

Consumer Bankruptcy

Surviving Individual Business Bankruptcies:
Considerations When Choosing Between
Chapter 13 and Chapter 11

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Surviving Individual Business Bankruptcies: Considerations between Chapter 13 and Chapter 11

- American Bankruptcy Institute
- 2014 Annual Spring Meeting
- Nina M. Parker, Esq. Moderator
- Leon S. Jones. Esq.
- Professor Bruce Markell
- Nancy Whaley, Chapter 13 Trustee

What is a business and who is an individual business debtor?

- Bills on monthly basis
- Incurs trade credit in production of income from employment

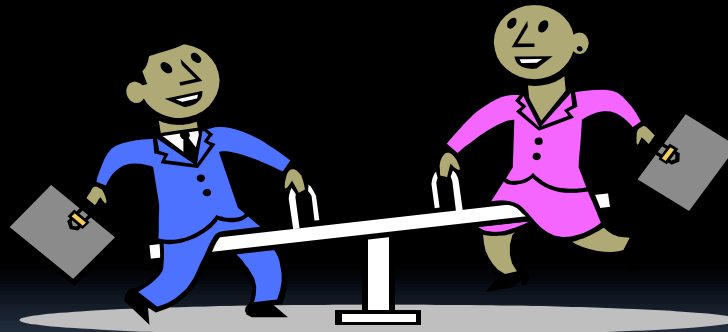
Guitar Teacher



Mom & Pop Store



Does Chapter selection determine success?



There are many considerations!

Things to think about

Debt Ceiling

Ch. 13

§ 109(e) Ch. 13- \$383,175 & \$1,149,525

Ch. 11

§ 101 (51D) Small Business 11-\$2,490,925

Property of the Estate

Ch. 13

§ 541 (a) and § 1306 (a)(2) post-petition earnings

Ch. 11

§ 541 (a) and § 1306 (a)(2) and § 1115
post-petition earnings



So many considerations

Chapter 13



Chapter 11

Chapter 13 Trustee by % age Plan	US Trustee Quarterly Fees by \$\$ expended
Periodic Operating Reports/P&L & DIP	Monthly Operating Reports & DIP
341 Meeting	IDC and 341 Meeting
No Creditors Committee	Creditors Committee
Confirmation Now	Confirmation Then....(Maybe?)
Valuation & Cramdown Now	Valuation & Cramdown - When?
Discharge 36/60 months	DischargeNow or then or when
Cost of the case	Cost of the case

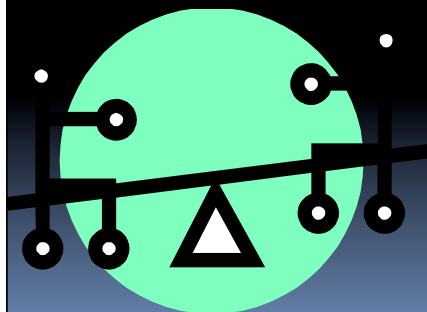
Getting employed and paid!

Chapter 13

- Fee Agreement
- "No Look Fee"/Fee Application
- 11 USC § 330(a)(4)(B) for benefit of Debtor
- Paid through Plan
- What about § 1306 ?

Chapter 11

- Application to be employed
- Fee Applications
- 11 USC § 330(a)(1) & (a)(4)(A) for benefit of Estate
- How paid?
- What about § 1115(a)(2) ?



Fees affect Feasibility

Chapter 13 vs. Chapter 11

Office Staffing considerations

Size of Retainer and Filing Fees

Hours to achieve confirmation

Active involvement of counsel

Necessity of other professionals (i.e. CPA, Appraisers, etc.)

