

Individual Chapter 11s: They're Not Big 13s

Mary Joanne Dowd, Moderator

Arent Fox LLP; Washington, D.C.

Hon. Nancy Hershey Lord

U.S. Bankruptcy Court (E.D.N.Y.)

Hon. Robert G. Mayer

U.S. Bankruptcy Court (E.D. Va.)

Hon. Frank J. Santoro

U.S. Bankruptcy Court (E.D. Va.)

Douglas M. Foley, Facilitator

McGuireWoods LLP; Washington, D.C.



AMERICAN
BANKRUPTCY
INSTITUTE

DISCOVER



search
search.abi.org

Online Tool Researches ALL ABI Resources



***Online Research for \$275*
per Year, NOT per Minute!***




With ABI's Search:

- **One search gives you access to content across ALL ABI online resources -- *Journal*, educational materials, circuit court opinions, *Law Review* and more**
- **Search more than 2 million keywords across more than 100,000 documents**
- **FREE for all ABI members**

One Search and You're Done!
search.abi.org

*Cost of ABI membership

66 Canal Center Plaza • Suite 600 • Alexandria, VA 22314-1583 • phone: 703.739.0800 • abi.org

Join our networks to expand yours:   

© 2013 American Bankruptcy Institute All Rights Reserved.

**RECENT DEVELOPMENTS IN
INDIVIDUAL CHAPTER 11 DEBTORS' CASES**

BY

**MARY JOANNE DOWD
ANDREW M. MURAD
ARENT FOX LLP
WASHINGTON, DC**

AND

**DOUGLAS M. FOLEY
J. ROBERTSON CLARKE
MCGUIRE WOODS LLP
WASHINGTON, DC**

I. Treatment of Absolute Priority Rule and New Value Exception for Individual Chapter 11 Debtors¹

A. Definition and Statutory Basis of the Absolute Priority Rule

The absolute priority rule is codified at 11 U.S.C. § 1129(b)(2)(B)(ii), and permits a chapter 11 debtor to impair a class of objecting unsecured creditors in a chapter 11 plan and bypass § 1129(a)(8) of the plan confirmation standards. The Bankruptcy Code specifically achieves this by requiring that any such plan “not discriminate unfairly” and be “fair and equitable.” The phrase “fair and equitable” – the bedrock principle of the absolute priority rule – is then defined in § 1129(b)(2)(B)(ii), which mandates that either the claim of a class of impaired objecting creditors be paid in full or:

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.

The absolute priority rule does not require that senior creditors actually be paid prior to junior creditors nor does it prohibit a junior creditor from receiving payments for debt arising post-petition. Practically speaking it is an ordering rule for a chapter 11 debtor in allocating distributions from the corpus of the bankruptcy estate. But looking closer to the rule as defined, the rule is both a protection of a senior creditor’s claim and a limit on that creditor’s recovery. The basic concept is that no junior class of creditors, including the equityholders of the debtor, will receive any part of the bankruptcy estate on account of their claims if a senior creditor class is not receiving the full value of their claims. The chapter 11 debtor, on the other hand, must only distribute the value of the bankruptcy estate, and the senior creditor class which is receiving the final distributions from the estate will have to tolerate less than full payment of their claims.

¹ Part I of this article is authored by Douglas M. Foley and J. Robertson Clarke of McGuire Woods LLP.

AMERICAN BANKRUPTCY INSTITUTE

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

In this way, the absolutely priority rule serves both the impaired creditor (by maintaining the priority scheme established under otherwise applicable state law) and the chapter 11 debtor (by permitting it to pay less than the full amount of creditors' claims).

B. **Absolute Priority Rule After BAPCPA – Can an Individual Chapter 11 Debtor Still Argue that It Does Not Apply?**

The U.S. Supreme Court applied the absolute priority rule to an individual chapter 11 case in 1988, confirming that the long-held rule applied to the same extent with individual cases as it does with business cases. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (U.S. 1988). In 2005 Congress amended § 1129(b)(2)(B)(ii) by adding the following italicized language specifically for individual chapter 11 cases:

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, *except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.*

The interplay between 11 U.S.C. § 1115 and § 1129 has generated significant discussion and debate as to whether the absolute priority rule was abrogated by the changes enacted by BAPCPA. This is due to the wording of § 1129(b)(2)(B)(ii), which states that the individual chapter 11 debtor “may retain property included in the estate under section 1115,” as it relates to the wording of § 1115(a), which was also enacted as part of BAPCPA and simply provides a definition of property of the bankruptcy estate in an individual chapter 11 case:

(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.

