129(a)(7) or the "feasibility" test of section 1129(a)(11).

39 In In re Johnson, 402 B.R. 851, 852-53 (Bankr. N.D. Ind. 2009), the court stated, without analysis and in dicta, that "[a]n individual [chapter 11] debtor's plan does not need to satisfy the absolute priority rule . . . ."

40 The opinion of the court in In re Lindsey, 453 B.R. 886, 893-97 (Bankr. E.D. Tenn. 2011), contains a lengthy description and summary of the rationales of the courts in Tegeder, Roedemier and Shat.

41 Friedman was a 2-1 decision. The dissent is discussed in note 84, infra.

Hon. Alan M. Ahart, U.S. Bankruptcy Judge in the Central District of California, has expressed his view that "§ 1115 should be construed so as to eliminate the Absolute Priority Rule," and explained his reasoning for that conclusion in The Absolute Abolition of the Absolute Priority Rule in Individual Chapter 11 Cases, 31 Cal. Bankr. J. 731, 732 (2011).

resulting in a dividend of less than 3%.[42] In deciding that the plan satisfied amended section 1129(b)(2)(B)(ii), the court first noted that the new exception is ambiguous and could plausibly be interpreted narrowly to apply only to section 1115 property or broadly to all property of the estate. If narrowly interpreted, however, the plan could not be confirmed because, under Ahlers, the debtor's contribution of $30,000 of his postpetition earnings could not satisfy the "new value exception." According to the court, this would severely limit the utility of the new proviso because, for most individual debtors, future earnings would be the only significant source of funds with which to purchase their prepetition assets. By contrast, the broad interpretation would reflect BAPCPA's importation of chapter 13 provisions into chapter 11 cases for individuals. As the court explained:

> Significantly, Chapter 13 does not impose the absolute priority rule on debtors. Taken together, these changes [which make chapter 11 for individual debtors much like chapter 13] indicate Congress intended to extend the exemption from the absolute priority rule to individual Chapter 11 debtors as well. If a class of unsecured creditors who are not to be paid in full under an individual Chapter 11 debtor's plan can bar the debtor from keeping any prepetition property (which will nearly always include the debtor's interest in whatever business the debtor engages in) by rejecting the plan and invoking the absolute priority rule – that is, if the new exception in § 1129(b)(2)(B)(ii) is read narrowly – then it is difficult to see what purpose these other, related amendments can serve.

374 B.R. at 276.[43]

In Shat, the debtors owned a profitable dry cleaning business and several unprofitable residential real properties. They proposed a plan under which they would retain all of their property, while paying an unsecured creditor class a 10% distribution over five years. Only one member of that class voted and it rejected the plan. Nevertheless, the court confirmed the plan. First, the court described the history of the BAPCPA amendments relating to chapter 11 cases of individuals, noting that the legislative history yields "no [useful] discussion of the policy behind, or purposes of, these changes." 424 B.R. at 861. However, the court did note their effect: "[I]t appears that Congress inserted the individual chapter 11 provisions to ensure no easy escape from means testing. The template for this effort was to adopt and adapt as much of chapter 13 as possible with respect to individual debtors in chapter 11." Id. at 862. Then, applying principles

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42 The court in Roedemeier was "convinced that the Debtor's plan would satisfy § 1129(a)(15)(B)," which imposes a projected disposable income test (discussed below under Good Faith). 374 B.R. at 271.

43 In chapter 13, which has no absolute priority rule, a debtor effectively purchases the other assets of the estate with three or five years of projected disposable income. See discussion below under Good Faith.

of statutory construction, the court adopted the broad interpretation of the new exception, finding that "Section 1115 absorbs and then supersedes Section 541 for individual chapter 11 cases." Id, at 865.[44] In doing so, the court in Shat concurred with the court in Roedemeier that the new exception is ambiguous and also that adopting the broad interpretation of new section 1115 properly reflects the other amendments to chapter 11 that cause it to function like chapter 13, which has no absolute priority rule. The court in Shat also noted that amended section 1129(b)(2)(B)(ii) should be read in light of new section 1129(a)(15) under which, in "perhaps" a "majority" of individual chapter 11 debtor cases, "the debtor will be forced to commit value equal to five-years' worth of earnings to the plan – earnings that are property of the estate under Section 1115." Id. at 864. Because, "[a] debtor can't really be said to 'retain' property or income that the Code requires be committed to plan payments," a narrow reading of the property encompassed within section 1115 that does not include section 541 property would leave only "miserly post-fifth-year income" as that excepted from the modified absolute priority rule of amended 1129(b)(2)(B)(ii). Id.[45]

In Biggins – the first reported opinion from an Article III court to deal with the issue – the debtors were the shareholders of Cypress Creek, which owned an assisted living facility. Cypress Creek had confirmed a plan in its own chapter 11 case, which provided for payment in full of the secured claim of SPCP over time with interest. Cypress Creek was making the required monthly payments to SPCP under its plan. Nevertheless, SPCP sued the individual debtors on their guaranties of Cypress Creek's debt, which precipitated the debtors' chapter 11 cases. The debtors' plans provided that they would retain their ownership interests in Cypress Creek and would not make any payments to SPCP, but that SPCP could enforce its guaranties if

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44 Although concluding that a "relatively straightforward reading of the statute" supports the broader interpretation, the court in Shat candidly admitted that

> the broad reading is not without problems. It essentially reads the absolute priority rule out of individual chapter 11 cases, but does so in a convoluted manner – arguably indicative that Congress did not fully appreciate the effect of the language it chose. This is especially true given that the addition of provisions requiring provision of the value of future labor effectively overruled Norwest Bank Worthington v. Ahlers without any mention of that case in the legislative history.

424 B.R. at 867 (footnotes omitted).

45 For an insightful analysis of Shat and the meaning of amended section 1129(b)(2)(B)(ii), see Ralph Brubaker, Individual Chapter 11 Debtors, BAPCPA, and the Absolute Priority Rule, 30 No. 4 Bankruptcy Law Letter (April 2010). See also Andrew G. Balbus, Does the Absolute Priority Rule Apply to Individuals in Chapter 11?, 20 Norton J. Bankr. L. & Prac. 79 (2011) (author argues that statutory construction (i.e., plain meaning), legislative history and practical arguments support interpreting amended section 1129(b)(2)(B)(ii) to abrogate the absolute priority rule in chapter 11 cases for individuals).

Cypress Creek defaulted on the payments due under its plan. The bankruptcy court confirmed the plans over SPCP's objection by following Shat and determining that the absolute priority rule of amended section 1129(b)(2)(B)(ii) no longer applies to chapter 11 debtors who are individuals. SPCP appealed to the district court, which affirmed. The district court eschewed analysis of the legislative history, such as the court in Shat had performed, "focusing [instead] on the statute's plain language." 465 B.R. at 322. "The meaning of [section 1115 and the new exception in amended section 1129(b)(2)(B)(ii)] is clear." Id. "[T]he absolute priority rule no longer applies to prevent individual Chapter 11 debtors from retaining pre- or post-petition property over an unsecured creditor's objection." Id. at 323.[46]

In Friedman, the debtors were "technology entrepreneurs who founded and operated several internet-related businesses." 466 B.R. at 473. Several of those businesses failed, "leaving the Friedmans with significant tax liabilities and unpaid secured and unsecured business debts." Id. The debtors owned an oversecured home, household goods and vehicles, and equity in their businesses. Their plan provided that, "upon confirmation, their assets, including their equity interests in their businesses, would revest in Debtors and they would continue to work and contribute all their disposable income to the plan." Id. at 476. An objecting creditor offered an expert opinion that one of their business ventures, which the debtors valued at zero, had a value of over $600,000. The bankruptcy court conducted a hearing and issued an opinion that addressed only the applicability of the absolute priority rule of amended section 1129(b)(2)(B)(ii), and determined that it applied to the debtors' plan. Therefore, the court denied confirmation and ultimately converted the case to chapter 7. The debtors appealed to the Bankruptcy Appellate Panel, which reversed in a 2-1 decision.[47]

The majority opinion began by noting that the absolute priority rule "has never been absolute," but rather is subject to judge-made exceptions, noting both the "new value corollary" and the exception for not-for- profit entities made in the Security Farms and Wabash

46 The only contrary case the court in Biggins discussed was In re Gelin, 437 B.R. 435 (Bankr. M.D. Fla. Sept. 29, 2010) (discussed infra), an opinion of a bankruptcy court in another division of the same district. Besides criticizing that court's determination that the statutory language was ambiguous and its consequent use of legislative history, the court in Biggins also distinguished Gelin because the distribution to unsecured creditors in Gelin was to be less than one percent of their claims and there was significant doubt about feasiblility, while SPCP was to be repaid in full over time with interest and the court that confirmed Cypress Creek's plan determined that it was feasible. See Biggins, 465 B.R. at 323 n.6.

The debtors in Biggins might have been able to obtain an injunction in the plan and confirmation order for Cypress Creek enjoining SPCP from enforcing their guaranties as long as Cypress Creek continued to make the payments on the underlying debt called for in Cypress Creek's plan. See, e.g., In re Seatco, 257 B.R. 469, on reconsideration, 259 B.R. 279 (Bankr. N.D. Tex. 2001).

47 "No party . . . participated as an appellee in [the] appeal." Friedman, 466 B.R. at 473.

Valley Power Association cases. Id. at 478.[48] It derived two points from that analysis: "First, courts have always viewed § 1129(b)(2)(B)(ii) through the lens of common sense and have approached legislative interpretation in a way to facilitate the goals of the statute. Second, simply because words may have alternative meanings, ambiguities do not necessarily arise." Id. at 479. The majority then applied the "plain meaning" approach, focusing on the non-limiting meaning of "includes" and "including" under section 102(3), and held that this "mandates that the absolute priority rule is not applicable in individual chapter 11 debtor cases." Id. at 482. The court considered unhelpful the analysis by other jurists and scholars regarding "legislative history, congressional intent, and other speculations surrounding the applicability of the absolute priority rule in individual debtor chapter 11 cases." Id. at 482-83. However, the court did find support for its "plain meaning" interpretation in the Bankruptcy Code itself because BAPCPA had imported several provisions – particularly section 1129(b)(15) – from chapter 13, where there is no absolute priority rule, into chapter 11 for individuals.[49] Based on this, the court determined that, "[i]n essence, Congress affirmatively amended the law so that § 1129(a)(15)(B) would trump § 1129(b)(2)(B)(ii) in individual debtor cases." Id. at 484.[50]

Reported Cases Holding That the New Exception in Section 1129(b)(2)(B)(ii) Does Not Abrogate the Absolute Priority Rule in Cases for Individual Debtors

By contrast to the five reported decisions adopting the broad interpretation that the absolute priority rule no longer applies in chapter 11 cases for individuals, 16 reported decisions dealing with this issue – including the first and only decision to date from a Court of Appeals – have opted for the narrow interpretation, i.e., that the exception from the absolute priority rule in amended section 1129(b)(2)(B)(ii) applies only to section 1115 property. See In re Maharaj, 681 F.3d 558 (4th Cir. 2012); In re Arnold, 2012 WL 1820877 (Bankr. C.D. Cal. May 17, 2012); In re Lively, 466 B.R. 897 (2011), certified for direct appeal to the Fifth Circuit, 467 B.R. 884 (Bankr. S.D. Tex. 2012); In re Tucker, 2011 WL 5926757 (Bankr. D. Ore. Nov. 28, 2011); In re Borton, 2011 WL 5439285 (Bankr. D. Idaho Nov. 9, 2011); In re Lindsey, 453 B.R. 886 (Bankr. E.D. Tenn. 2011); In re Maharaj, 449 B.R. 484 (Bankr. E.D. Va. 2011), aff'd, 681 F.3d 558 (4th Cir.

48 This exception for not-for-profit entities is discussed supra in note 26.

49 The majority in Friedman erred in its comparison of chapter 11 and chapter 13 in this regard. It said that "[a]s in Chapter 13, the disposable income requirement [of section 1129(a)(15)] insures that the individual debtor is required to dedicate all of his or her disposable income over a designated time period (three or five years in Chapter 13, at least five years in chapter 11) to plan payments directed to unsecured creditors." 466 B.R. at 483. However, as discussed supra, unlike section 1325(b), section 1129(a)(15) requires only that the value of the property that is distributed under the plan (which need not be the debtor's postpetition earnings) to any claimants or creditors (not just unsecured creditors) is not less than "projected disposable income."

50 The dissent in Friedman, as well as the majority's responses to the points raised therein, is discussed in note 84, infra.

2012); 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, 2010 WL 5418872 (Bankr. S.D. Cal. Nov. 16, 2010); In re Gelin, 437 B.R. 435 (Bankr. M.D. Fla. Sept. 29, 2010); In re Steedley, 2010 WL 3528599 (Bankr. S.D. Ga. Aug. 27, 2010); In re Mullins, 435 B.R. 352 (Bankr. W.D. Va. June 22, 2010); In re Gbadebo, 431 B.R. 222 (Bankr. N.D. Cal. April 16, 2010).[51]

In the first of these cases, Gbadebo, the debtor was a licensed professional engineer and sole shareholder of a corporation through which he operated "an electrical engineering and testing and consulting laboratory." Id. at 224. His plan provided that he would retain all of his property and pay general unsecured claims $100 per month for five years. The largest unsecured creditor voted against the plan. The court denied confirmation for a number of reasons, including that the plan violated the absolute priority rule of amended section 1129(b)(2)(B)(ii) because the debtor would retain his prepetition property.[52] The court considered the language of amended section 1129(b)(2)(B)(ii) to be "unambiguous" and "susceptible to only one meaning, i.e., added to the bankruptcy estate by § 1115," for four reasons. Id. at 229. First, the reference in new section 1115 to section 541 is necessary because, if it were not there, "the argument could have been made that an individual chapter 11 debtor's estate did not include his pre-petition property." Id. Second, Congress's purpose in making chapter 11 more like chapter 13 was consistent with the overall purpose of BAPCPA, i.e., "to impose greater burdens on individual chapter 11 debtor's rights so as to ensure a greater payout to creditors." Id.[53] Third, the absolute priority rule of

51 The opinion of the court in In re Lindsey, 453 B.R. at 897-903, contains a lengthy description and summary of the rationales of the courts in Gbadebo, Gelin, Mullins, Stephens, Karlovich, Walsh, Draiman, Kamell and Maharaj.

The court in In re Lett, 2011 WL 2413484, also applied the "narrow" view, but did not discuss the issue. "The Plan . . . violates the absolute priority rule because it provides that title to all property of the Estate shall revest in the Debtor." Id. at *4. Citing Ahlers, 485 U.S. at 207-08, the court in Lett also noted that, even if the property retained by the debtor had no value, retention would violate the absolute priority rule. The court also stated that amended section 1129(b)(2)(B)(ii) applies when, not the debtor, but another class of general unsecured claims, receives property under the plan before the dissenting class is paid in full, apparently because the dissenting class was designated class 8 and the class receiving property was designated as more junior number, i.e., class 9. Id. This is not correct; the appropriate test in that situation is under section 1129(b)(1).

52 Among the other reasons the court in Gbadebo denied confirmation was that the debtor had not filed the plan in good faith and had not proven that the plan satisfied section 1129(a)(15) (discussed below under Good Faith).

53 The idea that the principal purpose of BAPCPA was to favor creditors over debtors is also reflected in the U.S. Supreme Court's opinion in Ransom v. FIA Card Services, N.A., 131 S. Ct. 716 (2011). There, the Court held that an above-median-income chapter 13 debtor who does not make car loan or lease payments cannot take the car-ownership deduction under the means test. The Court stated that this result was supported by "BAPCPA's purpose," namely, "'to ensure that [debtors] repay creditors the maximum they can afford.'" Id. at 725 (quoting H.R. Rep. No.

amended section 1129(b)(2)(B)(ii) does not make it "virtually impossible" to confirm a plan for an individual chapter 11 debtor; rather, such plans can be confirmed with the consent of the class(es) of unsecured claims, which "[t]hey are likely to do . . . if a reasonable dividend is proposed, and they conclude that they will receive no dividend in a chapter 7 case." Id. at 229-230.[54] And, fourth, if the absolute priority rule does not apply in chapter 11 cases for individuals, then there is no reason to solicit the votes of unsecured creditors, as debtors are required to do even if the plan proposes not to pay them anything. See id.[55]

In Mullins, the debtor was a dentist who practiced through his professional corporation. He also owned his home and a separate parcel of rental property. Under his plan, the debtor proposed to retain all of his property, but put the rental property up for sale, and pay his general unsecured creditors approximately $1000 per month for a period of 96 to 105 months until they received approximately 12% of their claims, plus the net equity from the sale of the rental property (if and when sold). The general unsecured creditor class rejected the plan. The court declined to confirm the plan based on its determination that the narrow approach to the exception in amended section 1129(b)(2)(B)(ii), as articulated by the court in Gbadebo, is correct. The court agreed with the court in Gbadebo that the new statutory language is not ambiguous.