Hours to entry of discharge

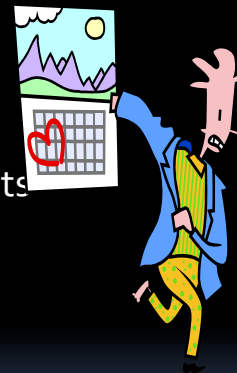
First Day Motions & Cash Collateral

Secured Creditors

Assignment of Leases and Rents

Adequate Protection

Operation in ordinary course



The “Plan” Process



Chapter 13

- Plan within 14 days
- Always “exclusive”
- Valuation at Petition Date
 - § 506(a)(2) retail standard
- § 1325(b)(2) and (b)(3)
- § 910 Car Claim
- Applicable Commitment Period of 36-60 Months
- “Local Plan Form”

Chapter 11

- Plan within 300 days (small bus.)
- 180 days “exclusive”
- Valuation at Confirmation/ Petition
 - Could be § 1111(b)
- § 1123(a)(8) all earnings as is necessary for execution of Plan
- § 1129(a)(15) value ≤ PDI (§ 1325(b)(2) only ?)
- To be received 60 Months or Plan payment period – which ever longer – no time specified

Confirmation

Chapter 13

- Priority claims paid through Plan
- Creditors do not vote
- No Absolute Priority Rule
- Freely amend terms but not ACP unless 100% Plan
- “Cram Down” means valuation

Chapter 11

- Priority claims on Effective Date
- Need votes in favor to Confirm
- Absolute Priority Rule may apply
 - 4th, 5th and 10th Cir. say it does
 - “new value exception”?
- “Cram Down” means votes over objection of impaired class

Discharge and Final Decree

Chapter 13

- Discharge 36/60 months or 100% Plan or Hardship
- DSO Certification
- Financial Management Certificate
- Case Closes and Chapter 13 Fees cease

Chapter 11

- Discharge after completion of "all payments under Plan"
- UST Fees until Discharge
 - Can close administratively
 - Must reopen for Discharge

Which Chapter Works Best?

Answer: It all depends.....



**SURVIVING INDIVIDUAL BUSINESS BANKRUPTCIES -
CONSIDERATIONS WHEN CHOOSING BETWEEN CHAPTER
13 AND CHAPTER 11**

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* These written materials are the sole responsibility of the author. An effort has been made to recover a broad topic. Any errors or omissions are the sole responsibility of the author and not the other panelists. The assistance of Tyler Henderson, Esq. in the preparation of these materials is appreciated.

**CHOOSING A CHAPTER: A COMPARATIVE ANALYSIS OF
CHAPTER 11 VERSUS CHAPTER 13 FOR INDIVIDUAL BUSINESS DEBTORS**

I. Introduction

Bankruptcy Court typically represents a “last resort” for financially distressed debtors. For certain individuals who do not qualify for relief under Chapter 7, Chapters 11 and 13 provide vehicles for restructuring their business affairs and repayment of debt. If the individual seeking to reorganize does not qualify for relief under Chapter 13 or Chapter 13 otherwise does not provide adequate remedies, Chapter 11 will sometimes represent the “last chapter” in the court of last resort.

Chapter 11 was formerly known as the chapter relating to “corporate reorganization.” Therefore, as a result, the provisions of Chapter 11 are not necessarily finely tuned to the needs of an individual debtor. Therefore, handling an individual Chapter 11 is sometimes like fitting a “square peg in a round hole.” In 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) amended the Bankruptcy Code¹ to include certain provisions specific to individual Chapter 11 debtors. However, the BAPCPA provisions which specifically relate to individual Chapter 11 debtors did not smooth out all of the rough edges. A number of incongruities with respect to individuals in Chapter 11 continue to exist under the statute. Bankruptcy practitioners should be mindful of these incongruities when deciding between Chapter 11 and Chapter 13, where such a choice is possible.

The purpose of these materials is to outline some of the issues which one should consider in determining which chapter an individual business debtor should select in order to obtain the most appropriate relief under the Bankruptcy Code. All of the issues which may be encountered in a Chapter 11 or Chapter 13 case are outside the scope of these materials. Rather, the focus of these materials and the speakers’ presentation is to highlight various distinctions most specific to individual Chapter 11 and Chapter 13 cases within the broader context of the Bankruptcy Code.

II. Eligibility

The first consideration for the bankruptcy practitioner regarding representation of an individual in financial distress concerns determination of the appropriate chapter for relief. The following is a brief outline of concerns appropriate to a determination regarding whether an individual should seek relief under Chapter 13 or Chapter 11.