VIEWS FROM THE BENCH, 2013

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

Thus an individual chapter 11 debtor can retain all property included in the bankruptcy estate under § 1115, which arguably is comprised of not only certain post-petition assets but also the entirety of the standard bankruptcy estate under 11 U.S.C. § 541. This approach is known as the “broad view” of the new language of § 1129(b)(2)(B)(ii), and has been followed by a minority of bankruptcy courts and the Ninth Circuit B.A.P. *See, e.g., Friedman v. P+P, LLC (In re Friedman)*, 466 B.R. 471, 482 (B.A.P. 9th Cir. 2012) (“A plain reading of §§ 1129(b)(2)(B)(ii) and 1115 together mandates that the absolute priority rule is not applicable in individual chapter 11 debtor cases.”).

In contrast, three Courts of Appeals – the Fourth, Fifth, and Tenth Circuits – have applied the “narrow view” of this issue and held that the absolute priority rule remains effective in individual chapter 11 cases. This growing acceptance from appellate courts of the “narrow view” of the interplay between § 1129(b)(2)(B)(ii) and § 1115(a), raises the question of whether the “broad view” remains a tenable argument in those jurisdictions where no appellate guidance has yet been given.

The first Court of Appeals to address this issue was the Fourth Circuit in *Maharaj v. Stubbs & Perdue, P.A. (In re Maharaj)*, 681 F.3d 558 (4th Cir. 2012). The Fourth Circuit first found that the relevant language in both § 1129 (“included in the estate”) and § 1115 (“in addition to the property specified in § 541”) was ambiguous and therefore required resort to an analysis of the larger statutory context of the absolute priority rule and the legislative history of the 2005 amendments. Primary amongst the Fourth Circuit’s considerations were the presumption against implied appeals, especially in the context of bankruptcy law, and the lack of any legislative history indicating Congressional intent to abrogate the absolute priority rule. *Id.* at 570-72 (“Furthermore, there is nothing in the BAPCPA’s legislative history that suggests that

AMERICAN BANKRUPTCY INSTITUTE

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

Congress intended to repeal the absolute priority rule. To say the least, that would be an odd occurrence for such a significant change.”).

The next Circuit Court to address this question was the Tenth Circuit in *Dill Oil Co. v. Stephens (In re Stephens)*, 704 F.3d 1279 (10th Cir. 2013). The Tenth Circuit followed the Fourth Circuit in finding that the language of the statutes was ambiguous and thus examined the provisions more closely. *Id.* at 1284-85. The *Stephens* Court then determined that Congress’s intent in enacting the 2005 changes to § 1129(b)(2)(B)(ii) were also ambiguous. Given that both the “the statutory language and legislative history lack any clear indication that Congress intended to erode a pillar of creditor bankruptcy protection,” the Tenth Circuit preserved the absolute priority rule for individual chapter cases. *Id.* at 1287.

Finally, in the shortest of these three appellate decisions, the Fifth Circuit recently issued its ruling on this question in *In re Lively*, 717 F.3d 406 (5th Cir. 2013). The Fifth Circuit determined that “[a] plain reading of § 1129(b)(2)(B)(ii) in light of § 1115(a) is that both provisions were adopted when BAPCPA was passed in order to coordinate individual debtor reorganization cases to some extent with Chapter 13 cases, whose debt limit may throw [certain Chapter 13 debtors] into a Chapter 11 reorganization.” *Id.* The Fifth Circuit, however, then agreed that to the extent there was ambiguity in the statutes, the implicit repeal was unacceptable, adding that “[t]he absolute priority rule, in particular, has been a cornerstone of equitable distribution for Chapter 11 creditors for over a century.” *Id.*

This developing consensus among the Courts of Appeals is narrowing the opportunity for individual chapter 11 debtors in other jurisdictions to attempt a cramdown plan in which he or she retains property of the estate outright. This may be especially true now that a case has been certified for direct appeal on this question in the Ninth Circuit, providing that Court of Appeals

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

with the opportunity to overrule the *Friedman* decision cited above. See *In re Arnold*, 471 B.R. 578 (Bankr. C.D. Cal. 2012). Increasingly it appears that, notwithstanding the vague language of § 1115 and § 1129, the absolute priority rule is here to stay with individual chapter 11 plans.

C. Exempt Property and the Absolute Priority Rule

A unique question in individual chapter 11 cases is whether the retention of exempt property by the debtor constitutes a violation of the absolute priority rule. Bankruptcy courts have issued conflicting opinions on the subject due to the lack of statutory guidance, two of which will be analyzed here.

The U.S. Bankruptcy Court for the Eastern District of Pennsylvania decided in *In re Egan*, 142 B.R. 730 (Bankr. E.D. Pa. 1992), that a chapter 11 debtor's retention of exempt property does not violate the absolute priority rule. The debtors in *Egan* initially filed a chapter 13 case but were forced to convert to a chapter 11 case because their debt exceeded the statutory limits for chapter 13. The debtors were able to resolve their secured creditors' claims but did not plan on providing for any payments to their unsecured creditors. Most of the unsecured creditors voted against the proposed plan but failed to file objections. The debtors intended to keep certain real property and a vehicle, among other things. The Bankruptcy Court determined that the debtors had properly claimed exemptions for all of the property that they were retaining and no objections had been timely filed to those exemptions. The Bankruptcy Court ultimately concluded that the debtors' retention of the exempt property was permissible under the absolute priority rule. The Bankruptcy Court stated that "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, 11 U.S.C. § 1129(b)(2)(B), including the class of unsecured creditors." *Id.* at 733. Importantly, the Bankruptcy Code in *Egan* distinguished between the

RPP/611138.1

AMERICAN BANKRUPTCY INSTITUTE

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

debtors' receipt of property through exemption and their receipt of the same property as equity holders through a provision in a chapter 11 plan.