> [I]f it had been the intent of Congress to eliminate entirely

109-31 ("House Report"), pt. 1, at 2 (2005)); accord id. at 721 ("Congress adopted the means test . . . to help ensure that debtors who can pay creditors do pay them.") (emphasis in original); id. at 729 (another interpretation "would frustrate BAPCPA's core purpose of ensuring that debtors devote their full disposable income to repaying creditors"). This mantra was adopted by the court in Baud v. Carroll, 634 F.3d 327, 352 (6th Cir. 2011), cert. denied, 132 S. Ct. 997 (2012), which held that the "applicable commitment period," as defined in section 1325(b)(4), is a temporal requirement that applies even to debtors with zero "projected disposable income." In doing so, the court stated:

> We believe it is now clear that, where each competing interpretation of a Code provision amended by BAPCPA is consistent with the plain language of the statute, we must, as the Supreme Court did in Lanning and Ransom, apply the interpretation that has the best chance of fulfilling BAPCPA's purpose of maximizing creditor recoveries.

Id. at 356. Note that Ransom and Baud interpreted aspects of the "means test," and not other aspects of BAPCPA, and also that they can be criticized as overbroad and incorrect interpretations of the purpose and results of BAPCPA generally and even of the "means test."

54 The court in Gbadebo indicated that the Debtor should be able to pay unsecured creditors $1,000 per month, ten times more than proposed. See 431 B.R. at 226.

55 After the court denied confirmation, the debtor in Gbadebo filed an amended plan that provided for payment of "an amount equal to all presently allowed [general unsecured claims (totaling $219,211.55)] over a period of 12 years and 11 months," in monthly installments commencing at $1,250.00 and increasing to $1,500 after five years and $2,000 after ten years. Debtor Michael A. Gbadebo's Third Amended Plan of Reorganization (Docket No. 78), filed in Case No 09-42526 (Bankr. N.D. Cal.). This plan was confirmed, with the consent of the previously objecting creditor, on August 30, 2010. See Order Confirming Plan (Docket No. 83).

> the operation of the absolute priority rule from individual chapter 11 cases, it would have been much clearer, easier and more direct for it to have said simply in § 1129(b)(2)(B)(ii) "except that in a case in which the debtor is an individual, this provision shall not apply."

435 B.R. at 360-61. While admitting that "the language used in the statute might lead one quite reasonably to the conclusion that it was not well thought out and didn't envision some of the practical problems that it would generate for the courts attempting to make individual chapter 11 cases work," the court nonetheless stated its belief that "the courts in the majority have strained to find ambiguity." Id. at 360. The court concluded that the statute does address "the chief problem which Congress seems to have had in mind," namely

> that pre-BAPCPA cases for individual debtors whose principal business endeavor was the earned income which their personal efforts generated were problematic for chapter 11 debtors because their post-petition earnings were not deemed to be property of the bankruptcy estate. The new statutory language quite clearly changed that prior rule.

Id.[56] The court then pointed out that, given that his plan was supported by the largest

56 According to the Mullins court, "the facts of this case demonstrate why Congress could have had a reasonable basis for making the policy choice indicated by the language it chose." 435 B.R. at 361.

> This is not a case in which the Debtor simply proposes to retain only an existing professional corporation of no significant independent value to carry on his dental practice. He also proposed to retain his residence valued at $305,000, subject to a mortgage debt of $272,317.65 requiring monthly payments of $1,670.48, a rental property valued at $135,000, subject to a mortgage debt of $125,913.82 requiring monthly payments of $935.51, and non-exempt personal property (not including the professional corporation) valued at $60,575. Obviously the payments made from the Debtor's income on the mortgage debts while he is making payments to his general creditors will increase his equity in such properties. Although the rental property currently is producing income, it is less than the mortgage payment upon such property, not to mention the other costs of ownership of such property. While the Amended Plan provides that if (or when) the rental property is sold, its net proceeds will be paid to the unsecured creditors, there is no deadline or specific obligation to do so, and even if that happens, any likely benefit to creditors does not appear to be material. Neither is there any obligation, if such property is sold, to use the Debtor's additional net cash flow resulting from elimination of the ownership expenses either to increase the promised 12% distribution to his unsecured creditors or accelerate the date by which it will be accomplished.

unsecured creditor, who was owed just less than two-thirds of the debt owed to voting creditors, the debtor should be able to negotiate a consensual plan – which is precisely what happened.[57]

In Steedley, the debtor operated "two businesses – the primary being the ownership and management of several residential rental properties and the other being a lawn maintenance business." 2010 WL 3528599, at *1. The debtor's plan proposed that he retain all of his property while general unsecured creditors would receive yearly pro rata payments ultimately totaling 20% of their claims. Two unsecured creditors rejected the plan. The court followed Gbadebo and held that the plain language of the relevant provisions of the Code unambiguously provided that individual chapter 11 debtors can retain only section 1115 property and still cram down a class of general unsecured claims.[58]

In Gelin, the debtors were a registered nurse and the assistant manager of a pharmacy, who was also a part-time realtor, and they owned six rental properties purchased between 2005 and 2007. They commenced their chapter 11 case "to reduce or, in some cases, eliminate their mortgage debt and to retain five of these six properties." 437 B.R. at 437. "Each property has two mortgages, the majority of which are adjustable rate mortgages. As a result of vacancies at the units and rising interest rates, the debtors almost immediately defaulted on their mortgages." Id. All of the junior mortgages were stripped off or avoided, converting the lenders' claims into unsecured claims. Under their plan, the debtors proposed "to pay their unsecured creditors all of their net disposable income for five years . . . ." Id. at 438. "[T]he debtors estimated they would make monthly payments of $251 for 60 months for . . . a return of less than one percent to unsecured creditors. These payments could increase if the debtors' income correspondingly increased for any reason, including the sale or refinancing of their real properties

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Id. Could the issues raised by the court have been dealt with through section 1129(b)(15), good faith, or the ability to modify the plan post-confirmation (discussed below under Good Faith and Timing of Discharge; Modification of Plan)?

57 On July 29, 2010, the debtor in Mullins filed Debtor's Fourth Amended Plan of Reorganization (Docket No. 125), in Case No. 09-70595 (Bankr. W.D. Va.). That plan provided that the debtor would pay to general unsecured creditors his "net monthly income" in an amount not less than $1,000 per month for five months, thereafter increased to $2,000 per month, until they were paid 15% of their claims, plus any net equity from the sale of the rental property. The estimated payout period was about six years. This plan was accepted by six of the seven general unsecured creditors voting. See Plan Ballot Summary (Docket No. 135). The plan was confirmed on September 16, 2010. See Order Confirming Plan (Docket No. 139).

58 The court in Steedley continued the hearing on confirmation to allow the debtor to amend the plan or demonstrate that the plan could be confirmed. See 2010 WL 3528599, at * 3. While the debtor did file an amended plan, he did not change the treatment of general unsecured creditors or the debtor's retention of his property. See Modification of Second Amended Plan and Disclosure Statement (Docket. No. 141) in Case No. 09-50654 (Bankr. S.D. Ga.). On December 21, 2010, at the request of the debtor, his case was converted to chapter 7. See Motion to Convert Case (Docket No. 160) and accompanying docket entry.

at a 'profit' or the receipt of tax refunds." Id.[59] "[T]he debtors did not solicit acceptances from their creditors, as required by § 1129(a)(8)" – "perhaps realizing the futility of this endeavor" – but relied on cramdown under amended section 1129(b)(2)(B)(ii). Id. at 438-39.[60]

The court, however, denied the debtors' motion to cram down their general unsecured creditors. While unlike the court in Gbadebo, the court in Gelin considered the operative language in new section 1115 and amended section 1129(b)(2)(B)(ii) to be ambiguous and considered the legislative history both silent and ambiguous, it found "the arguments supporting the narrow view . . . more persuasive." Id. at 441. "[A]s noted in Gbadebo, it is far more likely that the phrase 'in addition to' in § 1115 indicates that the purpose of the section is only to add property to an individual debtor's estate . . . ." Id. at 441-42 (emphasis in original). By contrast, the court in Gelin considered the broad reading to be "convoluted" and "incredibly complicated and forced," because "[i]f Congress meant to eliminate the absolute priority rule . . . for individual debtors, it could have simply stated that § 1129(b)(2)(B)(ii) is inapplicable in a case in which the debtor is an individual" or "referred to both §§ 541 and 1115." Id. at 442 (emphasis in original). The court also contended that the narrow reading did not render either new section 1115(a) or amended section 1129(b)(2)(B)(ii) meaningless. Section 1115 brings postpetition earnings into the estate so they are protected by the automatic stay and then "subject[ed] to the various tests for confirmation." Id. And, "[a]lthough . . . the narrow reading of 1115 implies that the added provisions of § 1129(b)(2)(B)(ii) are of little help to individual debtors' efforts to confirm a plan . . . ," the exemption of postpetition property and earnings "may nonetheless prove to be of some help to some debtors." Id.[61]

In Karlovich, the issue of the meaning of the new exception in amended section 1129(b)(2)(B)(ii) arose in the context of a relief from stay motion, because the undersecured creditor asserted that certain real property was not necessary to an effective reorganization under section 362(d)(2). "[T]he debtor argued that knowing whether the absolute priority rule applies in an individual Chapter 11 case is essential for the debtor to determine how to proceed." 2010 WL 5418872, at *1. The court obliged, and found that the narrow reading is "plain [and] unambiguous." Id. at *3. The court pointed out that

59 The court in Gelin indicated that it was skeptical of the debtors' projections, but declined to find that the plan was not feasible under section 1129(a)(11), saying that "in close cases . . . generally the Court will allow debtors an opportunity to demonstrate feasibility by performance." 437 B.R. at 438 n.9.

60 As the Gelin court noted, because the debtors did not solicit any acceptances, they failed to have the required accepting class as required by section 1129(a)(10), and confirmation could be denied for that reason alone. Id. at n.11.

61 As a result of the court's denial of confirmation of their plan, on October 13, 2010, the debtors in Gelin moved to dismiss their case, which the court ordered after notice and a hearing. See Debtors' Voluntary Motion to Dismiss (Docket No. 141); Order Granting Debtors' Motion to Dismiss (Docket No. 144), Case No. 6:09-15881 (Bankr. M.D. Fla.)

> [t]he effect of the new provision in § 1129(b)(2)(B)(ii) is not to abrogate the absolute priority rule, but to make it the same for individual and non-individual Chapter 11 debtors, as it was prior to BAPCPA. . . . [P]rior to BAPCPA, property of the estate did not include post-petition acquired property and earnings for individuals and non-individuals alike. Hence, post-petition acquired property and earnings could be retained by a Chapter 11 debtor, individual and non-individual alike, without running afoul of the absolute priority rule. The addition of § 1115 potentially changed that by adding to the property of the estate of an individual post-petition acquired property and earnings. Without a corresponding change to § 1129(b)(2)(B)(ii), individual debtors could no longer retain post-petition acquired property and earnings if they wished to "cram down" a plan. By adding the language excepting the § 1115 property from the absolute priority rule of § 1129(b)(2)(B)(ii), Congress merely ensured that the absolute priority rule would be the same as it had been prior to BAPCPA and be the same for all Chapter 11 debtors. In other words, what Congress took from the individual debtor with its § 1115-hand, it returned for application of the absolute priority rule with its § 1129(b)(2)(B)(ii)-hand.

Id. at *4.[62] The court also asserted that, if Congress intended to abrogate the absolute priority rule, it would "simply have amended the statutory debt ceilings for Chapter 13 cases . . . , and either eliminate[d] them or set them much higher." Id.[63]

In Stephens, the debtor had two businesses: an insurance agency and a mortgage brokerage business. He also owned eight parcels of real property, including his homestead. He proposed a plan pursuant to which he would retain, among other things, four of the properties, while paying general unsecured claims, scheduled in excess of $1.4 million, a total of $120,000 over 60 months. The unsecured creditor class voted against the plan, and the court refused to confirm it because the debtor had failed to satisfy the absolute priority rule. The court held that, based on its reading of the language of section 1115(a), the exception to amended section 1129(b)

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62 It is not true (as the court in Karlovich posits) that pre- and post-BAPCPA, the bankruptcy estate of a non-individual debtor did and does not include after-acquired property and earnings. This is because generally a non-individual debtor does not have earnings or property that does not derive from prepetition property of the estate and, therefore, encompassed within "[p]roceeds, product, offspring, rent or profits of or from property of the estate" under section 541(a)(6). See discussion above under Property of Individual Chapter 11 Debtor's Estate – Pre-BAPCPA.

63 The court's decision in Karlovich was appealed. See Notice of Appeal (Docket No. 215), filed on November 30, 2010, in Case No. 10-10860 (Bankr. S.D. Cal.). The appeal was certified to the Ninth Circuit (see Docket No. 233), but that court denied permission (see Docket No. 270). Thereafter, the parties "reached an agreement that resolve[d] the issues on [a]ppeal" (see Docket No. 286), and the appeal was dismissed based on the parties' stipulation (see Docket No. 300).

(2)(B)(ii) did not abrogate the rule.[64]

In Walsh, the debtor "own[ed] and operate[d] 56 residential apartments in five locations . . . and own[ed] a home and a vacation property." 447 B.R. at 46. Her proposed plan provided for the class of general unsecured claims to receive 5% of their claims over five years and for all of the properties to revest in the reorganized debtor. An undersecured creditor voted its secured and unsecured claims against the plan. In an opinion issued prior to the evidentiary hearing on confirmation, the court characterized the meaning of section 1115(a) as "hardly free from doubt." Id. at 48. Nonetheless, it rejected the reasoning of the court in Shat and adopted the plain meaning approach of the court in Gbadebo. Thus, if the class of general unsecured claims voted against the plan, it would not satisfy the absolute priority rule.[65]

In Draiman, the debtor held "interests in healthcare, real estate, and energy procurement." 450 B.R. at 786. The plan provided that he would retain certain non-exempt assets, including "the office equipment, furnishings, supplies, and certain management agreements of Future Associates [his sole proprietorship] as well as personal household items and a 1999 Jaguar." Id. at 821. Applying the "plain meaning rule" and "for the reasons stated in Gbadebo, Mullins, Gelin, Steedley, and Karlovich," the court adopted the narrow view that the new exception added to section 1129(b)(2)(b)(ii) retains the absolute priority rule in chapter 11 cases for individuals, but "limits the application [of the rule] by allowing an individual to retain . . . property that is added to the estate by § 1115." Id. at 821.[66]

In Kamell, the debtor was "a lawyer with an active personal injury practice." 451 B.R. at 506. He also owned his home and two rental real properties. A bank with a deficiency claim related to one of the rental properties objected to confirmation based on the absolute priority rule. The court eschewed the "plain meaning rule," considering the language of the new exception in amended section 1129(b)(2)(B)(ii) to be ambiguous. However, the court did

64 The debtor in Stephens filed a third amended plan on November 3, 2011, which was confirmed by order entered on November 16, 2011. See Third Amended Plan of Reorganization Filed by Debtor (Docket No. 196) and Order Confirming Debtor's Third Amended Plan of Reorganization (Docket No. 204), filed in Case No. 10-31263-H3-11 (Bankr. S.D. Tex.). The confirmed plan provided that the debtor would retain some of his prepetition property, and would pay general unsecured creditors $150,000 in monthly $2,500 installments over 60 months. It was confirmed consensually.

65 On June 27, 2011, the court in Walsh entered its Findings of Fact, Conclusions of Law and Order Confirming Second Modified Amended Plan of Reorganization of Mary Ann Walsh (Docket No. 284), in Case No. 09-16031-WCH (Bankr. D. Mass.).