A. Chapter 13 Eligibility

If a debtor does not qualify for relief under Chapter 7, or if other factors weigh against filing a Chapter 7, an individual debtor may seek relief under Chapter 13. For example, Chapter 13 provides a potential debtor the opportunity to cure mortgage arrearages. Chapter 13 also provides a potential debtor what used to be referred to as a “super discharge.”² Specifically, even

¹ 11 U.S.C. § 101 et seq. (the “Bankruptcy Code”).

² The term “super discharge” reflects the fact that the Chapter 13 discharge is broader than the Chapter 7 discharge. Refer to Bankruptcy Code § 1328 for the Chapter 13 discharge provisions.

under BAPCPA, Chapter 13 provides for discharge of certain debts which might be non-dischargeable in a Chapter 7 or 11 bankruptcy case.³

The “debt limits” under Chapter 13 are a common reason a debtor might look to Chapter 11 rather than Chapter 13.⁴ Also, Chapter 13 is available only to an individual with “regular income.”⁵ In addition, Chapter 13 Plan payment terms cannot exceed 60 months.⁶ Therefore, a debtor who needs more than 5 years to service required debt payments may consider opting to file an individual Chapter 11 case.⁷

Alternatively, a specific example of payment of debt in excess of 5 years relates to modification of “long term” debts.⁸ A Chapter 13 debtor may propose a Plan which provides for maintenance of existing debts which mature or continue after the expiration of the 5 year Chapter 13 Plan. However, a Chapter 13 debtor may not modify these payment obligations if the Plan proposes that payments will continue after the Plan term (applicable commitment period).⁹ Therefore, if a debtor seeks to modify long term debt, by reducing the interest rate or extending the term of payments, thereby reducing the amount of the monthly obligation, a debtor may not

³ For example, debts for willful and malicious injuries by the debtor to another or to property of another are not dischargeable in a Chapter 7 or 11. Bankruptcy Code § 523(a)(6). Such provision is not a part of the discharge provisions of Chapter 13. Therefore a 13 debtor may potentially discharge such a type of debt. See Bankruptcy Code § 1328(a)(2). Cf. Bankruptcy Code § 1328(a)(4) (excluding discharge of debt for civil awards resulting from willful or malicious personal injury).

⁴ Bankruptcy Code § 109(e) specifies that only an individual debtor with non-contingent, liquidated, unsecured debts of less than \$383,175.00 and non-contingent, liquidated, secured debts of less than \$1,149,525.00 qualifies for relief under Chapter 13. “Debt limit” numbers are not static as they are subject to periodic adjustment. In addition, an argument may be made that a common sense reading of Bankruptcy Code § 109(e) demonstrates that the debts of each individual joint debtor are counted separately for purposes of determining the debt limits. In other words, if the debts of each joint debtor are under the debt limits, then a debtor’s attorney may argue that each debtor qualifies for Chapter 13 separately based on the debt limits requirements, even though the debts of the two joint debtors combined may exceed the debt limits when totaled together. The two estates of married individuals are jointly administered but not substantively consolidated. See *Reider v. FDIC*, 31 F.3d 1102 (11th Cir. 1994). Therefore, under this argument it is possible that the total amounts reflected on Schedules D and F may exceed the Chapter 13 debt limits as long as the debts of each of the debtors, when counted separately, do not exceed the limits.

⁵ An individual without “regular income” may file a joint petition with their spouse who has regular income. See Bankruptcy Code § 109(e).

⁶ Bankruptcy Code § 1322(d).

⁷ The “applicable commitment period” for a Chapter 13 is generally 5 years, but can be 3 years for individuals with qualifying income. See Bankruptcy Code § 1322(d)(1) and (2).

⁸ For such long term debts, any arrearage must be cured during the Chapter 13 Plan. Bankruptcy Code § 1322(b)(5).