In contrast, the U.S. Bankruptcy Court of *In re Gosman*, 282 B.R. 45 (Bankr. S.D. Fla. 2002), held that the debtor's retention of "several items of valuable exempt property" violated the absolute priority rule and therefore denied confirmation of the plan. The Debtor exempted and sought to keep a mansion, artwork, and a partial ownership interest in a corporation owning valuable real estate. Although the debtor planned to make limited payments to the unsecured creditors, the Bankruptcy Court ultimately denied approval of the disclosure statement as the underlying plan was not feasible because it violated the absolute priority rule. In contrast to the *Egan* court, the *Gosman* court found that "[t]here can be no question that the Debtor in this case is a 'holder of an interest that is junior' to the claims of unsecured creditors . . . [because] Debtor owns an interest in the Exempt Property." *Id.* at 48. The Bankruptcy Court focused on the relevant statutory language of § 1129(b)(2)(B)(ii), which include "any property," and took an expansive view of the term in this context. It reasoned that the debtor's retention of the property, whether through exemption or a chapter 11 plan process, would still result in the debtor's receipt of property notwithstanding the fact that he would be the holder of a junior interest. The Bankruptcy Court asserted that the use of the phrase "any property" was an intentional effort to distinguish § 1129 from the standard definition of property of the estate.

The U.S. Bankruptcy Court for the Eastern District of Virginia briefly examined this issue of exempt property in the initial *Maharaj* decision, 449 B.R. 484, 493 n.4 (Bankr. E.D. Va. 2011). Citing both *Egan* and *Gosman*, the Bankruptcy Court indicated that the *Egan* court likely decided the issue correctly (though because the debtors in *Maharaj* were retaining property beyond the value of their exemptions, the determination was unnecessary to the court's final

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

ruling). The Bankruptcy Court considered 11 U.S.C. § 1123(c) – which was also added by BAPCPA in 2005 – and opined that permitting an individual chapter 11 debtor to retain exempt property in a cramdown situation was more consistent with that subsection.

D. New Value Exception For Individual Chapter 11 Debtors

Assuming that the absolute priority rule remains in effect for individual chapter 11 debtors, various courts have then analyzed whether the “new value exception” continues to be available as an exception for equity to retain ownership of estate property in technical violation of the normal hierarchy of distribution. Although the new value exception is nowhere to be found in the Bankruptcy Code, it dates back to the U.S. Supreme Court’s decision in *Case v. Los Angeles Lumber*, 308 U.S. 106 (1939). The basic effect of the exception is to permit equity holders of the debtor to “retain an interest in a reorganized debtor over the objection of a class of creditors whose claims are not paid in full, in exchange for a fresh contribution of new capital.” *In re Eagan*, 2013 WL 237812 (Jan. 22, 2013 W.D.N.C.). For debtors or their equity holders to benefit from the new value exception they must “make a new contribution (1) in money or money's worth, (2) that is reasonably equivalent to the value of the new equity interests in the reorganized debtor, and (3) that is necessary for implementation of a feasible reorganization plan.” *In re Woodbrook Assocs.*, 19 F.3d 312 (7th Cir. 1994). Some courts also require that the new value be “substantial.” *See, e.g., In re Bonner Mall P’ship*, 2 F.3d 899, 908 (9th Cir. 1993).

The U.S. Supreme Court added another requirement to this list with its decision in *Bank of Am. Nat’l Trust & Sav. Ass’n v. 203 N. LaSalle St. P’ship*, 526 U.S. 434, 445 (U.S. 1999). In order to further assure the parity of the new value contributed by the equity holder or debtor with the value of the property retained, the Supreme Court required that the “market test” be satisfied by exposing the debtor’s equity interests to the market. Although the Supreme Court declined to explain precisely how such market exposure should work, it determined that the free market was

RPP/611138.1

AMERICAN BANKRUPTCY INSTITUTE

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

the best measure to protect the absolute priority rule as opposed to the equity holders or the bankruptcy court. *Id.* at 457 (“It would thus be necessary for old equity to demonstrate its payment of top dollar, but this it could not satisfactorily do when it would receive or retain its property under a plan giving it exclusive rights and in the absence of a competing plan of any sort. Under a plan granting an exclusive right, making no provision for competing bids or competing plans, any determination that the price was top dollar would necessarily be made by a judge in bankruptcy court, whereas the best way to determine value is exposure to a market.”).