66 As discussed in note 38, supra, and under Good Faith below, the court in Draiman denied confirmation of the debtor's plan for, among other reasons, lack of good faith under section 1129(a)(3) and failure to satisfy the "best interests" test of section 1129(a)(7) and the "feasibility" test of section 1129(a)(11). See 450 B.R. at 803-07, 809-16. On May 12, 2011, the court entered its order converting debtor's case to chapter 7. See Order Converting Case Under Chapter 11 to Case Under Chapter 7 (Docket No. 697) in Case No. 09 B 17582 (Bankr. N.D. Ill.).

not accept the inference made by courts espousing the broad view that Congress intended to make chapter 11 cases of individuals "parallel to Chapter 13, which has never contained any version of the 'absolute priority rule.'" Id. at 508. The court felt that, even though most of the new provisions in chapter 11 were adopted from chapter 13, had Congress intended to abrogate the absolute priority rule, it "would have said so more clearly" – particularly in the context of BAPCPA, which has generally "been read to tighten, not loosen, the ability of debtors to avoid paying what can reasonably be paid on account of debt." Id.[67] The court noted that "[t]he absolute priority rule has been a mainstay of Chapter 11 and predecessor practice since at least the 1930's,"[68] and observed that "major changes to existing practice will not be inferred unless clearly mandated." Id. at 509-10.

Rather than eliminate the absolute priority rule, the court felt that what Congress intended was to add the "projected disposable income" test of new section 1129(a)(15) (discussed below under Good Faith), which was adapted from chapter 13, in addition to the pre-existing absolute priority rule. But, because new section 1115 includes in the estate of an individual chapter 11 debtor all of the debtor's postpetition earnings, Congress added the new exception to section 1129(b)(2)(B)(ii) so that, after confirmation, the debtor could "keep enough of his post-petition earnings to sustain his livelihood." Id. at 511. Thus, the court found it "at least equally plausible that Congress merely intended to make individual and non-individual Chapter 11 debtors more alike by including in the estate of an individual under § 1115 post-petition property and earnings, but at the same time avoiding through § 1129(b)(2)(B)(ii) the untenable situation that an individual cannot keep any of his post-petition earnings for the entire period of his plan nor any pre-petition property if he must resort to cram down." Id. (emphasis in original). Thus, "[i]n overall effect, application of the absolute priority rule is the same both before and after BAPCPA." Id. at 512.[69]

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67 See note 53, supra.

68 Actually, after amendment in 1952, Chapter XI of the Bankruptcy Act did not contain the absolute priority rule. However, when Chapter X and XI of the Bankruptcy Act were combined in chapter 11 of the Bankruptcy Code in 1978, a somewhat modified version of the absolute priority rule was included in chapter 11 as section 1129(b). See note 27, supra.

69 The debtor in Kamell filed a Second Amended Chapter 11 Plan of Reorganization, which provided for a "new value" contribution to be provided by a family member. See Debtor's Second Amended Chapter 11 Plan of Reorganization (Docket No. 134), filed on May 25, 2011 in Case No. 8:10-15501 TA (Bankr. C.D. Cal.). That plan, with further modifications, was confirmed by an order entered on February 21, 2012 (Docket No. 252, at 8), in which the court determined that amended section 1129(b)(2)(B)(ii) had been "satisfied through the contribution of $75,000 of new value which the Court finds to be (i) new; (ii) substantial; (iii) money or money's worth; (iv) necessary for a successful reorganization; and (v) reasonable equivalent to the value or interest received." A notice of appeal was filed (Docket No. 271). However, none of the issues on appeal relate to the application or applicability of the absolute priority rule of amended section 1129(b)(2)(B)(ii). See Appellant's Statement of Issues to Be Presented on Appeal (Docket No. 276).

In Maharaj, the debtors operated an auto body business. Their plan provided that they would retain their business and other assets. The debtors had been defrauded into signing multiple promissory notes that "were then sold to various secondary market purchasers, each of which believed it had the sole original note, secured by a first deed of trust" on the debtors' residence. 449 B.R. at 487. As a result, after the wholly underwater liens were stripped off, there remained millions of dollars of general unsecured claims against the debtors, who claimed projected disposable income of $1,000 per month. The general unsecured creditor class, which would receive only 1.7% of their claims over five years, did not accept the debtors' plan.[70] The bankruptcy court followed the narrow view that, under amended section 1129(b)(2)(B)(ii), "the absolute priority rule continues to exist in individual chapter 11 cases with respect to non-exempt property that was owned by the debtor on the filing date of the petition." Id. at 493. The court adopted the reasoning of the courts in Mullins and Karlovich, noting that, if Congress had intended to abrogate the absolute priority rule, it would have expressed that intention more clearly.[71]

In Lindsey, while the debtor's plan did contemplate the sale of some assets, it also provided that the debtor would retain several pieces of real property, three notes payable, some equity interests, office equipment, two vehicles, and a pistol. The class of general unsecured creditors were to be paid "not less than $1,275,000 over the life of the plan," which would not pay those claims in full.

On the objection of two creditors, the court granted summary judgment that the plan could not be confirmed as a matter of law because it violated the absolute priority rule of amended section 1129(b)(2)(B)(ii). The court began its analysis with a comprehensive description of all of the previously reported cases on the subject.[72] It then stated its "agree[ment] with the reasoning of those courts ascribing to the more narrow view – that the absolute priority rule continues to apply to individual chapter 11 cases." 453 BR. at 903. First, the court noted that the language of new section 1115 and amended section 1129(b)(2)(B)(ii) is ambiguous, "otherwise there would be no split of authority and the arguments in favor of each position so diverse." Id. Then, it noted that the legislative history is both sparse and unhelpful. Turning to the statutory language, the court found that new section 1115 supplements, and does not supplant,

70 The Fourth Circuit Court of Appeals, which affirmed the bankruptcy court's decision, noted that only one vote was cast in the general unsecured class, and that creditor, with a relatively small claim, voted to reject the plan. See In re Maharaj, 681 F.3d at 567.

71 The court in Maharaj reached this conclusion with "some reluctance" because the debtors' financial situation was the result of a third party's fraud and their income was "insufficient to permit more than a token payment on unsecured claims . . . . It is hardly surprising, therefore, that the unsecured creditors have not accepted the plan even through as a practical matter it provides them with more of a recovery than if the debtors had simply filed for chapter 7 relief." 449 B.R. at 494.

72 See notes 40 and 51, supra.

section 541 with respect to debtors who are individuals. Thus, "the more logical reading of the phrase 'included in the estate under section 1115' is the narrow one . . . ." Id. The court felt that, if Congress had meant something else, it would have been more explicit. Further, the court said, "the narrow interpretation [is] more in line with the primary purpose of BAPCPA 'to improve bankruptcy law and practice by restoring responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors.'" Id. at 904 (citing, inter alia, House Report, pt. 1, at 2). The court noted Congress's stated concerns about the perception that bankruptcy relief was too readily available, about the implicit "bankruptcy tax" it imposes on everyone else and on the national economy, and about debtors who could repay creditors but were not required to do so. Id. at 904-905 (citing House Report, pt. 1, at 3-5). Therefore, the court concluded that "it is not reasonable to think that Congress would amend § 1129(b)(2)(B)(ii) to abrogate the absolute priority rule in its entirety as to individual Chapter 11 debtors while at the same time attempting to shift the majority of filings from liquidation to reorganization and requiring individual debtors to repay more of their debts." Id. at 905.[73]

In Borton, the debtor was a dermatologist who operated her business through a subchapter S corporation of which she was the sole shareholder. "Debtor's income [was] derived solely from the corporation." 2011 WL 5439285 at *1. "[A] combination of difficulties with an ex-spouse and her business led Debtor to amass large amounts of debt, including substantial unpaid trust taxes and income taxes." Id. at n.3. The debtor's plan provided that she would retain all her property under the plan, while providing an estimated .05% distribution on general unsecured claims, funded at $100.00 per month. The class of general unsecured creditors did not accept the plan,[74] but no objections to confirmation were filed. Nevertheless, the court requested and received from the debtor a brief on the applicability of amended section 1129(b)(2)(B)(ii). The court noted that several courts had discussed the issue and reached different conclusions. For itself, the court held that the statute is unambiguous and that the narrow view is correct. "Section 1115 . . . speaks only of post-petition property. It therefore supplements § 541, but does not supplant or subsume § 541 . . . ." Id. at *4.[75]

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73 The debtor in Lindsey filed a notice of appeal (Docket No. 246) on August 10, 2011, in Case No. 3:10-31694 (Bankr. E.D. Tenn.). Briefing is complete (Docket Nos. 3, 5 & 8), but no opinion has been filed to date. See Docket of Case No. 3:11-00445 (E.D. Tenn.) Meanwhile, on the joint motion of the U.S. Trustee and a creditor, the bankruptcy court ordered that a chapter 11 trustee be appointed, which occurred on January 18, 2012. See Joint Motion to Appoint Trustee (Docket No. 306), Order Granting Motion to Appoint Trustee (Docket No. 313), and Order Granting Motion to Appoint Trustee (Docket No. 316), in Case No. 3:10-31694 (Bankr. E.D. Tenn.).

74 Three ballots in the general unsecured claims class were received. Two were acceptances, but the third ballot, a rejection, represented a larger amount than the acceptances. See Borton, 2011 WL 5439285, at *2.

75 The debtor in Borton filed an amended plan that provided that general unsecured

In Tucker, the debtors owned a tanning salon. Their plan provided that they would retain all of their assets, while general unsecured creditors in class 6 would receive approximately 16.19% of their claims over a period of 61 months. Class 6 rejected the plan. The court agreed with the narrow view of the new exception in amended section 1129(b)(2)(B)(ii) and "adopt[ed] the reasoning and holding of [the court] in . . . Karlovich . . . ." 2011 WL 5926757 at *2. The court in Tucker also held that the debtor's contribution of future salary over the term of the plan did not satisfy the "new value exception" to the absolute priority rule because it did not meet the "money or money's worth" requirement, citing Ahlers.[76]

In Lively, the debtor proposed to retain ownership of a mortgage note payable, nine railroad car leases and his interest in a recreational boat consignment lot, while using his salary, social security benefits, income from the mortgage note, income from the railcar leases and a periodic payment from the consignment lot run by his son to fund the plan. He forecast a 7.38% distribution to unsecured creditors. The unsecured creditor class voted against the plan. Although no creditor objected to confirmation, the court concluded that the plan did not satisfy the requirements of section 1129(b)(2)(B)(ii). It determined that the phrase "included in the estate under section 1115" is unambiguous and "means property added to the estate by § 1115," thus adopting the narrow view. 466 B.R. at 901 (emphasis in original). The court did, however, address what it considered "the crucial argument" against that interpretation, which was articulated by the court in Shat, i.e., "that the 'narrow' interpretation renders the exception trivial." Id. at 902. According to Shat, given section 1129(a)(15) (discussed below under Good Faith), under the narrow view, the new exception in section 1129(b)(2)(B)(ii) would protect "'only the value of the aggregate postpetition earnings payable after the fifth anniversary of

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creditors would receive "the sum of $100.00 per month through January 28, 2014, when all the priority and secured tax claims are paid in full. Thereafter the debtor shall pay unsecured creditors the sum of $16,069.37 per month for a period of one additional year," which the debtor estimated would result in a distribution of 26%. See Plan of Reorganization (Docket No. 228), filed on January 6, 2012, in Case No. 9-00196 (Bankr. D. Idaho). The general unsecured class accepted the plan, which was confirmed by order entered on February 28, 2012. See Debtor in Possession's Report on Confirmation of Plan (Docket No. 254); Order Confirming Plan (Docket No. 258).

76 The debtor in Tucker filed an amended plan, which increased to 43.40% the estimated distribution to Class 6 general unsecured creditors. See Debtor's Second Amended Plan of Reorganization (Docket No. 152), filed on November 28, 2011, in Case No. 10-67281 (Bankr. D. Ore.). Class 6 accepted the amended plan. However, before the amended plan was confirmed, the debtor filed a Motion to Reinstate and Confirm First Amended Plan . . . Due to Intervening Change in Law (Docket No. 168), based on the Bankruptcy Appellate Panel for the Ninth Circuit's decision in Friedman (discussed supra), in which the majority adopted the broad view of the new exception to amended section 1129(b)(2)(B)(ii). A hearing was held on the debtor's motion on May 25, 2012 (Docket No. 179), but no decision has been filed to date. N.B., the court in Arnold (discussed infra) has grappled with the effect of the Friedman decision on bankruptcy courts within the Ninth Circuit.

plan confirmation.'" Id. (citing Shat, 424 B.R. at 868). The Lively court countered that, notwithstanding section 1129(a)(15), "debtors [would] still have the ability to retain property earned during the first five years of the plan by either economizing or increasing their actual earned income." Id.[77];[78]

In Arnold, the debtors owned their personal residence, their former residence and a number of investment properties containing office buildings. They also owned a limited partnership, Full House, that owned other commercial property. After a bank foreclosed on some of Full House's property, the bank asserted a deficiency claim against the debtors on their guaranty of Full House's debt. The bankruptcy court had overruled the debtors' objection to the bank's claim, which, by virtue of its size, controlled the class of general unsecured claims. The debtors' plan proposed to retain their current residence and one of the investment properties. The bank objected to the disclosure statement on the ground, among others, that the plan was patently unconfirmable under amended section 1129(b)(2)(B)(ii). At the hearing on approval of the disclosure statement, the court adopted the narrow interpretation of the new exception to amended section 1129(b)(2)(B)(ii) and declined to approve the disclosure statement because it could not be confirmed over the bank's controlling negative vote.

Because the Friedman decision issued by the Bankruptcy Appellate Panel for the Ninth Circuit ("BAP") held that the absolute priority rule no longer applies to chapter 11 cases for individual debtors, the court in Arnold – a bankruptcy court in the Central District of California – first addressed whether it was bound by the Friedman decision, and determined that it was not.[79] Then, the court in Arnold decided that the Friedman majority opinion was not persuasive, not only because the BAP only received briefing on one side of the issue, but also because the Arnold court considered the statutory language to be ambiguous and "the broad interpretation [adopted by the majority in Friedman to be] strained and ultimately unpersuasive." 2012 WL 1820877 at *10. The Arnold court also noted that the Friedman interpretation was "not supported by the weight of the case law," and concluded that "legislative history and strong policy considerations require a

77 The court in Lively indicated that a creditor might attempt to modify the plan post-confirmation if the debtor cut his expenses or earned more income. However, the court said, "a court would not necessarily approve the modification." 466 B.R. at 903 n.10. Modification of chapter 11 plans for individual debtors post-confirmation is discussed below under Timing of Discharge; Modification of Plan.

78 The court in Lively certified its order denying confirmation for appeal to the Fifth Circuit. See 467 B.R. 884 (Bankr. S.D. Tex. Mar. 21, 2012). The Fifth Circuit granted the debtor's motion for direct appeal. See Order on Motion for Leave to Appeal Pursuant to 28 U.S.C. § 158(d), entered on April 24, 2012, in Case No. 12-90014 (5th Cir.). That appeal is now pending in the Fifth Circuit as Case No. 12-20277.

79 The court in Friedman noted that bankruptcy courts in the Ninth Circuit are divided as to whether BAP decisions are binding on them and that, while the BAP has concluded that its decisions are binding on bankruptcy courts in the circuit, the Ninth Circuit had not decided the issue. See 2012 WL 1820877 at *8-*9.

narrow reading of § 1115." Id.

Articulating its own analysis, the court in Arnold first discussed the centrality of negotiation and consent to the chapter 11 process and the critical role of the absolute priority rule in chapter 11 preserving it. "How the court interprets amended § 1129(b)(2)(B)(ii) and new § 1115(a) will ultimately affect the balance of power between the parties in . . . Chapter 11 bankruptcy case[s] of individual debtors." Id. at *16. Then, the court embarked on an exhaustive and technical grammatical analysis of the ambiguous language of new section 1115 and amended section 1129(b)(2)(B)(ii) to determine whether "the property specified in section 541" is or is not "property included in the estate under section 1115," and, therefore, may or may not be retained under the new exception in section 1129(b)(2)(B)(ii). Based on its grammatical role, the court determined that the phrase "in addition to property specified in section 541," as it appears in new section 1115(a), is an adverbial prepositional phrase that modifies the verb "includes." Therefore, the court concluded that "'the property specified in section 541' is not 'property included in the estate under section 1115,' which may be retained by an individual Chapter 11 debtor pursuant to the [new] exception to the absolute priority rule . . . ." Id. at *22. Also, because "'[p]hrases or clauses introduced by such expressions as together with, as well as, in addition to are not part of the subject and, therefore, do not affect the number of the verb,'" that "reinforces the idea that 'in addition to' means that the matter is 'besides' or 'separate from' the subject of the sentence, which in § 1115(a) means 'property of the estate' included under § 1115." Id. at *23 (citations omitted; emphasis in original). Further, the court noted that no language in new section 1115 creates an estate and, therefore, new section 1115 does not supplant or replace section 541. Rather, "[t]he first part of § 1115(a) referring to § 541 property looks and acts like a preamble because by using the words 'in addition to,' it sets a context for the addition of two different items not covered by § 541(a) to the bankruptcy estate of an individual debtor in Chapter 11, namely, postpetition assets and postpetition earnings." Id. at *25. On the contrary, "to adopt the . . . broad view . . . would render § 541 entirely superfluous in individual Chapter 11 cases without any clear indication from Congress that such a result was intended." Id. at *26.