⁹ See Bankruptcy Code § 1322(d)(1) and (2)(outlining the applicable commitment period under Chapter 13...either 5 or 3 years);“Consequently, if a Plan modifies a secured claim under Code § 1322(b)(2), it must provide for completion of payments on the secured claim within that time; the Plan cannot extend the time for its payment beyond the term of the Plan.” W. Homer Drake, Paul W. Bonapfel and Adam M Goodman, Chapter 13 Practice and Procedure § 9C:13 (2d ed. 2013); see also Bankruptcy Code § 1328(a)(1) (providing that secured claims of which the last payment is due after the date on which the final payment under the Plan is due will not be discharged).

be able to obtain this result under Chapter 13. However, a debtor may modify long term secured debt obligations under Chapter 11.

Chapter 13 does provide the debtor the advantage of the “automatic” dismissal. Chapter 13 provides a debtor the “absolute right” to dismiss their case.¹⁰ A Chapter 11 debtor on the other hand has no right to seek “automatic” dismissal of their case.¹¹

Generally, in absence of some specific advantage, a debtor will opt to file a Chapter 13 over a Chapter 11 bankruptcy case due to the higher costs and more burdensome procedures incumbent upon an individual Chapter 11 debtor.

B. Chapter 13 Business Cases

Although Chapter 13 is only available to individuals and not corporations or similar entities, a subset of Chapter 13 debtors exists which may be considered “business debtors.” A debtor is “engaged in business” if the debtor is (i) self-employed and (ii) incurs trade credit in the production of income from such employment.¹² First, the debtor is “self-employed” if it earns most of its income from the operation of a sole proprietorship, but not if it operates a wholly owned corporation or limited liability company.¹³ In the latter circumstance, it is the corporate entity that is engaged in business, not the debtor. Second, “trade credit involves the exchange of goods and services without the [contemporaneous] payment of money.”¹⁴

A Chapter 13 debtor which classifies as a debtor engaged in business may operate its

¹⁰ Bankruptcy Code § 1307 states that “on request of the debtor...the court shall dismiss a case under this chapter.” This is often referred to as the “absolute right” of the debtor to dismiss the case. Moreover, bankruptcy code §1307(b) provides that “any waiver of the right to dismiss” is unenforceable. However, a split of authority developed regarding what is referred to as the “bad faith” exception to this rule. Specifically, some courts held that the debtor did not have the “absolute right” to dismiss a case upon a finding of “bad faith.” The United States Supreme Court resolved this split in the case of Marramara v. Citizens Bank of Massachusetts, 549 U.S. 365, 127 S.Ct. 1105, 166 L.Ed. 956 (2007) and held that a Chapter 13 debtor who filed in bad faith does not have an absolute right to dismiss. Accordingly, the Chapter 13 debtor’s “absolute right” to dismissal has been tempered and is no longer absolute.

¹¹ Bankruptcy Code § 1112(b) provides that the Court shall “convert a case to Chapter 7 or dismiss the case, whichever is in the best interests of creditors and the estate” upon a showing of “cause.” Therefore, the debtor or a creditor may seek conversion or dismissal of the case upon a showing of cause and a determination under the “best interests” test. The Chapter 11 debtor does have the right to convert to Chapter 7 unless: (i) the debtor is no longer a debtor in possession (ii) the case was originally commenced as an involuntary case or (iii) the case has previously been converted to Chapter 11 other than on the debtor’s request. Bankruptcy Code § 1112(a). However, it is doubtful that an individual in Chapter 11 can convert to Chapter 7 if the individual would have been ineligible for relief under Chapter 7 at the time of the original petition. See Bankruptcy Code § 348(a) (effect of conversion).

¹² Bankruptcy Code § 1304(a).

¹³ See 1 W. HOMER DRAKE, JR., PAUL W. BONAPFEL & ADAM M. GOODMAN, CHAPTER 13 PRACTICE AND PROCEDURE § 6:8 (2d ed. 2013).