In the context of an individual chapter 11 case, however, the new value exception is more difficult to apply due to the nature of the debtor. As the *Eagan* court noted, “without ‘equity’ such as shares or membership interests to offer an investor, however, an individual has far fewer options than a corporate debtor to raise new capital.” *Eagan*, 2013 WL 237812 at *7. The Bankruptcy Court in *Eagan* faced a situation where an individual debtor sought to retain certain estate property in exchange for contributions from family members. Stating that “[a] reasonable middle ground [for the new value exception] must therefore be found if individual Chapter 11 cases are to retain any practical utility,” the Bankruptcy Court compared the value the estate against the value of the distributions under the proposed plan, including the contributions, and found that because the latter was greater than the value of the estate, the new value exception applied and the debtor’s plan was approved. *Id.*

It remains unclear, however, what exactly this middle ground looks like and to what extent the regular standards of the new value exception standards apply to individual chapter 11 debtors. As the Bankruptcy Appellate Panel for the Ninth Circuit opined in *Computer Task Group, Inc. v. Brotby (In re Brotby)*, 303 B.R. 177, 196 (B.A.P. 9th Cir. 2003), “in the case of an individual Chapter 11 debtor who works for wages or a salary, a new value contribution in

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

excess of that necessary to fund payments under the plan serves no reorganization purpose absent some identifiable use, other than to arguably manipulate the new value analysis.” The *Brotby* court contrasted this with corporate chapter 11 debtors where “new value contribution will presumably always have some use, whether it be for operating capital, financing for capital improvements or purchases, or to establish and maintain cash reserves, for example.” *Id.* In addition, an individual chapter 11 debtor will encounter difficulty is obtaining market exposure for the property he or she intends to retain so as to properly contribute sufficient value back to the estate under the guidance of *203 N. Lasalle*. Thus despite the continuing applicability of the absolute priority rule in individual chapter 11 cases, the application of the rule will continue to be uncertain.

II. Post-BAPCPA Discharge and Post-confirmation Modification for Individual Chapter 11 Debtors²

A. Introduction

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) significantly changed the treatment of individuals filing for Chapter 11 protection. Among the most important changes are the delayed discharge, which no longer takes place upon confirmation of the plan, but rather occurs upon the completion of all payments unless the debtor demonstrates “cause”, *see* 11 U.S.C. § 1141(d)(5)(A), and the post-confirmation modification provision, which permits the modification of the debtor’s plan at any time before completion of payments under the plan, *see* 11 U.S.C. § 1127(e).

These changes have raised new questions regarding the treatment of individual Chapter 11 debtors, which include:

² Part II of this article is authored by Mary Joanne Dowd and Andrew M. Murad of Arent Fox LLP.

AMERICAN BANKRUPTCY INSTITUTE

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

- When and in what circumstances will a court grant an early discharge to an individual Chapter 11 debtor for “cause” pursuant to Section 1141(d)(5)(A);
- Whether an individual Chapter 11 debtor can avoid the accrual of U.S. Trustee’s quarterly fees by closing his or her case, prior to the completion of plan payments, subject to being reopened by the court to enter a discharge; and,
- When and in what circumstances will a court modify an individual Chapter 11 debtor’s plan under Section 1127(e)?

Although case law is still developing, trends have emerged with respect to these topics as explained below.

B. Granting an Early Discharge for “Cause”

1. Section 1141(d)(5)(A)

Prior to the passage of BAPCPA, individual Chapter 11 debtors were largely treated like corporate Chapter 11 debtors and generally received a discharge upon the confirmation of a non-liquidating plan. This is no longer true with respect to individual debtors since the passage of BAPCPA. Instead, Section 1141(d)(5)(A) now provides:

In a case in which the debtor is an individual—unless after notice and a hearing³ 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[.]

³ A procedural issue that often arises is whether an individual Chapter 11 debtor provided adequate notice prior to his or her request for an early discharge. *See, e.g., In re Sheridan*, 391 B.R. 287, 291 (Bankr. E.D.N.C. 2008) (finding sufficient notice to creditors where debtors requested relief in notice of confirmation hearing and stated in bold letters on first page of disclosure statement “that they intend to seek . . . [discharge upon confirmation of Plan on Effective Date]”); *In re Brown*, 2008 WL 4817505, No. 07-00148, at *2 (Bankr. D.D.C. Oct. 29, 2008) (ruling that debtor should file separate motion for early discharge and serve notice of the motion to creditors in same envelope as proposed plan and disclosure statement).

There are differing views regarding the timing of when an individual Chapter 11 debtor must request a discharge for cause. *Compare In re Necaize*, 443 B.R. 483, 492 (Bankr. S.D. Miss. 2010) (denying debtor’s motion for early discharge because debtor did not make request at the time of plan confirmation), *with In re Beyer*, 433 B.R. 884, 886 n.3 (Bankr. M.D. Fla. 2009) (confirmation order permitted debtor to request early discharge by separate motion).