Looking at legislative history, the court in Arnold found it generally unhelpful, except that "[w]hat legislative history does exist, . . . actually reinforces the idea that 'the purpose behind BAPCPA was to have debtors pay more, not less'" (id. at *27 (citations omitted)) – rather than "to further an individual debtor's fresh start," as the court in Shat found (id. at *28). "[B]ased on . . . legislative history, it is incongruous to conclude that Congress intended to relax plan confirmation standards for individual Chapter 11 debtors by removing the creditor protection of the absolute priority rule and thereby allowing these debtors to retain their prepetition assets and cram down unsecured creditors." Id. at *28 (citations omitted).

As a matter of policy, the court in Arnold embraced the analysis that Congress amended section 1129(b)(2)(B)(ii) to enable individual debtors in chapter 11 to retain post-

confirmation their postpetition earnings and property, which had been added to the estate by new section 1115. "[W]ith the creation of § 1115 and the exclusion of postpetition property from § 1129(b)(2)(B)(ii), Congress struck a careful balance between the rights of an individual debtor to cram down and the rights of creditors to be given fair and equitable treatment." Id. at *29. By contrast, the broad view of the new exception would "change . . . the fundamental dynamic of Chapter 11," i.e., "creditor consent and negotiation." Id. at *30. Under the broad view, there would be "no need for an individual debtor-in-possession to negotiate with creditors to seek their consent and solicit their votes for a reorganization plan if the debtor knows in advance that he or she can resort to cramdown and keep his or her prepetition property regardless of any vote in a plan confirmation process." Id. The court considered it unlikely Congress would do this in such an ambiguous way and without even mentioning it in the legislative history. See id. at *31-*32. Further, the court noted, because unsecured creditors would likely fair poorly in an alternative chapter 7 liquidation, they are likely to negotiate and consent if given a reasonable dividend.

> Commenting on the case at hand, the court in Arnold said:
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> "Without requiring the Plan to comply with the absolute priority rule, the Debtors would write off about $3.5 million in unsecured debts, forcing General Unsecured Creditors to take a loss of at least 85 cents on the dollar, while the Debtors retain all prepetition and postpetition property, including an investment property valued at $5,434,000 at a time that arguably may be the bottom of the real estate market. Under the proposed Plan, the Debtors have unlimited upside potential for profit on their prepetition and postpetition assets while [the bank] and other General Unsecured Creditors must absorb the loss fixed under the proposed Plan."

Id. at *32. "This situation in this case appears to be what Congress stated it intended to prevent with the passage of BAPCPA." Id.[80]

The most recent reported decision on the effect of BAPCPA on the absolute priority rule is that of the Fourth Circuit Court of Appeals in Maharaj.[81] The Fourth Circuit began it analysis by describing the history of the absolute priority rule, noting in particular Congress's explicit exclusion of the rule from Chapter XI when it amended the Bankruptcy Act in 1952 and its inclusion of a modified version of the rule in chapter 11, when it merged many aspects

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80 The debtors in Arnold filed a notice of appeal, a motion for stay pending appeal, and a motion to certify direct appeal to the Ninth Circuit. See Debtors' Notice of Appeal (Docket No. 196), Debtors' . . . Motion for Stay Pending Appeal (Docket No. 200), and Debtors' . . . Motion to Certify Direct Appeal to the Ninth Circuit Court of Appeals (Docket No. 202), filed in Case No. 2:12-15623 (Bankr. C.D. Cal.). The hearing on the motion for stay and on the motion to certify direct appeal is set for July 24, 2012.

81 The bankruptcy court's decision in Maharaj is discussed supra.

of Chapter X and XII into that new chapter in the Bankruptcy Reform Act of 1978.[82] The court then reviewed the "significant split of authorities [that had] developed nationally among the bankruptcy courts regarding the effect of the BAPCPA amendments on the absolute priority rule when the Chapter 11 debtor is an individual." 681 F.3d at 563.

Commencing its own analysis, the Fourth Circuit looked first at the language of new section 1115 and amended section 1129(b)(2)(b)(ii), and concluded that it is ambiguous. In no small measure, this was because of the discord among courts that had addressed the issue. The court then considered "the specific context in which the language is used, and the broader context of the statute as a whole." Id. at 569. It found convincing the analysis of the court in Karlovich, that the new exception in section 1129(a)(2)(B)(ii) was amended to ameliorate the effect of new section 1115, which expanded property of the estate to include postpetition earnings and other property acquired postpetition, and thus "preserved the absolute priority rule as it operated prior to the passage of BAPCPA." Id. The court did not consider this effect to be trivial, as some courts argued. The court also stated in that "[i]n [its] view, the context demonstrates that Congress intended § 1115 to add property to the estate already established by § 541," not to supplant section 541. Id. at 570.[83]

Importantly, the court found nothing in the statutory language or the sparse legislative history of BAPCPA that clearly indicated that Congress intended to repeal the absolute priority rule in chapter 11 cases for individuals. "The lack of any clear statement, either in the text of § 1129(b)(2)(B)(ii) or the legislative history of BAPCPA, is fatal to the 'broad view'. . . ." Id. at 572. This was particularly so, according to the court, because there are instances in the legislative history of BAPCPA where changes to longstanding bankruptcy practice are discussed, and because, when Congress amended the Bankruptcy Act in 1952 to eliminate the absolute priority rule from Chapter XI, it "clearly explained its actions in the accompanying legislative history." Id. "History shows that Congress knows how to abrogate the absolute priority rule, and it has not done so here." Id. at 753. The court also rejected the argument that Congress intended

82 See note 27, supra.

83 The Fourth Circuit in Maharaj found support for this position in Seafort v. Burden (In re Seafort), 669 F.3d 662, 667 (6th Cir. 2012). See 681 F.3d at 570. The issue before the court in Seafort was "whether the income that becomes available after the [chapter 13] debtors have fully repaid their 401(k) loans . . . is 'projected disposable income' to be paid to the unsecured creditors or whether the income can be used to begin making voluntary contributions to the debtors' 401(k) plans and deemed excludable from both disposable income and property of the estate under 11 U.S.C. § 541(a)(1) and (b)(7)." 669 F.3d at 663. According to the court in Seafort, courts have developed three different approaches to that question. The answer turns, in part, on the relationship between section 1306(a) – the chapter 13 counterpart of section 1115(a) – and section 541(a). The Sixth Circuit described that relationship as follows: "Section 1306(a) expressly incorporates § 541. Read together, § 541 fixes property of the estate as of the date of the filing, while § 1306 adds to the 'property of the estate' property interests which arise post-petition." Id. at 667.

to harmonize chapter 11 for individual debtors with chapter 13. It agreed with the court in Gbadebo that this would be consistent with the general approach of BAPCPA to "'impose greater burdens on individual chapter 11 debtors' rights so as to ensure a greater payout to creditors.'" Id. And, it agreed with the court in Karlovich that, if Congress had intended to abrogate the absolute priority rule, it "could have effected the changes . . . in a far less awkward and convoluted manner . . . ." Id.

While the court did not consider itself obligated to do so, the court also discussed public policy, and rejected the contention that retention of absolute priority rule for individual debtors is "antithetical to the aims of Chapter 11 because if a debtor who is a sole proprietor is forced to sell a business that is a sole source of income, the debtor will have insufficient means to fund payments under the plan." Id. at 574. After noting again the pro-creditor bias of BAPCPA and the lack of indication in the statutory language or legislative history that Congress intended to abrogate the absolute priority rule, the court countered that "plan acceptance is still very much a possibility." Id. at 575. Citing the dissent in Friedman, the court said: "Debtors 'may negotiate a consensual plan, pay higher dividends, pay dissenting classes in full, or comply with the [absolute priority rule] by contributing prepetition property.'" Id.

Summary and the "New Value Exception"

Thus, the reported cases dealing with the issue are split 16-5[84] as to what, if

84 As noted above, the BAP split 2-1 in Friedman. The dissent criticized the majority for adopting the broad view of the new exception to amended section 1129(b)(2)(B)(ii) based on "plain meaning" and "its conviction that Congress intended to align individual chapter 11's almost entirely with chapter 13's . . . ." 466 B.R. at 484. She posited that the majority's analysis violated a key tenant of statutory construction by rendering sections 541 and 1129(b)(2)(B)(i) superfluous and undermining the requirement for voting in chapter 11 cases for individual debtors. Among other things, she rejected the majority's interpretation of the word "includes" in section 1115(a) as "inclusive," because it is not used there as a preamble followed by examples. Rather, it is used to reflect something "in addition," in no small measure because "property of the estate is already defined in § 541." Id. at 488. She also argued that, if the new exception eliminates subclause (ii) in section 1129(b)(2)(B), it must necessarily eliminate subclause (i) as well "because otherwise the statute would express a nonsensical and harsh alternative in (B)(i)." Id. at 489. She also disagreed with the majority's conclusion that BAPCPA amended the Code "'so that §1129(a)(15)(B) would trump § 1129(b)(2)(B)(ii) in individual debtors cases,'" because section 1129(a)(15) is triggered by the objection of a single general unsecured creditor, while section 1129(b)(2)(B)(ii) is triggered by the negative vote of a class. Id. The dissent also adopted the Lively court's analysis that debtors who are individuals receive a benefit even from the narrow interpretation of the new exception in amended section 1129(b)(2)(B)(ii) in that they may well be able retain more of their postpetition earnings if they economize or work hard and earn more, despite the ability of creditors to seek to modify their plans post-confirmation. Further, the dissent criticized the majority's approach as inconsistent with the purpose of BAPCPA, which was "to have debtors pay more, not less," and destructive of "the careful balance between an individual chapter 11 debtor's interest in reorganizing and restructuring his or her debts and the creditors' interest in maximizing

anything, happened to the absolute priority rule for individual debtors in chapter 11 cases as a result of BAPCPA. Interestingly, if the § 1129(b)(2)(B)(ii) exception is considered unambiguous, there are 'plain meaning' cases to support both the broad view (Tegeder, Biggins and the majority in Friedman) and the narrow view (Gbadebo, Mullins, Steedley, Karlovich, Stephens, Walsh, Draiman, Borton and Lively). If the exception is considered ambiguous, there are interpretations of language, congressional intent and public policy to support both the broad view (Roedemeier and Shat) and the narrow view (Gelin, Maharaj (Fourth Circuit), Kamell, Lindsey, Arnold and the dissent in Friedman). See Michael F. Coury, Sweat Equity Redux: Does the Absolute Priority Rule Survive for Individual Chapter 11 Cases?, 2011 Norton Bankr. L. Adviser 1.

As several of the courts and the dissent in Friedman pointed out, if the narrow view is accepted, cramdown in chapter 11 cases of individual debtors remains virtually unchanged by BAPCPA and most individual debtors will be unable to confirm chapter 11 plans under which they retain prepetition property (possibly other than exempt property) without the consent of the general unsecured creditor class(es).[85] See discussion above under Cramdown Pre-BAPCPA. It is the value of the bankruptcy estate." Id. at 490-91. "Individual chapter 11 debtors are not simply chapter 13 debtors with larger debts." Id. at 491. Therefore, the dissent said, there is no reason to believe that Congress intended to abrogate the absolute priority rule, which "has been embedded in bankruptcy jurisprudence and codified for many years," especially without any express guidance from Congress in that regard. Id. In addition, the dissent said, maintenance of the absolute priority rule with respect to prepetition property does not make it "virtually impossible" for sole proprietors to confirm a chapter 11 plan. Id. Because they would often receive little or nothing in chapter 7, general unsecured creditors "have traditionally been highly motivated to negotiate." Id. at n.26.

The majority in Friedman confronted some of the dissent's criticisms. It argued that the broad view does not render section 541 surplusage anymore than new section 1115's counterpart, section 1306, does. See id. at 482. However, because there is no absolute priority rule in chapter 13, the interpretation issue posed by the language of new section 1115 in light of amended section 1129(b)(2)(B)(ii) does not arise in chapter 13. Also, the majority counters the dissent's point that new section 1129(a)(15) (discussed below under Good Faith) works differently in chapter 11 for individual debtors than its counterpart, section 1325(b)(1) does in chapter 13 because section 1129(a)(15) is triggered only if a creditor with an allowed unsecured claim objects, while section 1325(b)(1) applies regardless of objection. The majority ascribed this difference to a "nuance" "[t]he drafter's failure to anticipate," and considered it unrealistic to posit that "all unsecured creditors voting against the plan would simultaneously fail to object to confirmation." However, that is just what happened in some of the cases discussed in note 90 infra.

85 If the new exception in section 1129(b)(2)(B)(ii) applies only to section 1115 property, there could be challenging issues in sorting out the extent to which property of the estate at confirmation has been acquired with postpetition earnings or is otherwise "proceeds, product, offspring, rents, or profits of or from" property acquired postpetition by the debtor (rather than the estate) and, therefore, may be retained by the debtor. There may be a premium on asset segregation and good recordkeeping. For example, should postpetition expenses that "preserve" or otherwise relate to the property specified as property of the estate in section 541 ("section 541 property") be allocated to section 541 property, while other "personal" postpetition expenses of the

noteworthy, however, that in Draiman, the court held that the debtor had satisfied the "new value exception" to the absolute priority rule. There, the debtor contributed $100,000 as consideration for the assets he would retain. "The Disclosure Statement explains that 'Debtor has secured a commitment from Ronald Shabat, a business associate, to provide the funds necessary for Debtor to make the $100,000 payment . . . .'" 450 B.R. at 822. This "outside funding" satisfied the requirement that the amount contributed be "new" and "in cash." Id. The court also determined that the contribution was "substantial," "necessary for the success of the plan" because it would provide the seed money for the Liquidation Trust, and "reasonably equivalent to the value" of the assets to be retained by the debtor. Id.[86]

Good Faith

Pre-BAPCPA

Under section 1129(a)(3) (both before and after BAPCPA), a chapter 11 plan cannot be confirmed unless it "has been proposed in good faith and not by any means forbidden by law." "Good faith" is not defined in the Code, but for purposes of section 1129(a)(3), most courts follow In re Madison Hotel Associates, 749 F.2d 410, 424-25 (7th Cir. 1984) and "'look[] to the debtor's plan and determine[], in light of the particular facts and circumstances, whether the plan will achieve a result consistent with the Bankruptcy Code.'" See 7 Collier ¶ 1129.02[3][a][ii][A] (citing Madison Hotel Associates).

In the reported opinions dealing with section 1129(a)(3) in individual debtor chapter 11 cases pre-BAPCPA, courts generally ascertained "good faith" by looking at the ability of the debtor to pay his or her creditors. They considered all of the debtor's available resources, including postpetition earnings – even though such earnings were statutory excluded from property of the estate.[87] Expenses considered extravagant or unnecessary were not tolerated. For

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debtor are allocated to section 1115 property?

86 See note 69, supra. In Tucker, 2011 WL 5926757, another case in which the court adopted the narrow view of the new exception to section 1129(b)(2)(B)(ii), the court also discussed the "new value exception" and held that debtor's proposed contribution of future salary did not satisfy the "new value exception" under Ahlers)

87 Addressing the propriety of this practice, the court in In re Weber, 209 B.R. 793 (Bankr. D. Mass. 1997), stated:

> [T]he fact that a debtor's postpetition earnings are not property of the estate does not mean that the court is precluded from considering those earnings in connection with a determination of a debtor's good faith in proposing a plan. On the contrary, all of the cases which address this issue hold that an individual debtor in Chapter 11 must make a sufficient financial commitment to creditors to satisfy the good faith requirement.

Id. at 798 (footnote and citations omitted).