¹⁴ In re Whitcomb, 310 B.R. 428, 431 (Bankr. W.D. Ark. 2004 (citing Rice v. Bol, 116 S.W.3d 599, 605 (Mo. Ct. App. W.D. 2003)).

business and has the right to use, sell or lease property of the estate in the ordinary course of business pursuant to Bankruptcy Code § 363(c). If the property is encumbered by a security interest of a creditor, then other provisions of the Bankruptcy Code are implicated. For Example, a Debtor needs authority to use “cash collateral.” See Bankruptcy Code § 363.¹⁵ A Chapter 13 business debtor is additionally required to file “periodic” reports regarding the operation of the business. Such reports shall include a statement of receipts and disbursements and other information that the Trustee may require.¹⁶ However, if the debtor is self-employed but does not incur trade credit, it is not “engaged in business” under Section 1304 and therefore does not possess the express authority to operate the business post-petition or the duty to file the periodic reports.¹⁷

C. Chapter 11 Eligibility

Chapter 11 has been referred to as “corporate reorganization.” Today, the title of the Chapter is simply “reorganization.” In 1991, the United States Supreme Court removed any doubt that individuals may file for relief under Chapter 11.¹⁸ Moreover, BAPCPA added provisions which are specifically addressed to individual debtors under Chapter 11.¹⁹

BAPCPA created a sub category of Chapter 11 cases: “small business cases.” Debtors in such cases may be referred to as “small business debtors.” Like the Chapter 13 debt limits, a debt limit ceiling determines whether a Chapter 11 debtor may qualify as a small business debtor. The debt limit for qualification as a small business case is not static and is periodically updated.²⁰

In the event that an individual Chapter 11 debtor falls within the sub-set of small business

¹⁵ Bankruptcy Code § 1304(b).

¹⁶ *Id.* § 1304(c).

¹⁷ The conjunctive “and” used in Section 1304 requires that both prongs are satisfied.

¹⁸ *Toibb v. Radloff* 501 U.S. 157, 111 S.Ct. 2197, 115 L.Ed. 2d 145 (1991). Some of the legislative history to the 1978 Bankruptcy Code indicated that individuals might file for relief under Chapter 11. S.Rep.No. 95-989, p.3.(1978) U.S. Code Cong. Admin. News 1978, p.5789 (1978)(Chapter 11 is “primarily designed for businesses, although individuals are eligible for relief under [Chapter 11]. The procedures for Chapter 11, however, are sufficiently complex that they will be used only in a business case and not in the consumer context.”) In *Toibb*, the Supreme Court resolved a split in the circuit authority. See *In re Moog* 774 F.2d 1073 (11th cir. 1985) (individual qualified); and *Wamsganz v. Boatmen’s Bank of De Sota*, 804 F.2d 503 (8th cir. 1986) (individual ineligible).

¹⁹ See generally Bankruptcy Code § 1115 (property of an individual Chapter 11 debtor’s estate includes earnings from post-petition services) and 1129(b)(2)(B)(ii) (terms and applicability of the absolute priority rule to individual debtors).

²⁰ Bankruptcy Code § 101(51D) defines a small business debtor as a “person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under the [Bankruptcy Code] and excluding a person whose primary activity is the business of owning or operating real property ...) that has aggregate non-contingent liquidated, secured and unsecured debts [of...] not more than \$2,490,925.00 (excluding debts owed to one or more affiliates or insiders). In the event that the United States trustee appoints a creditor committee in a Chapter 11, the debtor is no longer treated as a small business debtor.

debtors, then certain requirements follow. A small business debtor is required to file its most recent balance sheet, statement of operations, cash-flow statement, and federal income tax returns within 7 days of the petition.²¹ A small business debtor in Chapter 11 faces certain other procedural hurdles as well. The most onerous is the requirement to file a Plan within 300 days of the petition.²² There are advantages to qualification as a small business debtor though -- specifically the ability of a small business debtor to consolidate the hearing on final approval of the disclosure statement with confirmation of a proposed Plan.²³ This procedural advantage greatly facilitates the debtor's ability to expedite the case and therefore manage the case more economically.

In summary, an individual Chapter 11 debtor, which in and of itself represents a sub-set of Chapter 11 debtors, may also constitute a further sub-sub-set -- individual Chapter 11 debtors who are also small business case debtors.