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

11 U.S.C. § 1141(d)(5)(A).

Unless individual Chapter 11 debtors can show *cause*, he or she must now wait until the completion of the plan to obtain a discharge. Although Congress carved out an early discharge exception for “cause,” it did not define the term. Thus, as discussed below, bankruptcy courts have considered various criteria to determine whether an individual Chapter 11 debtor has shown “cause” to obtain an early discharge.

2. Factor-based Approach

Bankruptcy courts look to several factors to determine whether an individual Chapter 11 debtor has established “cause” for an early discharge under 11 U.S.C. §1141(d)(5)(A). In general, courts analyze “the likelihood that the debtors will make all of their plan payments and the assurance, in the form of collateral, that creditors will receive the amount they have been promised even if the plan payments are not made.” *In re Sheridan*, 391 B.R. 287, 291 (Bankr. E.D.N.C. 2008). In addition, the debtor usually must demonstrate “more than just substantial consummation” of the plan; rather, “[t]he debtor must convince the Court that he or she will and can make all future payments with a high degree of certainty.” *In re Beyer*, 433 B.R. 884, 888 (Bankr. M.D. Fla. 2009).

As discussed below, courts rarely find that individual Chapter 11 debtors have demonstrated sufficient “cause” to support an early discharge.

a. *In re Sheridan*, 391 B.R. 287 (Bankr. E.D.N.C. 2008).

In re Sheridan is one of the only published cases where a bankruptcy court held that individual Chapter 11 debtors were entitled to an early discharge for “cause.” Under the individuals confirmed Chapter 11 plan, general unsecured claims would receive \$20,000 plus interest over a five-year period. *Id.* at 289. Importantly, one of the debtors was an attorney with a stable income, and the debtors proposed payments to unsecured creditors were secured by a

RPP/611138.1

AMERICAN BANKRUPTCY INSTITUTE

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

second deed of trust on the debtors' home. *Id.* at 291.

Upon confirmation of the plan, the debtors' sought an early discharge for cause. The bankruptcy court ultimately found cause, holding that it was likely that the debtors would complete their payments under the plan, and that the creditors had sufficient assurance of payment even if the debtors defaulted under the plan. *Id.* The court explained that one of the debtor's income as an attorney was "sufficiently reliable that there is a strong probability that Class IX will be paid the \$20,000 plus interest called for in the plan." *Id.* In addition, the court found that there was "sufficient equity" in the debtors' home (approximately \$70,000 after accounting for the first lien), which could be used to satisfy the payments under the plan in the event of default. *Id.* Therefore, the court granted an early discharge upon the confirmation of the plan because of "[t]he combination of the likelihood of payment and the assurance that the unsecured creditors will receive what they have agreed to accept in satisfaction of their claims." *Id.*

- b. *Bankruptcy Courts Usually Deny Requests for Early Discharge for "Cause."*

As demonstrated in the cases below, bankruptcy courts rarely grant an early discharge to individual Chapter 11 debtors for "cause."

- (i) *In re Beyer, 433 B.R. 884 (Bankr. M.D. Fla. 2009).*

In *In re Beyer*, the debtor, who was in the business of purchasing real estate, proposed a five-year plan whereby he would surrender certain real estate assets to his secured creditors in full satisfaction of his secured claims. He also planned to pay his unsecured creditors in full.

After confirmation of the plan, the debtor requested an early discharge for cause, claiming that upon surrendering the real estate to his secured lenders, he *could* be subject to federal income tax for debt forgiveness. The debtor feared that if the surrendered real estates'

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

fair market value was less than the underlying mortgages, then the secured creditor could charge off the unsecured portion of the debt and issue a 1099C form making the debtor liable for income tax on the forgiven unsecured debt. *Id.* at 886–87. The debtor alleged that if he was liable for any potential income tax stemming from his forgiven debt, he would have less money to distribute to his unsecured creditors. *Id.* at 887.

The bankruptcy court denied the debtor's request for an early discharge because the debtor failed to show that he "will and can make all future payments with a high degree of certainty." *Id.* at 888. The court held that the debtor's desire to avoid an "unknown, potential federal tax liability" was not sufficient cause. *Id.* at 889. Moreover, because the debtor did not know which properties he intended to surrender, had not commenced payments to his unsecured creditors, and could not establish that he had the actual ability to make such payments, the debtor failed to justify his request for an early discharge. *Id.* at 888.

3. A Desire to Avoid U.S. Trustee's Quarterly Fees is Not Sufficient Cause

As further discussed in Part II.C., many courts have denied requests to close individual Chapter 11 debtors' cases before the completion of plan payments, thus requiring debtors to pay the United States Trustee's ("UST") quarterly fees for the life of the plan, which could be as long as five years. Some individual Chapter 11 debtors have argued that avoiding the payment of UST quarterly fees is sufficient cause to warrant an early discharge under Section 1141(d)(5)(A). Courts considering this issue usually hold that a bare desire to avoid these quarterly fees is not sufficient cause. Indeed, as noted by one court, if a desire to avoid quarterly fees was sufficient cause, then "the exception would swallow the general rule because such fees are of general application to individual chapter 11 debtors and any debtor presumably would prefer to avoid such fees rather than pay them." *In re Belcher*, 410 B.R. 206, 217 (Bankr. W.D. Va. 2009).