In Henderson, 321 B.R. at 560, the court noted that issues as to the unfairness of the debtor's

example, in In re Kemp, 134 B.R. 413, 415 (Bankr. E.D. Cal. 1991), the court refused to confirm the debtor's plan under section 1129(a)(3) because, after considering his salary and the net income of his wholly-owned corporation (together, $161,500 annually) and his expenses ($20,000 annually), the court concluded that "the debtor is capable of making payments substantially higher than [the $48,000 annually] he has offered in his Plan." And, in Harman, 141 B.R. at 889, the bankruptcy court refused to confirm the debtors' plan because

> a debtor's failure to make anything close to the best offer of payment to creditors violates both 11 U.S.C. §§ 1129(a)(3) and (b)(1). It is not an act of "good faith" to propose a plan in which the Debtors retain one hundred (100%) of the expenditure necessary to support a lavish lifestyle, and, consequently, require the creditors to either wait 30 years for payment or accept a guaranteed payment of fifteen (15%) percent – or twenty-five (25%) if they are lucky.

In In re Weber, 209 B.R. at 799, the court used the chapter 13 disposable income test (set forth in section 1325(b) (pre-BAPCPA)) as a guideline "to determine whether a debtor has committed sufficient available resources to a plan" for purposes of the good faith requirement of section 1129(a)(3). As the court explained:

> In order to demonstrate that a debtor has made its best effort to repay creditors, it is certainly appropriate to examine both the use of the debtor's resources during the administration of a Chapter 11 case and the debtor's projected use of those resources after confirmation of the debtor's plan. The difficulty lies in determining how to measure whether a financial commitment is sufficient. One obvious analogy is the disposable income test used in Chapter 13. . . . However, in this context the Court views that test with some hesitation. Chapter 13 is different from Chapter 11 in several important respects. . . . . Nevertheless, the Court finds disconcerting the notion that a debtor who is unable to qualify for Chapter 13 relief because his or her liabilities exceed the debt limits may receive more favorable treatment in Chapter 11 than a debtor in Chapter 13 who has fewer debts. . . . As a result, this Court believes that the disposable income test, while it cannot constitute a bright line for determining good faith in all individual Chapter 11 cases, is useful as a guideline to determine whether a debtor has committed sufficient available resources to a plan.

Id. at 798-99.

The court in In re Flor, 166 B.R. 512 (Bankr. D. Conn. 1994), rejected this approach entirely.[88] The court refused to confirm a chapter 11 plan in which the individual retention of $3.5 million of exempt property (including their unlimited homestead exemption) should be dealt with as a question of good faith under section 1129(a)(3).

88 The court in In re Dapontes, 364 B.R. 866, 867-68 (Bankr. D. Conn. 2007), also a pre-BAPCPA case, followed Flor.

debtors committed to pay their general unsecured creditors from their post-confirmation earnings a total of $52,000 in monthly installments over a seven-year period. There was no question that the payments were substantial enough. Rather, the court noted that, in chapter 11, postpetition earnings are not property of the estate and likened the plan to a voluntary wage assignment, which would be unenforceable under applicable nonbankruptcy law. The court then held that the plan violated public policy and section 1129(a)(3) (as a plan proposed by "means forbidden by law"). The court was not persuaded by the argument that the debtors' plan merely paralleled chapter 13; it explained: "Chapter 13 allows a debtor to fund a plan out of the debtor's earnings, . . . but only after paying careful attention to the doctrine of Local Loan and the prohibition of involuntary servitude contained in the Thirteenth Amendment." Id. at 514-15. In that regard, the court mentioned that, among other things, (a) chapter 13 can be commenced only voluntarily and can be dismissed or converted unilaterally, (b) a chapter 13 plan can provide for payments only over three or, for cause, five years, and (c) the amount of debt a chapter 13 debtor may have is limited.

Post-BAPCPA

BAPCPA added two new provisions to the Code that deal with issues raised by the courts pre-BAPCPA in dealing with "good faith." First, BAPCPA added a new paragraph (8) to section 1123(a), which resolves to some extent the issues raised in Flor.[89] It provides:

> (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.

Second, BAPCPA added a new paragraph (15) to 1129(a), which provides that the court cannot confirm a plan unless:

> (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

89 New section 1123(a)(8) does not resolve the constitutional issue raised in Flor. See note 7, supra.

> 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.

The general effect of new section 1129(a)(15) is to import into chapter 11 a variant of the projected disposable income test of chapter 13, as the debtor is required to devote to the plan value equal to a minimum of five years of projected disposable income if the holder of an allowed unsecured claim objects to confirmation of the individual chapter 11 debtor's plan.[90]

The chapter 13 disposable income test was also amended by BAPCPA. It is set forth in section 1325(b)(1) & (2), which, as amended by BAPCPA,[91] provides as follows:

> (b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan –
>
> (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount

90 New section 1129(a)(15), by its own terms, is triggered when "the holder of an allowed unsecured claim objects to confirmation of the plan." Thus, the court in In re Shat, 424 B.R. at 857 n.4, held that the requirements of section 1129(a)(15) are not triggered when a general unsecured creditor voted against the plan but did not object to confirmation, saying:

> Doing nothing more than casting a rejecting ballot might indicate an objection to the plan, but it is also consistent with the belief that the plan is legally sufficient, coupled with an acknowledgement by the creditor that it will be bound by the decision of a majority of creditors in its class or by an appropriate cramdown.
>
> In contrast, an objection requires more – at a minimum, the objector must affirmatively take a position [that] the plan proposed is objectionable on some legal ground. . . . As a result Section 1129(a)(15) does not apply in this case because the dissenting creditor did not also file or otherwise assert any objection to the Plan.

Id. (citations omitted); accord, In re Roedemeier, 374 B.R. at 271 (section 1129(a)(15) applies only when a holder of an allowed unsecured claim objects to confirmation). Similarly, the court in In re Washington, 2010 WL 1417708, at *2-3 (Bankr. N.D. Tex. April 2, 2010), held that section 1129(a)(15) was not triggered when the unsecured class voted to reject the plan, but no unsecured creditor objected to the plan. Accord, In re Lively, 466 B.R. at 899 n.1. Professor Brubaker, however, rejects this approach as "an overly technocratic trap for the unwary, unsophisticated, and un-bankruptcy-lawyered-up." Ralph Brubaker, Individual Chapter 11 Debtors, BAPCPA, and the Absolute Priority Rule, 30 No. 4 Bankruptcy Law Letter (April 2010).

91 BAPCPA's amendments to section 1325(b)(2)(A) and (B) were relatively limited. Before and after BAPCPA, they provide for deduction of amounts reasonably expended for support and maintenance of the debtor and dependents, for certain charitable deductions and for business expenses. Principally, BAPCPA added a deduction for domestic support obligations.

of such claim; or

(B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

(2) For purposes of this subsection, the term "disposable income" means current monthly income received by the debtor (other than child support payments, foster care payments, or disability payments for a dependent child made in accordance with applicable nonbankruptcy law to the extent reasonably necessary to be expended for such child) less amounts reasonably necessary to be expended –

(A)(i) for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation, that first becomes payable after the date the petition is filed; and

(ii) for charitable contributions (that meet the definition of "charitable contributions" under section 548(d)(3) to a qualified religious or charitable entity or organization (as defined in section 548(d)(4)) in an amount not to exceed 15 percent of gross income of the debtor for the year in which the contributions are made; and

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

Section 1325(b)(3) delineates how "[a]mounts reasonably necessary to be expended under paragraph (2)" are to be determined if the debtor has "current monthly income" (defined in new section 101(10A)) greater than the applicable "median family income" (defined in new section 101(39A)) of the applicable State. Generally speaking, subparagraph (b)(3), as amended by BAPCPA, incorporates into chapter 13 the "means test" deductions of new section 707(b)(2)(A)(ii).

A description of the "means test" is far beyond the scope of this paper. However, Official Forms relating to the "means test" have been prepared and approved by the Advisory Committee on Bankruptcy Rules and approved by the Standing Committee on Rules of Practice and Procedure of the Judicial Conference of the United States and by the Judicial Conference of the United States, together with the Committee Note. Pursuant to Fed. R. Bankr. P. 9009, these Official Forms must be "observed and used with alterations as may be appropriate."

It is noteworthy that the Official Forms include different versions of the "means

test" form for use in chapter 7, 11 and 13 cases because BAPCPA applies the "means test" differently in each chapter. It is particularly noteworthy that the Official Form for chapter 11 (Official Form 22B) requires only the computation of "current monthly income," purportedly in accordance with section 1325(b)(2) (incorporated into new section 1129(a)(15) by reference) and the definition of "current monthly income" in new section 101(10A). It does not deal with deductions – either those specified in section 1325(b)(2)(A) and (B) (incorporated into new section 1129(a)(15) by reference) or those specified in section 1325(b)(3) (which incorporates new section 707(b)(2)).

The Committee Note explains:

> The Chapter 11 form is the simplest of the three, since the means-test deductions of § 707(b)(2) are not employed in determining the extent of an individual Chapter 11 debtor's disposable income. Section 1129(a)(15) requires payments of disposable income "as defined in section 1325(b)(2)," and that paragraph allows calculation of disposable income under judicially-determined standards, rather than pursuant to the means test deductions, specified for higher income Chapter 13 debtors by § 1325(b)(3). However, § 1325(b)(2) does require that [current monthly income, calculated in accordance with § 101(10A)] 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) . . . .

The conclusion that section 1325(b)(3) is not applicable in determining deductible expenses in chapter 11, even if the debtor's "current monthly income" is greater that the applicable median, was adopted by the court in the only reported case explicitly dealing with the issue in a chapter 11 context, In re Roedemeier, 374 B.R. at 272-73. See also U.S. v. Villalobos (In re Villalobos), 2011 WL 4485793 at *8 ("The calculation of disposable income takes into account the debtor's reasonable expenses related to certain support and maintenance obligations. See §§ 1129(a)(15), 1325(b)(2)"); In re Bacardi, 2010 WL 54760, at *5 n.2 (N.D. Ill. Jan. 6, 2010) ("[T]he means test does not in fact apply in chapter 11. Section 1129(a)(15) mentions section 1325(b)(2) but not section 1325(b)(3)."); In re Smith, 2009 WL 4262842 , at *3 n.4 (Bankr. N.D. W.Va. Nov. 23, 2009) ("The court's determination of an [sic] debtor's ability to pay based on actual income and expenses under the totality of the circumstances test [of section 707(b)(3)(B)] is relevant in the event the case is converted to Chapter 11 . . . ."). This approach is also supported by Collier. See 7 Collier ¶ 1129.02[15][a]. However, it is not without naysayers, because section 1325(b)(3) specifies that "[a]mounts reasonably necessary to be expended under paragraph (2) shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2) . . . ."[92]

92 See In re Dumas, 419 B.R. 704, 711 (Bankr. E.D. Tex. 2009) (in context of

It appears to be without dispute, however, that "current monthly income" for purposes of the disposable income test of section 1129(a)(15) is determined the same way as in section 1325(b)(2). "Current monthly income," as defined in new section 101(10A):

> (A) means the average monthly income from all sources that the debtor receives . . . without regard to whether such income is taxable income, derived during the 6-month period ending on –
>
> (i) the last day of the calendar month immediately preceding the date of the commencement of the case if the debtor files the schedule of current income required by section 521(a)(1)(B)(ii); or
>
> (ii) the date on which current income is determined by the court for purposes of this title if the debtor does not file the schedule of current income required by section 521(a)(1)(B)(ii); and
>
> (B) includes any amount paid by any entity other than the debtor . . . , on a regular basis for the household expenses of the debtor or the debtor's dependents . . . , but excludes benefits received under the Social Security Act, payments to victims of war crimes or crimes against humanity on account of their status as victims of such crimes, and payments to victims of international terrorism . . . or domestic terrorism . . . on account of their status as victims of such terrorism.

Thus, under BAPCPA, "current monthly income" is always measured by the past. If the debtor files a schedule of current income (Schedule I to Official Form 6),[93] "current monthly income" is determined based on the six full months that precede the filing of the case; if the debtor does not file Schedule I, "current monthly income" is determined based on the six months immediately preceding "the date on which current income is determined by the court." 11 U.S.C.

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determining motion to dismiss chapter 7 case based on the "totality of the circumstances . . . of the debtor's financial situation" under section 707(b)(3), court indicated that new section 1129(a)(15) imports section 1325(b)(3) into chapter 11); In re Johnson, 399 B.R. 72, 77, 79 (Bankr. S.D. Cal. 2008) (same); In re Bennett, 2008 WL 1869308, at *2 n.6 (Bankr. E.D. Va. April 23, 2008) (in dicta, indicated that "projected disposable income" is calculated the same way in chapter 11 as in chapter 13, including using the expense deductions specified in section 1325(b)(3); held that objecting creditor has initial burden of producing evidence that a plan does not satisfy new section 1129(a)(15), even if debtor provides no evidence to establish his or her projected disposable income).

93 N.B., Schedule I of Official Form 6 (Current Income of Individual Debtor(s)) is separate and different from the Statement of Current Monthly Income (Official Form 22B). The information and computations required in Schedule I and Schedule J (Current Expenditures of Individual Debtors) do not conform to the "means test" of section 707(b)(2).

§ 101(10A)(A)(ii).[94]

Therefore, in determining the minimum amount of value an individual chapter 11 debtor must distribute under the plan under new section 1129(a)(15)(B), if an unsecured creditor objects, the court is directed to start with "current monthly income," an amount of income determined by the past, and then deduct: (a) child support, foster care or disability payments to the extent reasonably necessary for a dependent child; (b) reasonable and necessary expenses to maintain and support the debtor and dependents; (c) postpetition domestic support obligations; (d) charitable contributions up to 15 percent of annual gross income; and (e) necessary business expenses, if the debtor is engaged in business.[95]

94 N.B., Rule 1007(b)(1)(A) and (C) requires an individual chapter 11 debtor to file Schedule I within 15 days of the commencement of a voluntary case (unless extended by the court for cause), and section 1112(b)(4)(F) lists "unexcused failure to satisfy timely any filing or reporting requirement established by . . . any rule applicable to a case under this chapter" as "cause" for "mandatory" dismissal under section 1112(b)(1).

In In re Dunford, 408 BR. 489, 491 (Bankr. N.D. Ill. 2009), the chapter 13 debtor did not file Schedule I, but rather filed a motion seeking to waive the requirement that she file Schedule I and a delay of the deadline to file Official Form 22C (the chapter 13 "means test" form) and requesting the court to set alternative dates for determining her "current monthly income." Because the debtor lost her job a month before filing her chapter 13 petition, she requested that the six-month period be deferred to include three months before and three months after the petition date. The court granted the motion. The court reasoned that, under section 521(a)(1)(B)(ii), it had discretion to waive the requirement to file Schedule I and, under section 101(10A), because the debtor had not filed Schedule I, the court had discretion to set the date on which current income is to be determined. The court then applied a good faith standard to the debtor's request, which it determined she satisfied principally because of her employment situation.

95 See 11 U.S.C. § 1325(b)(2). This calculation assumes that section 1325(b)(3) does not apply to the determination of the debtor's "projected disposable income" under new section 1129(a)(15).

Section 1322(f) provides that amounts required to repay loans described in section 362(b)(19) – in general, loans from qualified pension, profit-sharing, stock bonus and other plans – "shall not constitute 'disposable income' under section 1325." In addition, "section 541(b)(7) specifically provides that neither amounts withheld from wages or received by employers as contributions to employee benefit plans, deferred compensation plans, or [Internal Revenue Code] section 403(b) plans shall be considered disposable income under section 1325(b)(2)." 8 Collier ¶ 1325.11[4][b]. These exclusions may not apply to the computation of disposable income in a chapter 11 case because they are not included in section 1325(b)(2).

In re Gray, 2009 WL 2475017 (Bankr. N.D. W. Va. Aug. 11, 2009), is an example of a chapter 11 case for an individual in which the court determined whether certain expenses were reasonably necessary for purposes of section 1129(a)(15) and eliminated several items in the debtor's budget. For example, the court ruled that $750 per month for the care of 15 dogs was unreasonable and unnecessary because the animals "provide no necessary service to the Debtor." Id. at *3. The court also disallowed the expense of a second television service and a second internet service, and reduced the debtor's monthly cellular phone budget from $250 to $100, including elimination of the service charge for the debtor's adult, "gainfully employed and

While this calculation may provide "disposable income," there remains the question of how "projected disposable income" under section 1129(a)(15) is determined. The phrase "projected disposable income" is also used in section 1325(b)(1)(B). Prior to BAPCPA, the disposable income test of chapter 13 was a forward-looking concept; courts considered both the debtor's anticipated actual income and actual reasonable and necessary expenses in the future in determining what the debtor should pay to creditors over the period of the plan. However, BAPCPA created uncertainty and, therefore, controversy as to whether that approach was still appropriate.