D. Effect of Prior Dismissals

In addition to the eligibility requirements discussed above, there are several other potential obstacles that the bankruptcy practitioner should consider prior to filing. Bankruptcy Code § 109(g) prohibits individuals from filing under any chapter of the Bankruptcy Code if they were previously a debtor in a bankruptcy case that was dismissed within the preceding 180 days and (i) the dismissal was due to the debtor's failure to abide by orders of the court or appropriately appear to prosecute the case, or (ii) the debtor voluntarily sought and obtained dismissal of the case following the filing of a request for relief from the automatic stay under Section 362. This Section prevents debtors from abusing the protective mechanisms of the Bankruptcy Code in order to delay or frustrate their creditors' recovery efforts.²⁴

E. Automatic Stay Exceptions

²¹ Bankruptcy Code § 1116(1)(A).

²² *Id.* § 1121(e)(2). A Chapter 11 small business debtor's "exclusivity period" in which only the debtor may file a Plan is 180 days. Bankruptcy Code § 1121(e)(1). Additionally, Section 1129(e) requires confirmation of the Plan in a small business case within 45 days of the Plan's filing date. However, the court may enlarge the 300 day and 45 day deadline and the exclusivity period provided the order extending time is signed before the existing deadline has expired. Bankruptcy Code § 1121(e)(1)(B).

²³ Bankruptcy Code § 1125(f)(3). The Court may determine that the Plan itself provides adequate information without the necessity of a separate disclosure statement. Bankruptcy Code § 1125(f)(1). Bankruptcy Code § 1125(f) also provides that in a small business case, the court may "conditionally approve a disclosure statement subject to final approval after notice and a hearing...." Bankruptcy Code § 1125(f)(3)(a). "[T]he hearing on the disclosure statement may be combined with the hearing on confirmation of the Plan." Bankruptcy Code § 1125(f)(3)(C). This consolidated hearing shortens the confirmation process for a small business debtor because two notice periods (one for hearing on approval of the disclosure statement and a second for hearing on actual confirmation of the Plan) are not required. "[A]cceptances and rejections of a Plan may be solicited based on a conditionally approved disclosure statement...." Bankruptcy Code § 1125(f)(3)(b).

²⁴ *In re Ulmer*, 19 F.3d 234 (5th Cir. 1994).

For individuals filing under any chapter of the Bankruptcy Code, the automatic stay generally takes effect immediately upon the filing of the petition. However, for a variety of policy reasons that are beyond the scope of this paper, there are a number of exceptions for which the automatic stay does not apply. For example, the filing of a bankruptcy petition does not operate to stay criminal actions against the debtor or family law actions (except where the proceeding concerns the division of property of the estate), among other exceptions.²⁵

In both Chapter 13 and Chapter 11 cases, debtor's counsel should be aware of the automatic stay exceptions and its termination as well. Normally, the stay terminates when the subject property is no longer property of the estate.²⁶ Otherwise, the stay continues until either the case is closed, dismissed or a discharge is granted or denied.²⁷ However, there are other instances when the automatic stay either expires early or does not take effect at all.

First, if the individual becomes a debtor in a case under any chapter within one year of his or her status as a debtor in another case that was dismissed, the automatic stay expires 30 days after the filing of the latter case.²⁸ Debtors may avoid the termination of the stay at 30 days by demonstrating, through motion and after notice and a hearing, that the latter case was filed in good faith.²⁹ Prompt action is crucial though, as the hearing on the motion requesting the continuation of the stay must be completed before the 30 day period expires.

Second, the stay is not automatically in effect at all if the individual has had two or more cases under any chapter dismissed within the preceding one year period.³⁰ As with the 30 day stay termination under Bankruptcy Code § 362(c)(3), the stay may be instated by order of the court if the debtor demonstrates that the present case was not filed in bad faith.³¹ In order to be adequately prepared to address such situations, debtor's counsel should thoroughly review the individual's bankruptcy track record, if any, to ensure that the appropriate measures are taken to obtain the protection of the Section 362 stay.

F. The Codebtor Stay

²⁵ See Bankruptcy Code § 362(b) for the full list of actions to which the automatic stay does not apply.

²⁶ Bankruptcy Code § 362(c)(1).