AMERICAN BANKRUPTCY INSTITUTE

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

In *In re Ball*, 2008 WL 2223865, No. 06-1002 (Bankr. N.D. W. Va. May 23, 2008) an individual Chapter 11 debtor, who planned to fund his plan through liquidation of his assets, moved to close his case and obtain an early discharge. At the time of the request, the debtor had one asset left to liquidate under the plan. To ensure payment to his remaining creditors, the debtor executed a promissory note and granted a security interest in the remaining asset. *Id. at* *1. The court held that the debtor was not entitled to a discharge because the “[p]ayment of Chapter 11 quarterly fees is simply the cost of doing business under Chapter 11.” *Id. at* *4. The court also noted that such a request for an early discharge was especially unwarranted in the current scenario because the liquidation plan “contemplates a relatively short life span.” *Id.*⁴

4. Conclusion

These cases suggest that individual Chapter 11 debtors face an uphill battle when requesting an early discharge for cause under Section 1141(d)(5)(A). When considering requests for an early discharge for cause, courts require something more than a bare desire to avoid UST fees. Instead, most courts apply a fact specific approach which looks to the likelihood that creditors will receive the payments promised through the life of the plan even if the individual debtor receives an early discharge.

⁴ *But see* 8 *Collier on Bankruptcy* ¶ 1141.05[2][a] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.) (suggesting that it would appropriate to grant an early discharge to “an individual debtor who did not expect to make plan payments primarily from future earnings . . . but rather contemplated a plan more consistent with the ordinary chapter 11 model, such as by distributions of property or, in the unusual case, by the issuance of securities by the debtor’s business, perhaps from a new corporation to be formed by the debtor under the plan.”)

The Court in *In re Ball* raised an interesting point as to whether the desire to avoid UST quarterly fees would be sufficient cause to permit an early discharge in a longer, five-year plan. *See In re Ball*, 2008 WL 2223865, at * 4 (“The court leaves for another day the issue of whether such an accommodation would be appropriate in an individual Chapter 11 case of more significant duration, such as a five-year plan required under § 1129(a)(15).”).

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

C. Closing Case to Prevent Accrual of U.S. Trustee's Fees Prior to Completion of Plan

1. Introduction

The delayed discharge amendment raises the question with respect to individual Chapter 11 debtors: can courts close a debtor's case prior to the completion of the plan, subject to reopening the case upon completion of payments to grant a discharge? Since individual Chapter 11 debtors will not receive a discharge until the completion of plan payments (unless they can show "cause"), many individuals seek to close their case prior to discharge to avoid paying quarterly fees to the UST throughout the life of the plan.

Pursuant to 28 U.S.C §1930(a)(6), Chapter 11 debtors are obligated to pay quarterly fees to the UST for each calendar quarter that the case remains open and is not converted, dismissed or closed. Under Section 350(a) of the Bankruptcy Code, the court must close the debtor's case "[a]fter an estate is *fully administered* and the court has discharged the trustee." 11 U.S.C. §350(a) (emphasis added). Because the Bankruptcy Code does not define the phrase "fully administered," courts often consider the 1991 Advisory Committee Notes to Bankruptcy Rule 3022, which lists the following six factors:

Factors that the court should consider in determining whether the estate has been fully administered include (1) whether the order confirming the plan has become final, (2) whether deposits required by the plan have been distributed, (3) whether the property proposed by the plan to be transferred has been transferred, (4) whether the debtor or the successor of the debtor under the plan has assumed the business or the management of the property dealt with by the plan, (5) whether payments under the plan have commenced, and (6) whether all motions, contested matters, and adversary proceedings have been finally resolved.

Fed. R. Bankr. P. 3022, Advisory Committee Note (1991). Importantly, the Advisory Committee Notes state that an "[e]ntry of a final decree closing a chapter 11 case should not be delayed solely because the payments required by the plan have not been completed." *Id.*

AMERICAN BANKRUPTCY INSTITUTE

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

In a 2010 article, the UST Program stated that it “will not object to an individual chapter 11 debtor’s request to close the case before discharge, subject to reopening for the entry of a discharge upon the completion of plan payments, if the estate has been fully administered and any trustee has been discharged.” Walter W. Theus, Jr., “Individual Chapter 11s: Case Closing Reconsidered,” 29 Am. Bankr. Inst. J., Feb. 2010, at 1. Because most individual Chapter 11 cases do not involve trustees, the issue usually hinges on whether the case has been “fully administered.” As the case law demonstrates, bankruptcy courts are afforded wide discretion in considering an individual Chapter 11 debtor’s request for an early closing; therefore, courts have reached varying results when considering whether the debtor’s case has been “fully administered.”⁵

2. Courts That Have Denied Debtors’ Requests for Early Closing

The following courts have denied individual Chapter 11 debtors’ requests to close their cases, subject to reopening for a discharge upon the completion of plan payments.