Prior to the U.S. Supreme Court's decision in Hamilton v. Lanning, 130 S. Ct. 2464 (2010), there was a split among the circuits as to an aspect of the proper manner to calculate "projected disposable income" of an above-median income chapter 13 debtor given the changes made by BAPCPA. For example, in Manry v. Kagenveama (In re Kagenveama), 541 F.3d 868, 872-75 (9th Cir. 2008), the Ninth Circuit held that, based on "the plain meaning of the statute," "projected disposable income" under section 1325(b)(1)(B) is to be determined by mechanically multiplying "disposable income," determined under section 1325(b)(2) & (3), by the applicable commitment period (if any). However, four circuit courts – and many bankruptcy courts – held that "projected disposable income" in section 1325(b)(1)(B) is different from "disposable income" as determined under section 1325(b)(2) and (3). See In re Turner, 574 F.3d 349, 356 (7th Cir. 2009); Nowlin v. Peake (In re Nowlin), 576 F.3d 258, 260 (5th Cir. 2009) Hamilton v. Lanning (In re Lanning), 545 F.3d 1269, 1270, 1274-82 (10th Cir. 2008), aff'd, 130 S. Ct. 2464 (2010); Coop v. Frederickson (In re Frederickson), 545 F.3d 652, 658-60 (8th Cir. 2008).

The Supreme Court resolved this dispute in Hamilton v. Lanning. There, the Court sided with the majority of circuit courts and held, in an 8-1 decision,[96] that "when a bankruptcy court calculates a debtor's projected disposable income [under section 1325(b)], the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation." 130 S. Ct. at 2478 (emphasis added). Logically, the Supreme Court's approach to projected disposable income in chapter 13 cases would apply to chapter 11 cases for individuals. Thus, if the debtor's "current monthly income" is demonstrably more or less than he or she is "known or virtually certain" to be able to earn or acquire, then under Hamilton v. Lanning, the more realistic amount would be used in determining "projected disposable income"

self-reliant" daughter's cell phone. Id. at *4 & n.2. The court, however, approved inclusion in the budget of expenses to support the debtor's companion of over 20 years who "[f]or the past twelve months, . . . has not contributed to the household expenses because she has had two major surgeries, and . . . suffers from severe arthritis." Id. at *1-3. The court determined that the debtor's companion was a "dependent" within the meaning of section 1325(b)(2)(A)(i). Not all courts would agree. For a discussion of the inconsistent interpretations of "dependent" in the bankruptcy context, see Erin K. Healy, It Depends: Prioritizing Function Over Form to Evaluate a Debtor's Dependency Relationships in Consumer Bankruptcy, 22 Emory Bankr. Dev. J. 185 (2005).

96 Justice Antonin Scalia dissented. See 130 S. Ct. at 2478.

for purposes of new section 1129(a)(15).

New section 1129(a)(15) provides that the period over which projected disposable income is to be determined is "the 5-year period beginning on the date that the first payment is due under the plan, or . . . the period for which the plan provides payments, whichever is longer." If a debtor's plan provides for payments for more than five years, e.g., on student loans or secured debt, the issue of the applicable time period arises. This issue has been raised, but not yet determined, in the reported case law. For example, in In re Washington, 2010 WL 1417708, the debtors owned ten encumbered rental properties, and the plan provided that the debtor and the lender would enter into new secured notes to be paid down over 30 years. The bankruptcy judge asked for "briefing on the issue of whether the Debtors are required to devote an amount equal to the disposable income they would receive over the next thirty years to payments to creditors in order to satisfy Section 1129(a)(15)(B)." Id. at *1. However, the court did not reach the issue because no general unsecured creditor objected to confirmation. See note 90, supra.[97] Similarly, in In re Johnson, 402 B.R. 851, 855 (Bankr. N.D. Ind. 2009), in the context of deciding whether to close the debtor's case before the discharge had been granted, the court surmised that

> a Chapter 11 plan [for an individual debtor] . . . could last for decades. All it would take for that to happen is for a debtor to have a 20 to 30 year home mortgage . . . and for the confirmed plan to provide that the mortgage debt will be paid according to its terms. . . . In Chapter 11 the payments under such a plan would not be completed, and the debtor would not be entitled to a discharge, until the mortgage debt was duly satisfied – 20 to 30 years hence.

In any event, it is important to note that new section 1129(a)(15) does not require that the debtor actually devote his or her post-confirmation "projected disposable income" to the payment of unsecured creditors, as section 1325(b) does.[98] Rather, an individual chapter 11

97 This issue and the related issue of when, under new section 1141(d) (5)(A) and (B), an individual chapter 11 debtor is entitled to a discharge before completion of payments under a plan does not arise in chapter 13 because of provisions like section 1322(b)(5), which accommodate long-term obligations (such as mortgage debt) in conjunction with the maximum three- or five-year duration of a chapter 13 plan under section 1322(d)(1) and (2). The Code provides a solution for the discharge-after-completion-of-payments issue by explicitly permitting the court, for cause, to grant a discharge before payments under the plan have been completed. See 11 U.S.C. § 1141(d)(5)(A) & (B); see In re Brown, 2008 WL 4817505, at *1 (Bankr. D.D.C. Oct. 29, 2008) (Because chapter 11 for individuals mirrors chapter 13, "Congress likely did not intend for § 1141(d)(5) to delay entry of a chapter 11 debtor's discharge [after payments to unsecured claims are made] pending the debtor's completion of all remaining regular monthly mortgage payments that the debtor obligates herself to pay under a confirmed chapter 11 plan."). See discussion below under Timing of Discharge; Modification of Plan.

98 There is some dispute in the case law about this requirement in chapter 13. The majority of courts hold that section 1325(b) imposes a temporal requirement, i.e., that the duration of a chapter 13 plan must equal the applicable commitment period, either three or five years, while

debtor is required to distribute (not necessarily to unsecured creditors)[99] property (which need not be post-petition earnings) under the plan of a value that is not less than his or her "projected disposable income" calculated as set forth in section 1129(a)(15)(B). See Baud v. Carroll, 634 F.3d at 340 (In new section 1129(a)(15)(B), "Congress made clear that a Chapter 11 plan of any length may be confirmed as long as the value of the property to be distributed is not less than the projected disposable income of the debtor to be received over five years (or the length of the plan, whichever is longer).").

Another question: If the plan for a chapter 11 debtor complies with new section 1129(a)(15) – whether by distributing the requisite value under the plan or because no unsecured creditor objects – can the court require the debtor to provide more value to creditors in order to satisfy the "good faith" requirement of section 1129(a)(3)? In In re Draiman, 450 B.R. 777, the court denied confirmation of the debtor's plan for, among other reasons, lack of good faith under section 1129(a)(3), even though it determined that the debtor had satisfied section 1129(a)(15). Citing pre-BAPCPA case law, including In re Weber, 209 B.R. 793, the court stated that "[i]t is appropriate to consider both the use of a debtor's income during the pendency of a Chapter 11 case and a debtor's projected use of that income after confirmation." 450 B.R. at 804. In doing so, the court considered several instances of post-petition behavior that it considered "excessive," "unnecessary" and "extravagant," including "exorbitant expenditures for household expenses, food, entertainment and travel," an Hawaiian vacation at the Ritz-Carlton Hotel in Kapalua, "expensive shopping excursions at women's clothing stores," even though the debtor was unmarried and had no dependents, and gambling at a casino. Id. at 806-07. "[T]hese facts indicate to the Court that the Debtor has shown an intent to utilize the bankruptcy process for his own benefit . . . . The Debtor's excessive and unnecessary expenditures and extravagant lifestyle do not manifest a fundamental fairness in dealing with his creditors." Id. at 807.[100]

In re Ekstrom, 2010 WL 1254893 (Bankr. D. Ariz. Mar. 23, 2010), stands in contrast, if only in dicta. There, the debtor devoted his projected disposable income to the plan a significant minority hold that section 1325(b) requires only payment of the amount of projected disposable income that would be received during the applicable period and does not specify the term of the plan. This case law split is described in the recent case of Baud v. Carroll, 634 F.3d at 336-37.

99 In In re Ekstrom, 2010 WL 1254893 (Bankr. D. Ariz. Mar. 23, 2010), the court confirmed a chapter 11 plan for an individual debtor finding that it satisfied new section 1129(a)(15), even though general unsecured creditors would receive nothing under the plan because all distributions other than to secured creditors were to taxing authorities. Accord Proudfoot Consulting Co. v. Gordon (In re Gordon), 465 B.R. at 693 n.8 ("11 U.S.C. § 1129(a)(15) only requires the amount of projected disposable income equal the 'value of the property to be transferred under the plan' to all creditors, not just unsecured creditors.").

100 As discussed below under Cramdown, the court in Draiman also refused to confirm the plan under the narrow view of the exception to the absolute priority rule in amended section 1129(b)(2)(B). See also note 38 and note 66, supra.

in accordance with new section 1129(a)(15) and, in addition, also devoted "all of his exempt and non-exempt property to the payment of creditors, had his wife "devote her social security payments to the funding necessary for the plan," and "obtained funding from a third party." Id. at *9 The court determined that this plan, which the debtor "negotiated with all of his creditors" and which garnered "near-unanimous consent of his creditors" – although the general unsecured class rejected it – was proposed in good faith under section 1129(a)(3), even though it provided no payments to general unsecured creditors. Id. In its discussion, the court said that, "[p]resumably, if a debtor meets the requirements of new Section 1129(a)(5), the debtor has met the statutory confirmation requirements that are consistent with the objectives and purposes of the Bankruptcy Code, and the Court should overrule the good faith objection." Id.

At a further extreme, in In re Washington, 2010 WL 1417708, at *3, the debtors did not have to provide the value that would have been required by section 1129(a)(15) because no unsecured creditor objected. In fact, "the evidence established that the Debtors' disposable income [was] $1,200 per month – an amount in excess of the $500 per month that they [would] be paying to unsecured creditors." Id. Nonetheless, the court determined that the plan was proposed in good faith as required by section 1129(a)(3) because "this result is permitted by the Bankruptcy Code" and, therefore, "the Plan cannot have been proposed in bad faith." Id. The court also noted, however, that "no party . . . submitted any evidence that the Plan [had] not been proposed in good faith," citing Fed. R. Bankr. P. 3002(b)(2). Id.[101]

Timing of Discharge; Modification of Plan

Pre-BAPCPA

Under section 1141, unless the plan or the confirmation order provided otherwise, confirmation of a chapter 11 plan for an individual debtor had the following consequences: (1) all of the property of the estate vested in the debtor; (2) the debtor received his or her discharge (subject to debts excepted from discharge under section 523); and (3) the property dealt with in the plan was free and clear of all claims and interests (except for nondischargeable debts).

Under section 1127(b), only the proponent of the plan or the reorganized debtor could modify a plan after confirmation, and no modification was permitted after substantial consummation.

Post-BAPCPA

BAPCPA changed the discharge provisions as they apply to individual chapter 11 debtors.[102] It amended section 1141(d)(2) and added section 1141(d)(5), which now resemble

101 Fed R. Bankr. P 3002(b)(2) provides that "[i]f no objection is timely filed, the court may determine that the plan has been proposed in good faith and not by any means forbidden by law without receiving evidence on such issues."

102 BAPCPA did not modify section 1141(d)(3) pursuant to which, even if the debtor would

section 1328(a) and (b), and which provide as follows (including amendments made by the Technical Corrections Act):

> (2) A discharge under this chapter does not discharge a debtor who is an individual from any debt excepted from discharge under section 523 of this title.
>
> * * * *
>
> (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

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be denied a discharge under section 727(a) if the case were under chapter 7, the debtor will nonetheless receive a discharge unless "the plan provides for the liquidation of all or substantially all of the property of the estate" and "the debtor does not engage in business after consummation of the plan." Thus, in Wachovia Securities, LLC v. Jahelka (In re Jahelka), 442 B.R. 663, 667 (Bankr. N.D. Ill. 2010), the court dismissed without prejudice claims for relief under section 727(a)(3) and (5) seeking denial of discharge and alleging that the individual chapter 11 debtor "failed to keep records from which his business transactions might be ascertained" and "cannot explain satisfactorily the loss of $10,000 in assets while the bankruptcy case was pending." The court noted that section 727(a) applies in chapter 11 only indirectly through section 1141(d)(3), which requires, in addition to satisfaction of section 727(a), two other elements. Because the debtor stated an intention to file an amended plan and the deadline to do so had not passed, the court could not determine whether paragraphs (A) and (B) of section 1141(d)(3) had been satisfied and, therefore, dismissed the claims for relief for lack of subject matter jurisdiction as unripe. See id. at 672-74. Similarly, in In re Draiman, 450 B.R. at 799-800 (footnote omitted), the court rejected the argument that a plan could not be confirmed because "the Debtor failed to maintain adequate books and records as required by . . . § 727(a)(3) and . . . failed to satisfactorily explain any loss or deficiency of assets pursuant to . . . § 727(a)(5)," because "§ 727(a) does not apply to Chapter 11 cases." "[Section] 727(a) applies in Chapter 11 cases only with respect to the discharge denial provision of § 1141(d)(3)." Id. at 800. Also, in Torrington Livestock Cattle Co. v. Berg (In re Berg), 423 B.R. 671, 674 (B.A.P. 10th Cir. 2010), the court reversed and remanded a judgment against an individual chapter 11 debtor that his discharge was denied under section 727(a)(3) because he "failed to maintain business records sufficient to allow the court to determine [his] financial condition or the propriety of [his] prepetition financial transactions." The bankruptcy court erred because it had not addressed all three elements of section 1141(d)(3). "All three of the elements of § 1141(d)(3) must be established before a Chapter 11 debtor's discharge may be denied. A Chapter 11 discharge cannot be denied solely on the ground that the debtor would have been denied a discharge under Chapter 7." Id. at 677.

> 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; and
>
> (ii) modification of the plan under section 1127 is not practicable; and
>
> (iii) subparagraph (C) permits the court to grant a 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;
>
> (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 subparagraphs (A) and (B) are met.

Note that, under new section 1141(d)(5)(B)(ii), an early discharge cannot be granted unless "modification of the plan . . . is not practicable."

Under BAPCPA, a confirmed chapter 11 plan for an individual debtor may be modified even after substantial consummation. New section 1127(e) and (f), which is substantially similar to section 1329(a)(1)-(3) and (b) (before and after BAPCPA), provides as follows (including amendments made by the Technical Corrections Act):

> (e) If the debtor is an individual, the plan may be modified at any time after confirmation of the plan but before the completion of payments under the plan, whether or not the plan has been substantially consummated, upon request of the debtor, the trustee, the United States trustee, or the holder of an unsecured claim, to –
>
> (1) increase or reduce the amount of payments on claims of a particular class provided for by the plan;
>
> (2) extend or reduce the time period for such payments; or
>
> (3) alter the amount of the distribution to a creditor whose claim is provided for by the plan to the extent necessary to take account of any payment of such claim made other

than under the plan.

(f)(1) Sections 1121 through 1128 and the requirements of section 1129 apply to any modification under subsection (e).

(2) The plan, as modified, shall become the plan only after there has been disclosure under section 1125 as the court may direct, notice and a hearing, and such modification is approved.

The effect of these BAPCPA provisions is to import the chapter 13 concepts of deferred discharge and post-confirmation modification into chapter 11 cases for individuals.[103] For example:

(1) Under section 1328(a), both before and after BAPCPA, the chapter 13 debtor receives his or her discharge "after completion by the debtor of all payments under the plan." However, section 1328(a) does not provide, as new section 1141(d)(5)(A) does, that the court can, "for cause," authorize discharge at confirmation.[104] BAPCPA provides no guidance

103 The court in In re Johnson, 402 B.R. at 855 n.3, noted that, under new section 1127(e), "even if a debtor receives an early discharge, the language of the statute still allows a plan to be modified – or at least offers the opportunity to seek modification – any time before payments are completed." It is not clear, however, that modification is permissible after the debtor has been granted a discharge.

104 It may be that early discharge "for cause" under new section 1141(d)(5)(A) can be obtained only at confirmation. See In re Necaise, 443 B.R. 483 (Bankr. S.D. Miss. 2010) (early discharge under section 1141(b)(5)(A) not available because not requested at time of confirmation).