²⁷ *Id.* § 362(c)(2).

²⁸ *Id.* § 362(c)(3). The stay limitation does not apply if the prior case was a Chapter 7 case and was dismissed pursuant to a presumption of abuse under the means test of Bankruptcy Code § 707(b).

²⁹ *Id.* § 362(c)(3)(B).

³⁰ Bankruptcy Code § 362(c)(4).

³¹ *Id.* § 362(c)(4)(B). Debtor's counsel should also be familiar with Bankruptcy Code § 362(n) which applies only to Chapter 11 small business debtors. Section 362(n) provides that the stay does not arise in a small business Chapter 11 case when the debtor (i) is also a debtor in a pending small business case, (ii) was a small business debtor in a case that was dismissed during the preceding 2 years, (iii) was a small business debtor in a case where a Plan was confirmed during the preceding 2 years, or (iv) is an entity that acquired substantially all of the assets of such a debtor unless the entity can prove that the acquisition was made in good faith.

Chapter 13 debtors are presented with an additional protective mechanism that is not available for Chapter 11 debtors – the codebtor stay. While not directly benefitting the debtor individually, the codebtor stay of Bankruptcy Code § 1301 prevents creditors from collecting a consumer (as opposed to a business) debt of the debtor from any other individual that is also liable for the debt or that secured the debt. However, the codebtor stay does not apply if (i) the other individual became liable for the debt in the ordinary course of business, or (ii) the Chapter 13 case is dismissed, converted to Chapter 7 or 11, or closed.³² Of course, the creditor may seek relief from the codebtor stay of Section 1301(a) just as it could from the automatic stay of Section 362(a).³³

It is also worth noting that the codebtor stay can operate to stay actions against the debtor even where the automatic stay does not arise or expires after 30 days, such as in situations where the debtor has had multiple, recent dismissals.³⁴ For instance, the Chapter 13 codebtor stay can prohibit a creditor from taking action against property of the estate where the property is jointly owned by the debtor and a codebtor, even where the debtor has had two or more cases dismissed within the preceding one year period that precluded the imposition of the Section 362(a) stay.

III. Filing and Case Requirements

The items which are required to initiate a bankruptcy petition are always of paramount importance to the bankruptcy practitioner. Often, bankruptcy petitions must be filed on an emergency basis. Therefore, it is critical that the attorney ensure that all steps necessary to properly initiate a bankruptcy petition have been completed. The following may serve as a checklist for items required to initiate the case.

A. Pre-petition Credit Counseling

An individual Chapter 11 debtor, as with an individual Chapter 7 or Chapter 13 debtor, must complete “credit counseling” within the 180-day period prior to the petition date, or qualify for an exemption or waiver of the requirement.³⁵ Typically a bankruptcy practitioner will have an established relationship with a credit counseling service and ensure that the client has completed the pre-petition credit briefing prior to the filing of the case rather than rely upon an exemption or waiver of such requirement. Failure to complete credit counseling prior to the petition date can be fatal to the case.

³² Bankruptcy Code § 1301(a).

³³ See Bankruptcy Code § 1301(c) (on request of a creditor and after notice and a hearing, the court shall grant relief from the codebtor stay if (i) the protected individual received the consideration for the claim held by the creditor, (ii) the Plan filed by the debtor proposes not to pay such claim, or (iii) such creditor’s interest would be irreparably harmed by continuation of the stay).

³⁴ See *In re Lemma*, 393 B.R. 299 (Bankr. E.D.N.Y. 2008).

³⁵ Bankruptcy Code § 109(h).

B. Filing fees

The filing fee payable to the Bankruptcy Clerk upon the filing of the Chapter 11 case greatly exceeds the filing fees due upon the filing of a Chapter 7 or Chapter 13. Currently, the filing fee for a Chapter 11 Bankruptcy Case equals \$1,213.00, as opposed to the current Chapter 7 filing fee of \$306.00 and the Chapter 13 filing fee of \$281.00. A bankruptcy practitioner may use this fact to impress upon the potential Chapter 11 individual debtor client the level of commitment which is required in order for the client to succeed in Chapter 11.