- a. *Shotkoski v. Fokkena (In re Shotkoski)*, 420 B.R. 479 (B.A.P. 8th Cir. 2009).

In *In re Shotkoski*, the bankruptcy court declined to close the individual Chapter 11 debtor’s case, ruling that the case would not be fully administered until the entry of the debtor’s discharge. *Id.* at 481. On appeal, the Eight Circuit Bankruptcy Appellate Panel reviewed the bankruptcy court’s holding for abuse of discretion. The B.A.P. acknowledged that bankruptcy

⁵ In the Eastern District of North Carolina, generally, Chapter 11 cases are closed after substantial consummation and reopened upon the completion of plan payments to enter a discharge. *See In re Sheridan*, 391 B.R. 287, 290 n.2 (Bankr. E.D.N.C. 2009) (“In most cases in the Eastern District of North Carolina, even though discharge will typically be entered when all payments are completed, the case will be closed upon substantial consummation under § 1101(2) when there has been a commencement of distribution under the plan. In the EDNC orders confirming plans for individuals provide that “upon the filing of a ‘Notice of Completion of Plan Payments and Request for Entry of Discharge’ accompanied by a certificate of service, the case will be automatically re-opened pursuant to § 350 without the payment of a fee.” The notice, which the debtor serves on all creditors and the bankruptcy administrator, provides that if there is no response within 20 days, a discharge order may be entered.”).

VIEWS FROM THE BENCH, 2013

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

courts must review debtors' requests to close the case "on a case-by-case basis" to "determine[] whether an estate has been fully administered." *Id.* at 482. The B.A.P. affirmed the bankruptcy court, giving deference to the lower court due to its "knowledge of the specific circumstances of the case. *Id.*

Importantly, the panel explicitly stated that its holding did not require all individual Chapter 11 cases to remain open until the completion of payments and the receipt of discharge. *Id.* Instead, because it is a case-by-case inquiry, the court acknowledged that in the proper circumstances, individual cases could be closed early. *Id.* ("[W]e 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.").

b. *In re Belcher*, 41 B.R. 206 (Bankr. W.D. Va. 2009).

In *In re Belcher*, discussed *supra*, the bankruptcy court also considered the debtor's request to close the case, subject to the debtor's right to reopen the case upon the completion of payments under the five-year plan. The court denied the debtor's request, holding that both the pre-BAPCPA practice of closing debtors' cases prior to the completion of plan payments and the Advisory Committee Notes to Bankruptcy Rule 3022 did not apply to individual Chapter 11 debtors in the "new post-BAPCPA world." *Id.* at 219.⁶ Because the debtor's plan was funded through "property of the estate not yet in existence" —*i.e.* post-petition earnings—the court held that full administration could not take place until the completion of all payments. *Id.* In addition, the court found that the debtor could always move to modify the plan if the payment of

⁶ In a recent case, the Bankruptcy Court for the Northern District of Alabama similarly held that closing, subject to reopening upon completion of the plan, is inconsistent with the post-BAPCPA framework for individual Chapter 11 debtors. *See In re Kerley*, 2011 WL 5330667, No. 09-43154-JJR11, at *2–*3 (Bankr. N.D. Ala. Nov. 4, 2011) ("While sympathetic with the Debtors regarding the expense of chapter 11 cases, it is up to Congress, and not this Court, to fashion the rules regarding what fees are due and when those fees may be waived").

AMERICAN BANKRUPTCY INSTITUTE

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

the UST's quarterly fees became too burdensome. *Id.*⁷

3. Courts That Have Allowed Administrative Closing Prior to Completion of Plan⁸

The following courts have allowed individual Chapter 11 debtors to administratively close their case, prior to the completion of plan payments, subject to their right to reopen the case to obtain a discharge.

a. *In re Johnson*, 402 B.R. 851 (Bankr. N.D. Ind. 2009).

Here, the individual Chapter 11 debtor funded his confirmed plan with post-petition earnings over a five-year period. The plan did not include a fixed amount of payments to his unsecured creditors; rather, payments were based on a formula that considered the debtor's income after subtracting his various expenses, including administration expenses such as UST quarterly fees. *Id.* at 853. At the time the debtor moved for an order closing the case, all issues concerning the debtor's plan had been resolved; the only remaining item was for the debtor to make the required payments under the plan. *Id.* at 854. The UST, who was the only party to object, argued that an early closure would make it difficult for creditors to monitor the debtor and to effectuate a conversion or dismissal if need be. *Id.*

The bankruptcy court acknowledged that determining whether a case is "fully administered" is a case-specific inquiry. The court found that the debtor satisfied all of the factors in the Advisory Committee Notes to Bankruptcy Rule 3022, and entered an order

⁷ Post-BAPCPA plan modification is discussed *infra* in Part II.D.