Courts differ as to the proper procedure for satisfying the "notice and a hearing" requirement of new section 1141(d)(5)(A). For example, in In re Brown, 2008 WL 4817505, at *2, the court required a separate motion and notice that the motion for early discharge would be heard at the confirmation hearing, but allowed the notice to be served with the proposed plan and disclosure statement. It did so because new section 1141(d)(5)(A) "provid[es] that the confirmation of the plan does not alter the statutory rule, [and] it is [thereby] implicit that any attempt to alter the usual statutory rule ought to be accomplished via a procedural mechanism separate and apart from including a provision altering the usual statutory rule within the plan itself." Id. By contrast, in In re Sheridan, 391 B.R. 287, 290-91 (Bankr. E.D.N.C. 2008), the court decided that conspicuous notice in the disclosure statement and the notice of the confirmation hearing was sufficient. Accord, In re Draiman, 450 B.R. at 824 ("notice and hearing" requirement was satisfied because both plan and disclosure statement, which were served on all creditors, stated that debtor was seeking discharge at confirmation and debtor so testified at confirmation hearing). Similarly, in In re Kirkbride, 2010 WL 4809334, at *3 (Bankr. E.D.N.C. Nov. 19, 2010), the court held that the claim of a secured creditor had been discharged at confirmation under section 1141(d)(5)(A) by "a conspicuous notice in the disclosure statement and by a statement of notice during the confirmation hearing that a consent order would be entered into that allowed the creditor to foreclose in exchange for full satisfaction of the creditor's claim." Interestingly, in In re Haines, 2012 WL 1790219, at *1 (Bankr. N.D. Ohio 2012) (not intended for publication or citation), the court noted that the confirmed chapter 11 plan for the individual debtor provided

as to what constitutes "cause" under new section 1141(d)(5)(A). Compare In re Sheridan, 391 B.R. 287, 290-91 (Bankr. E.D.N.C. 2009) (court granted individual chapter 11 debtors discharge at confirmation because there was a "strong probability" that the debtors would make all of their plan payments and their obligation to do so was secured by a second deed of trust on their home) with In re Beyer, 433 B.R. 884, 888 (Bankr. M.D. Fla. 2009) (avoiding possibility of incurring taxes on forgiveness of indebtedness when secured creditors ultimately take property by deed in lieu of foreclosure – even though tax liability could adversely impact debtor's ability to make payments due in the future under the plan – is not sufficient "cause" for discharge at confirmation when the plan is not substantially consummated because the debtor has not yet indicated which properties he will keep and which he will surrender and payments to unsecured creditors will not begin for a year; as in Sheridan, "[t]he debtor must convince the Court that he or she will and can make all future payments with a high degree of certainty");[105] and In re Ball, 2008 WL 2223865 (Bankr. N.D. W. Va. May 23, 2008) (desire to avoid paying U.S. Trustee's quarterly fees and filing post-confirmation reports (at least in case where post-confirmation administration will not be lengthy) does not constitute "cause" to grant individual chapter 11 debtor discharge before all payments under plan have been completed). In In re Belcher, 410 B.R. 206, 217-18 (Bankr. W.D. Va. 2009), the court also held that avoiding the obligation to pay U.S. Trustee's quarterly fees is not sufficient "cause" to grant an early discharge because this reason is present in all individual debtor chapter 11 cases. However, it considered "[m]ore in keeping with the intent of [§ 1141(d)(5)(A)] . . . a determination of 'cause' for granting a discharge after payment of the sixty payments to the Distribution Fund to satisfy the obligation of the Plan to general unsecured creditors with dischargeable claims against the debtor . . . , but prior to completion of payments due on the educational loans or the Debtors' long term mortgage obligations." Similarly, in In re Brown, 2008 WL 4817505, at *1, in the context of a plan that called for payment of unsecured creditors shortly after the effective date of the plan, the court distinguished payments under the plan due on long term secured debt, such as a mortgage, and payments due to unsecured creditors. It expressed the view that, as in chapter 13, Congress was concerned with assuring that unsecured creditors would be paid, and likely did not intend to delay discharge once unsecured creditors are

for discharge on confirmation. However, without explanation, the court also said that it had not entered a discharge order and that "Debtors do not have a discharge." Id.

105 Citing Sheridan and Beyer, the court in In re Draiman, 450 B.R. at 824-25, stated that, even if it had confirmed the debtor's plan, it would not have granted the debtor's request for discharge at confirmation. "First, [the Debtor] has not substantially consummated the Plan. . . . Furthermore, the Debtor has not convinced the Court that he has the financial ability to make Plan payments by a preponderance of the credible evidence," including that "he has a stable future stream of income." The Debtor "testified that an early discharge [would] enhance his ability to generate income and make the required" payments under the plan, and that he was confident he would be able to make the payments. However, "[t]he Debtor's confidence does not translate into likelihood of payment or assurance of payment to the creditors."

paid until completion of long-term mortgage payments.[106]

106 In In re Johnson, 402 B.R. 851, the issue was whether to close an individual debtor's chapter 11 case prior to his completion of payments and discharge, subject to reopening after all payments had been made in order to grant the debtor's discharge, or for other purposes. The reason for closing the case was to eliminate ongoing quarterly U.S. Trustee's fees. Only the U.S. Trustee objected. The court granted the debtor's motion to close the case based on the criteria set forth in the Advisory Committee Note (1991) to Fed. R. Bankr. P. 3022 ("After an estate is fully administered in a chapter 11 reorganization case, the court . . . shall enter a final decree closing the case."). In Johnson,

> [t]he order confirming this debtor's plan has become final, there was no deposit to distribute, any property the plan contemplates transferring has been transferred or otherwise disposed of, the reorganized debtor has begun to manage his affairs, payments to creditors have commenced, the plan has been substantially consummated, and all outstanding motions, adversary proceedings, and contested matters (save this one) have been resolved.

402 B.R. at 856. Further, because the plan provided for payments to creditors out of future earnings for five years, with secured and priority creditors paid first, general unsecured creditors, not the debtor, would benefit from closing the case and cutting off U.S. Trustee's fees; their estimated recovery would increase from approximately $38,000 to approximately $51,000. The court noted that the case differed from In re Ball, supra, where the creditors' recovery would not be affected by avoiding U.S. Trustee's fees. While recognizing the argument that closing the case would make it more difficult for creditors to monitor the debtor's activities and, if appropriate, seek modification of the plan or dismissal or conversion of the case, the court indicated that the creditors had opted to receive the additional money. Further, "nothing about this case suggests that there is any need for the increased oversight that would be facilitated by leaving the case open or that the debtor cannot be trusted to properly perform his post confirmation obligations." 402 B.R. at 858. The court in In re Necaise, 443 B.R. at 493, also applied the criteria set forth in the Advisory Committee Note (1991) in deciding to close the debtor's case before payments had been completed or discharge was otherwise available.

The court in In re Hilburger, 2009 WL 1515125 (Bankr. W.D.N.Y. May 29, 2009), faced the same issue as the Johnson court, and reached the same conclusion. However, the court warned that

> "gaming the system" will not be tolerated. In some cases, the quarterly fees would not substantially injure creditors; the Plan would simply have to run longer, delaying creditors somewhat, but not reducing the "present value" of whatever portion of their claim will be paid. For example, when a plan is "driven" by the Chapter 7 test (e.g., nonexempt equity in realty or other property), the case might remain open unless its early closure is necessary for substantial consummation, such as where a refinancing will fund the plan or make it otherwise feasible, and the lender conditions the refinancing on closing the case.

Id. at *1.

The court in In re Belcher, 410 B.R. at 219, declined to follow Johnson, finding that the factors listed in the Advisory Committee Note to Fed. R. Bankr. P. 3022 "are not appropriate to

(2) Under section 1328(b), both before and after BAPCPA, the court may grant

the new post-BAPCPA world of chapter 11 plans funded by post-filing and post-confirmation earnings by individual debtors." Because the plan could be modified prior to the completion of payments and "[p]lan obligations [were] to be satisfied from property of the estate not yet in existence," the court was not persuaded that the case had been "'fully administered' within the meaning of . . . § 350(a)." Id. The court also felt that requiring the debtors to bear a share of the cost of the U.S. Trustee system was not unreasonable, particularly because, "[i]f it proves more than the Belchers can reasonably pay, they may . . . seek a modification of the terms of the confirmed plan." Id.

Similarly, the court in In re Haines, 2012 WL 1790219, denied the debtor's motion for a final decree. Like the court in Belcher, it questioned the post-BAPCPA vitality of the 1991 Advisory Committee Notes, and it considered payment of [U.S. Trustee] fees "a cost of bankruptcy." Id. at *2. Further, the court noted that payment of the fees in the case at hand would not significantly affect creditor recoveries because "Debtors are paying unsecured creditors one hundred percent." Id. Also, even if the Advisory Committee considerations applied, the court found that "the case has not yet sufficiently progressed to qualify as fully administered." Id. This was because a $300,000 lump sum payment to a secured creditor under the plan had not yet been made, and there remained nearly $166,000 owed to priority creditors. "These outstanding payments convince the court that entry of a final decree would be premature." Id.

The court in Shotkoski v. Fokkena (In re Shotkoski), 420 B.R. 479 (B.A.P. 8th Cir. 2009), affirmed the bankruptcy court's denial of the debtors' motion for final decree, which was filed on the date the order confirming their plan was entered. In doing so, the Bankruptcy Appellate Panel applied an abuse of discretion standard because the bankruptcy court's "experience and oversight of the case . . . likely [gave it] insights and know[lege] of practical considerations not conveyed by the appellate record." Id. at 482 (citation and inside quotation marks omitted). The court also noted, as did the court in Belcher, that the factors set forth in the Advisory Committee Note to Fed. R. Bankr. P. 3022 may not be applicable because the Note was drafted before BAPCPA deferred an individual chapter 11 debtor's discharge until completion of payments under the plan. On that basis, because "the bankruptcy court was aware of the specific terms of the debtor's confirmed Chapter 11 plan, which provided for the long-term repayment of several real estate and other loans totaling in excess of $1,700,000.00 and eight classes of impaired claims," the Bankruptcy Appellate Panel deferred to its determination not to grant a final decree. Id. at 483. However, the court also made it clear that it was

> not holding that every individual Chapter 11 case must remain open until such time as all long-term plan payments have been completed and a discharge is entered. In fact, since the Bankruptcy Code expressly contemplates the reopening of cases and the exercise of continuing jurisdiction by the bankruptcy court (see 11 U.S.C. § 350(b)), we do not disagree with those courts choosing, for purposes of convenience and efficiency, to close individual Chapter 11 cases prior to completion of payments and entry of discharge. Again, we believe it is a case-by-case analysis best left to the discretion of the bankruptcy judge.

Id. (emphasis in original).

The Office of the U.S. Trustee has taken the position that, despite BAPCPA's changes in chapter 11 as applied to individuals, including the deferred discharge and the potential for

a discharge under certain circumstances even though the chapter 13 debtor has not completed payments under the plan. However, section 1328(b)(1) contains a "hardship" requirement, namely, that the debtor's failure to complete the payments under the plan must be "due to circumstances for which the debtor should not justly be accountable." No such test is present in new section 1141(d)(5). While, under section 1328(c), the "hardship" discharge in chapter 13 is more limited than the discharge after all plan payments have been completed, there is no similar

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modification of plans after substantial consummation, it "will not normally object to an individual chapter 11 debtor's request to close the case before discharge once the estate has been fully administered," as described in the Advisory Committee Note to Fed. R. Bankr. P. 3022. Walter W. Theus, Jr., Individual Chapter 11s: Case Closing Reconsidered, 29-FEB Am. Bankr. Inst. J. 1, 63 (2010) ("Theus Article") (author was a trial attorney with the Executive Office for U.S. Trustees). That the U.S. Trustee confirmed this policy in its brief was "[o]f particular importance" to the court in Necaise in deciding to permit the debtor's case to close, subject to reopening for entry of the discharge or other appropriate business. 443 B.R. at 493.

In light of the Theus Article and Shotkowski, the court in In re Mendez, 464 B.R. 63 (Bankr. D. Mass. 2011), was "persuaded that an individual Chapter 11 case need not remain open during the entire post-confirmation period only because a discharge has not entered and plan payments have not been completed," even though the reason for closing the case was to avoid having to continue paying U.S. Trustee's fees. Id. at 65. In the Mendez case, "the debtor ha[d] substantially consummated his plan and there [were] no motions or adversary proceedings pending." Id. at 66.

However, the court in Mendez noted "a couple of complicating matters." Id. The first was that, under section 362(c)(2)(A), the closing of the case would terminate the automatic stay, even though the discharge injunction was not yet in place. Further, if the automatic stay terminated, this would end the tolling of unexpired nonbankruptcy statutes under section 108(c). Therefore, both debtors and creditors could be harmed if the case were closed without dealing with these issues. Further, the court noted that Fed. R. Bankr. P 4006 "instructs the clerk of the court to issue a notice of no discharge" upon the closing of a case without a discharge." Id. That would be "unsuitable, and indeed would be misleading, when the debtor anticipates a discharge upon completion of his plan payments." Id. Therefore, in conjunction with closing the case administratively, and invoking section 105(a), the court stated that it would "order[] that the automatic stay pursuant to Bankruptcy Code § 362 continue and instruct[] the clerk of courts not to issue notice under Fed. R. Bankr. P. 4006." Id. The court also noted that "[t]he Jacksonville and Tampa Divisions of the United States Bankruptcy Court for the Middle District of Florida have implemented a series of approved forms which individual debtors may use to accomplish precisely [this] result." Id. at 66-67.

By contrast, the court in In re Kerley, 2011 WL 5330667 (Bankr. N.D. Ala. Nov. 4, 2011), rejected the approach of the Mendez court in significant measure because it viewed the provisions of sections 362(c)(2)(A) and 108(a) and Fed. R. Bankr. P. 4006 as indications that Congress did not intend chapter 11 cases for individual debtors to be closed prior to discharge. The court also cited Ball and Belcher in questioning the applicability of the 1991 Advisory Committee Note to Fed. R. Bankr. P. 3022 to chapter 11 cases for individuals after BAPCPA. In addition, the court in Kerley was concerned that the cost of reopening a closed case, involving a $1,000 fee pursuant to the Appendix to 28 U.S.C. § 1930, as well as attorneys' fees for filing a motion, would chill creditors' exercise of their rights to move for modification of a confirmed plan or dismissal on default.

limitation on an early discharge in chapter 11.[107]

(3) Like new section 1141(d)(5)(C), section 1328 (as amended by BAPCPA) includes a provision (subsection (h)) requiring the court to deny or defer discharge if section 522(q) does or may apply. In very general terms, section 522(q) imposes a cap of $125,000 on the debtor's homestead exemption (except to the extent reasonably necessary to support the debtor and dependents) if (a) the debtor has been convicted of a felony that demonstrates that the filing of the case was an abuse of title 11, or (b) the debtor owes a debt arising from (i) violation of Federal or State securities laws, regulations or orders, (ii) fraud, deceit or manipulation in a fiduciary capacity or in connection with the purchase or sale of a registered security, (iii) any civil remedy under RICO, or (iv) any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding five years.

(4) New section 1127(e) and (f),[108] regarding modification of confirmed plans,

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107 In In re Belcher, 410 B.R. at 217, the court refused to grant an early discharge under new section 1141(d)(5)(B) because, even though the debtors had distributed under the plan more than creditors would have received in a chapter 7 liquidation, the debtors had not satisfied the requirement that modification of the plan is not practicable. In Belcher, no plan modification was requested or warranted at the time of the debtors' motion for early discharge. However, modification might be necessary in the future. "Accordingly, the Court conclude[d] that in an individual chapter 11 case plan under which payments from future income are to be made to creditors whose debts will be partially paid, . . . it is not possible in the absence of some particular factual situation being presented to determine that modification of such a plan . . . could not be 'practicable' within the meaning of § 1141(d)(5)(B)(ii)." Id. Similarly, in In re Necaise, 2010 WL 3294692, at *8, the court refused to grant the debtor an early discharge under new section 1141(d)(5)(B) in part because the debtor had not shown that modification at some point would be impracticable, citing the debtor's brief in which he admitted that he couldn't "'think of a case where modification of the plan under § 1127 is not practicable,' and that a modification of [his] Plan may be necessary to clarify the amount of administrative expenses paid from the Debtor's share of sales proceeds." Id. at *8, n.13. In addition, the court in Necaise rejected the debtor's argument that the liquidation test of new section 1141(d)(5)(B)(i) had been satisfied because "no distributions of property would have been made if his estate had been liquidated under chapter 7" on the effective date of the plan as, "after liquidation, a chapter 7 trustee must object to claims, file tax returns, submit a final report, and obtain approval of that final report, all of which may take 18 months to two years to accomplish." Id. at *8. The court pointed out that the test of section 1141(d)(5)(B)(ii) is hypothetical, based on the value that would ultimately be distributed if there were a chapter 7 liquidation. Because the debtor provided no evidence regarding that value, he failed the hypothetical liquidation test.