⁸ It is important to note the potential consequences of closing an individual Chapter 11 debtor's case prior to the completion of payments under the plan and the entry of a discharge. First, some, but not all, courts may find that the automatic stay terminates upon the closing of the debtor's case prior to the entry of a discharge. Compare *Santander Consumer, USA, Inc. v. Houlik (In re Houlik)*, 481 B.R. 661 (B.A.P. 10th Cir. 2012) (finding no violation of the automatic stay where secured party repossessed vehicle after closure of case but prior to entry of discharge), with *In re Mendez*, 464 B.R. 63 (D. Mass. 2011) (entering order to administratively close case and ordering continuation of automatic stay). Moreover, individual debtors should consider whether their jurisdiction will impose a reopening fee. See 28 U.S.C. § 1930(11) (\$1,167 reopening fee in Chapter 11 cases).

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

administratively closing the case despite the fact that the debtor still needed to complete his payments. *Id.* at 856.

The court noted that there were several concerns which counseled against the UST's position. The court stated that an individual Chapter 11 debtor's plan could have a "potentially unlimited duration," if, for example, the debtor's plan included payment of his or her mortgage debt. *Id.* at 855. In these situations, the court found it "difficult to believe that Congress" would "require their cases to remain open for the entire term of the mortgage." *Id.* In addition, the court justified its decision because any reduction in the UST's quarterly fees would "result in a corresponding increase in the payment to creditors." *Id.* at 857. Thus, the court felt that the equities were balanced in favor of the debtor's creditors as opposed to the UST. *Id.*

b. *In re Necaize, 443 B.R. 483 (Bankr. S.D. Miss. 2010).*

The *In re Necaize* Court also allowed the debtor to administratively close the case, subject to being reopened to enter a discharge upon completion of the plan payments. In reaching its decision, the bankruptcy court applied the factors in Advisory Committee Note to Bankruptcy Rule 3022. *Id.* at 493. The court stated that the only item remaining under the plan was the liquidation of debtor's three remaining assets, "for which court approval is not required"; therefore, the court granted the debtor's request to close the case. *Id.* By closing the case and avoiding the UST's quarterly fees, the debtor could potentially increase his payments to his creditors. *Id.* Moreover, the court acknowledged that the UST's policy of not objecting to individual debtor's requests for early closure upon full administration was "[o]f particular importance to the Court in reaching [its] decision." *Id.*

4. Conclusion

Generally, outside of jurisdictions where local practice adopts closing of the case and re-opening to obtain discharge, a court's decision to close an individual Chapter 11 debtor's case

AMERICAN BANKRUPTCY INSTITUTE

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

prior to completion of payments, subject to reopening the case to enter a discharge, depends on whether the case has been “fully administered” pursuant to 11 U.S.C. § 350(a). This is a case-by-case analysis whereby courts analyze the factors in the Advisory Committee Notes to Bankruptcy Rule 3302 and consider policy implications, including whether an order administratively closing the case is consistent with the post-BAPCPA amendments to the Bankruptcy Code.

D. **Post-confirmation Modification of Individual Chapter 11 Debtor’s Plan**

BAPCPA also changed the circumstances in which individual Chapter 11 debtors, trustees, the United States Trustee, and unsecured creditors may seek to modify an individual debtor’s plan. Section 1127(e) of the Bankruptcy Code states:

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 allowed 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.

11 U.S.C.A. § 1127(e) (emphasis). As this new provision makes clear, a modification to the individual debtor’s plan can occur at any time prior to the completion of the plan and such a modification can increase or reduce the amount of payments to creditors.

Courts have yet to develop standards to apply to modification requests under Section 1127(e). Case law has, however, acknowledged the use of 1127(e) as a modification tool in other contexts without deciding when, and in what circumstances, a creditor or debtor may modify the confirmed plan. *See, e.g., In re McMahan*, 481 B.R. 901, 920–22 (Bankr. S.D. Tex.

VIEWS FROM THE BENCH, 2013

RECENT DEVELOPMENTS IN INDIVIDUAL CHAPTER 11 DEBTORS' CASES

2012) (dismissing individual debtor's Chapter 13 filing where debtor, who defaulted under confirmed Chapter 11 plan, circumvented modification procedures of Section 1127(e) by filing a Chapter 13 bankruptcy rather than pursuing Chapter 11 modification); *In re Belcher*, 410 B.R. 206, 217 (Bankr. W.D. Va. 2009) (denying individual Chapter 11 debtor's request for discharge under Section 1141(d)(5)(B), in part, because "if one of the Debtors were to suffer some disabling injury or illness, or, on a more optimistic note, were to benefit from some great unexpected good turn of fortune prior to completion of Plan payments, some modification of the Plan, either adverse or favorable to the interests of the unsecured creditors, would appear to be not just possible, but quite likely").