108 Before the Technical Amendments Act, new section 1127(f)(1) by its terms applied not to modification of a confirmed plan under new section 1127(e), but to modification before confirmation under section 1127(a). This created serious inconsistencies within section 1127 and, thus, appeared to be a "typo." It was corrected in the Technical Amendments Act. Nevertheless, at least two reported cases applied subsection (f) to pre-confirmation modifications. See In re Sentinel Management Group, Inc., 398 B.R. 281, 300 (Bankr. N.D. Ill. 2008); In re Save Our Springs (S.O.S.) Alliance, Inc., 388 B.R. 202, 225 (Bankr. W.D. Tex. 2008), aff'd on other grounds, 632 F.3d

is modeled after section 1329(a)(1)-(3) and (b). BAPCPA added an additional paragraph (4) to section 1329(a), however, which permits an amendment to "reduce amounts to be paid under the plan by the actual amount expended by the debtor to purchase health insurance" under certain circumstances. That provision was not included in new section 1127(e).[109]

New subsection (f)(1) of section 1127 sets forth the tests the court is to apply to a proposed post-confirmation modification of an individual chapter 11 debtor's plan, i.e., it must comply with sections 1121[110] through 1129, and there must be such disclosure under section 1125 as the court may direct,[111] notice and a hearing, and court approval. Similarly, section 1329(b)(1) delineates the provisions of chapter 13 that apply to modifications of confirmed chapter 13 plans. Neither section 1127(e) or (f) nor section 1329 imposes any requirement like "good cause." However, through reference to section 1129 and 1325(a), they appear to impose a "good faith" requirement on plan modifications.

The author is not aware of any reported cases dealing with post-substantial consummation modification of chapter 11 plans for individuals. However, there are a myriad of cases dealing with modification of chapter 13 plans, which Professor David Carlson refers to as being in "chaotic disarray." See David Gray Carlson, Modified Plans of Reorganization and the Basic Chapter 13 Bargain, 83 Am. Bankr. L.J. 585 (2009). One issue of note is whether res judicata should apply, given that, under section 1327(a) "[t]he provisions of a confirmed plan bind the debtor and each creditor . . . ."[112] Collier states that "[b]ecause chapter 13 is completely voluntary, the debtor may propose any modified plan that satisfies the requirements of chapter 13. Res judicata does not bar such modifications by the debtor . . . ." 8 Collier ¶ 1329.02 (footnote omitted). However, there is a split in the circuits as to the circumstances under which the trustee, the U.S. Trustee or an unsecured creditor can obtain a modification of a confirmed chapter 13 plan. Collier argues that:

> The right of the trustee or the holder of an unsecured

168 (5th Cir. 2011).

109 It is possible that new paragraph (4) of section 1329(a) was intended to apply to modifications of pre-existing chapter 13 plans. However, it does not appear that there is any special effective date for this paragraph which, therefore, applies only to cases filed on or after October 17, 2005.

110 New subsection (f)(1) incorporates section 1121, which deals with who may file a chapter 11 plan. This may create a conflict. New section 1127(e) permits modification at the request of the debtor, the trustee, the United States Trustee, or the holder of an allowed unsecured claim. By contrast, under section 1121, the United States Trustee cannot file a plan and, if exclusivity has expired or terminated, any party in interest may file a plan.

111 To the extent that new subsection (f)(2) is intended to impose disclosure requirements different from section 1125, there would appear to be a conflict between paragraphs (1) and (2) of subsection (f).

112 Section 1141(a) similarly provides that "the provisions of a confirmed plan bind the debtor . . . and any creditor . . . ."

> claim should be limited to situations in which there has been an unanticipated substantial change in the debtor's income or expenses that was not anticipated at the time of the confirmation hearing. As to other matters, the confirmation order should be considered res judicata insofar as the matters do not relate to a change in the debtor's ability to pay, subject only to the limited right to revocation of the order of confirmation and, of course, the debtor's right to voluntarily request modification.

Id. at ¶ 1329.03 (emphasis added; footnotes omitted). Essentially, this is the approach taken by the Fourth Circuit in Arnold v. Weast (In re Arnold), 869 F.2d 240 (4th Cir. 1989).[113] The other three circuit courts that have opined on the issue disagree with Collier and Arnold. See Barbosa v. Solomon, 235 F.3d 31 (1st Cir. 2000);[114] In re Witkowski, 16 F.3d 739 (7th Cir. 1994);[115] Meza

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113 In Arnold, the chapter 13 plan provided that the debtor, a salesman on commission, would pay $800 per month for 36 months, which would pay approximately 20% to unsecured creditors. At the time of confirmation in 1985, the debtor's income was approximately $80,000 per year. By 1987, the debtor's income was nearly $200,000 per year. An unsecured creditor moved to modify the plan, and the bankruptcy court increased the debtor's monthly payment to $1,500 and extended the payment period to 60 months. The Fourth Circuit affirmed because there had been a substantial change in the debtor's financial condition that could not have been reasonably anticipated at the time of confirmation. See 869 F.2d at 243.

The Fourth Circuit endorsed the Arnold approach to post-confirmation modifications in Murphy v. O'Donnell (In re Murphy), 474 F.3d 143 (4th Cir. 2007).

114 In Barbosa, real property that had been valued under the plan at $64,000 (by stipulation between the chapter 13 debtor and the secured creditor) was sold not long after confirmation, as provided in the plan, for $137,500. The chapter 13 trustee sought to modify the plan to require that the "excess proceeds" of approximately $51,000 be paid to unsecured creditors. This would result in the payment of approximately 100% of their claims, compared to the 10% provided in the plan. The bankruptcy court approved the modification, in part because "'there is something unsavory about Chapter 13 Debtors "stripping down" a mortgage . . . and receiving the "super" discharge . . . while walking away with substantial cash proceeds due to the appreciation in value of their Property, without amending their plan to satisfy the claims of their unsecured creditors.'" Barbosa, 235 F.3d at 34 (quoting the opinion of the bankruptcy court, In re Barbosa, 236 B.R. 540, 551-52 (Bankr. D. Mass. 1999)). The district court and First Circuit affirmed.

Professor Carlson (83 Am. Bankr. L.J. at 597) points out that the First Circuit in Barbosa equivocated when it approved that portion of the bankruptcy court's opinion where it concluded that "'motions to modify cannot be used to circumvent the appeals process for those creditors who have failed to object to confirmation of a Chapter 13 plan or whose objections to confirmation have been overruled,'" and that, while res judicata is not required, "'as a practical matter, parties requesting modification of Chapter 13 plans must advance a legitimate reason for doing so . . . .'" 235 F.3d at 41 (quoting In re Barbosa, 236 B.R. at 547-48).

115 In Witkowski, the chapter 13 plan provided that the debtor would pay $600 per month until all unsecured creditors were paid 10% of their allowed claims. When, after confirmation, a number of unsecured creditors failed to file proofs of claim, the trustee moved to modify the plan to increase to 19% the percentage payments to the unsecured creditors that had

v. Truman (In re Meza), 467 F.3d 874, 877-78 (5th Cir. 2006) (follows Barbosa and Witkowski without analysis).[116] Both the Barbosa and Witkowski courts noted that the "plain meaning" of section 1329(a)(1)-(3) imposes no threshold test for amendments, and decided that res judicata is largely irrelevant because the Code specifically provides for post-confirmation amendment. The courts also noted that section 1329 provides some criteria for granting a modification:

> First, "modifications are only allowed in [the] three limited circumstances" provided by the statute. . . . Second, as provided by § 1329(b)(1) of the Code, "a modified plan is available only if §§ 1322(a), 1322(b), 1325(a) and 1329(c) of the bankruptcy code are met." . . . Third, a modification may only be proposed in good faith. . . . Fourth, "all proposed modifications need not be approved and in practice not all modifications are approved."

Barbosa, 235 F.3d at 39-40 (citing Witkowski, 16 F.3d at 745-46). As the court in Barbosa discussed, lower court cases are in disarray on the tests or principles to be applied to post-confirmation modifications sought by non-debtors under section 1329. See 235 F.3d at 38-39.

Thus, it is not clear what standards will apply to post-confirmation modifications of chapter 11 plans.[117]

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filed claims. The bankruptcy court granted the modification, and the district court and Seventh Circuit affirmed.

116 For a circuit-by-circuit description of approaches to non-debtor, post-confirmation modification of chapter 13 plans, see William Andrew McNeal, Modification of a Confirmed Chapter 13 Plan: What Does It Take in Each Circuit?, 27-SEP Am. Bankr. Inst. J. 10 (Sept. 2008). For a critique of current case law and an effort to develop coherent principles for modification, see David Gray Carlson, Modified Plans of Reorganization and the Basic Chapter 13 Bargain, supra at 585, 588 (The "organon" of his thesis is "the basic chapter 13 bargain," which Professor Carlson describes as follows: "In chapter 13, the debtor is offered a bargain. If a plan is confirmed, property of the estate is vested (i.e., sold) back to the debtor. In exchange, the debtor must pay postpetition disposable income in sufficient quantity to guarantee every unsecured creditor at least what she would have received in a chapter 7.").

117 Does the prospect of post-confirmation modification to increase or extend (or both) payments due under a plan incentivize a debtor not to strive for financial success? Does it adversely affect his or her ability to obtain post-confirmation credit? Does that matter?

The issue of post-confirmation modification was discussed in In re Lively, a chapter 11 case for an individual debtor in which the court adopted the narrow interpretation of the new exception to the absolute priority rule of section 1129(b)(2)(B)(ii). The court, in discussing why the narrow approach does not render the new exception trivial, said that "debtors still have the ability to retain property earned during the first five years of the plan by either economizing or increasing their earned income." 467 B.R. at 892. The examples the court gave were (i) of married debtors who, post-confirmation, sold their cars and purchased cars with lower monthly payments, thus reducing their expenses, and (ii) of married debtors who, post-confirmation, received a raise or worked more hours per week, thus increasing their income. The court noted that, under either circumstance, a creditor could attempt to modify the plan under new section 1127(e). However, the court said, without citing any authority, that

PARTING THOUGHTS

BAPCPA reflects the intention of Congress to make it more difficult for debtors with above-median "current monthly income" to utilize chapter 7. As the Hon. Eugene Wedoff, United States Bankruptcy Judge for the Northern District of Illinois and Member of the Advisory Committee of Bankruptcy Rules of the Judicial Conference of the United States, explains the "means test" in chapter 7:

> (1) if the debtor has at least $166.67 in monthly disposable income (that is, in the language of the statute, if the debtor's monthly disposable income, multiplied by 60, is not less than $10,000), abuse is presumed regardless of the amount of the debtor's non-priority unsecured debt, and
>
> (2) if the debtor has at least $100 of monthly disposable income ($6000 over the 60 months of a hypothetical Chapter 13 plan), abuse is presumed if the income is sufficient to pay at least 25 percent of the debtor's non-priority unsecured debt.

Eugene R. Wedoff, Means Testing in the New § 707(b), 79 Am. Bankr. L.J. 231, 242 (2005).

Just as clearly, BAPCPA reflects the intention of Congress to import provisions from chapter 13 into chapter 11 so that the alternatives for those who would otherwise "abuse" chapter 7 have some significant similarities. There are, however, still some important statutory differences between chapter 13 and chapter 11 cases for individuals, including the following:[118]

(1) The chapter 11 disposable income test in new section 1129(a)(15) probably does not incorporate the specific expense limitations set forth in section 1325(b)(3) and derived from section 707(b)(2)(A)(ii).

(2) In chapter 11, under new section 1129(a)(15), "the value of property to be distributed under the plan" must be at least equal to the debtor's projected disposable income. In chapter 13, under section 1325(b)(1), the debtor's projected disposable income is to be "applied to make payments to unsecured creditors under the plan."

(3) The early discharge in chapter 11 (new section 1141(d)(5)(B)) does not

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> a court would not necessarily approve the modification. Regarding the trade-in, a modification would have the perverse result of punishing debtors for economizing. As to the example of a debtor deciding to work more hours, a debtor might return to the regular normal number of hours if the only result of the greater effort is an increased payout to creditors.

Id. at n.10. The dissent in In re Friedman, 466 B.R,. at 490, which also espoused the "narrow" view, adopted the analysis of the Lively court, also without citing any additional authority.

118 I am indebted and grateful to the Hon. Bruce A. Markell, United States Bankruptcy Judge for the District of Nevada, for this list of differences. See Bruce A. Markell, The Sub Rosa Subchapter: Individual Debtors in Chapter 11 After BAPCPA, 2007 U. Ill. L. Rev. 67, 79-81.

include the "hardship" requirement of section 1328(b)(1). Only in chapter 11 can discharge be granted "for cause" at confirmation (under new section 1141(d)(5)(A)).

(4) While both section 1325(b) and new section 1129(a)(15) provide a period with respect to which projected disposable income is to be calculated, and both section 1328(a) and new section 1141(d)(5)(A) provide for discharge on completion of payments under the plan, chapter 11 does not contain provisions like sections 1325(b)(5) and 1329(c) that accommodate long-term obligations, such as home mortgage debt. This creates uncertainly as to how long the computation period for projected disposable income is and when discharge can be granted in chapter 11 cases for individuals.

(5) There is a co-debtor stay in chapter 13 (section 1301), but there is no such stay in chapter 11. Chapter 13 also includes a specific provision permitting separate classification of consumer debts on which the debtor and another individual are liable (section 1322(b)(1)), which has no chapter 11 counterpart.

(6) The collateral valuation standard set forth in section 506(a)(2) for determining the allowed amount of certain secured claims applies in chapter 13, but not chapter 11. Section 506(a)(2) requires use of "replacement value" with respect to personal property, and specifies that, with respect to "property acquired for personal, family, or household purposes," replacement value means what a retail merchant would charge for it.

(7) The "hanging paragraph" at the end of section 1325(a), as amended by BAPCPA, contains a limitation on cramdown of certain purchase money security interests. Chapter 11 contains no similar provision.

(8) Chapter 11 has more expensive filing fees.

(9) Under section 1325(b)(4), a chapter 13 plan that does not pay allowed unsecured claims in full can be less than five years in duration. By contrast, under section 1129(a)(15), if an unsecured creditor objects, the individual chapter 11 debtor is required to devote value to the plan equal to at least five years' – and maybe more – projected disposable income.

(10) The small business provisions of chapter 11 do not apply in chapter 13. See section 101(51C) ("The term 'small business case' means a case filed under chapter 11 of this title in which the debtor is a small business debtor.").

(11) While not as broad as it was prior to BAPCPA, chapter 13 still contains a mini-"super-discharge" in section 1328.

(12) Under section 1328(g)(1), a chapter 13 debtor will in most cases have to complete an instructional course concerning personal financial management before he/she can get a discharge. Chapter 11 contains no similar requirement.

(13) Section 348(f), which deals with effect of conversion of a case from chapter 13 to another chapter and, among other things, limits property of the estate in the converted case, by its terms does not apply to conversion of a case from chapter 11 to another chapter. This is

true even though property of the estate is defined almost identically for purposes of chapters 11 and 13. See sections 541, 1115 and 1306; Pergament v. Pagano (In re Tolkin), 2011 WL 1302191, at *10 (Bankr. E.D.N.Y. Apr. 5, 2011), aff'd, 2012 WL 1828854 (E.D.N.Y. May 16, 2012); In re Quillen, 408 B.R. 601, 619 n.33 (Bankr. D. Md. 2009), aff'd, 2010 WL 1416122 (D. Md. April 5, 2010). However, in In re Evans, 464 B.R. 429, 438-41 (Bankr. D. Colo. 2011), the court nevertheless applied the rule of section 348(f) – which excludes a debtor's postpetition earnings from property of a chapter 7 estate, upon conversion from chapter 13 – to a case converted from chapter 11 to chapter 7.

(14) Creditors whose claims are classified and impaired must be solicited and have the opportunity to vote on a chapter 11 plan. See sections 1125, 1126. There is no creditor voting in chapter 13.

(15) An official creditors' committee may be appointed in chapter 11. See section 1102(a). There are no committees in chapter 13.

(16) There is no absolute priority rule in chapter 13. The absolute priority rule may still apply in chapter 11, depending on the interpretation of the exception added by BAPCPA to section 1129(b)(2)(B)(ii).

(17) Chapter 11 debtors must pay U.S. Trustee's fees of a minimum of $325 per quarter. See 28 U.S.C. § 1930(a)(6). Chapter 13 debtors do not.