C. Pleadings Due on the Petition Date

1. Chapter 11

For the Chapter 11 debtor, the following pleadings are due on the petition date: (1) Voluntary Petition; (2) List of Creditors; (3) schedule of the 20 largest Unsecured Creditors; (4) Individual debtor's Statement of Compliance with Credit Counseling Requirement; and (5) Statement of Social Security Number (official form 21).³⁶

2. Chapter 13

In a Chapter 13 case, the following pleadings are due on the petition date: (1) Voluntary Petition; (2) Certifications as to Section 522(q) obligations, if applicable; (3) Individual debtor's Statement of Compliance with Credit Counseling Requirement; and (4) Statement of Social Security Number.³⁷ A debtor in Chapter 13 is not required a list of its 20 largest unsecured creditors.

D. Additional Pleadings

As stated and delineated above, certain pleadings are due on the first day of the case. If the debtor is a small business debtor in a Chapter 11 case, additional pleadings are due within 7 days following the petition date. Specifically, a small business debtor must file its most recent balance sheet, statement of operations, cash flow statement, and federal income tax returns within 7 days of the petition.³⁸ Alternatively, the small business debtor may file a statement under penalty of perjury that no balance sheet, statement of operations, or cash flow statement have been prepared, or no federal tax return has been filed.³⁹

Where a debtor in either Chapter 11 or Chapter 13 has filed only the items set forth above

³⁶See Bankruptcy Code §§ 301, 521, and 1116(3). See also Bankruptcy Rules 1002, 1007, and 3015. See also Official Form B200: Required List of Schedules Statement of Fees.

³⁷ See Bankruptcy Code §§ 301 and 521. See also Bankruptcy Rules 1002 and 1007. See also Official Form B200: Required List of Schedules Statement of Fees.

³⁸ Bankruptcy Code § 1116(1)(A).

³⁹ *Id.* § 1116(1)(B).

which are absolutely required on the first day of the case, i.e., a skeletal petition, additional pleadings must be filed within 14 days of the petition date. In such event, the debtor must file its Schedules, Statement of Financial Affairs (sometimes referred to as the “SOFA”), Statement of Current Monthly Income and Disposable Income Calculation (individual only – official form 22B), Copies of the Payment Advices (or declaration of the inapplicability of such requirement), and the Attorney Compensation Disclosure Statement per Bankruptcy Rule 2016(b).⁴⁰

The deadline for filing such pleadings which are due within 14 days of the petition date may be extended. The debtor may request such an extension as long as the extension is requested prior to the expiration of the 14 day deadline.⁴¹ Typically such a request is made by application to the Court and granted for cause. Courts are usually understanding of a need for additional time to timely complete the schedules and SOFA so that the same accurately reflect the financial affairs of the debtor. However, BAPCPA’s special provisions respecting small business cases provide that the Court “shall not” extend the 14 day deadline to a date more than 30 days after the petition “absent extraordinary and compelling circumstances.”⁴² Additionally, courts are usually hesitant to extend such a date after the Section 341 meeting of creditors.

E. The Chapter 11 Initial Debtor Interview

Unlike a Chapter 7 or Chapter 13 debtor, a Chapter 11 debtor is also required to attend an “initial debtor interview” (commonly referred to as the “IDI”) prior to the § 341 meeting of creditors.⁴³ Within districts operating under the U.S. Trustee system, the Office of the United States Trustee (sometimes referred to as the “UST”) typically conducts the initial debtor interview in its offices or via telephone and requires the debtor’s presentation of documentary evidence prior to conducting the IDI.⁴⁴ Although there is no IDI in Chapter 13 cases, Chapter 13 trustees in certain districts schedule a more intensive Section 341 meeting for Chapter 13 “business” debtors, such as those “engaged in business” under Section 1304.

IV. Property of the Estate

Bankruptcy Code § 541(a) provides that property of the estate consists of all legal or equitable interests of the debtor in property at the commencement of the case⁴⁵. In Chapter 13

⁴⁰ A corporate Chapter 11 debtor must also file a Statement of Corporate Ownership and the names and addresses of equity security holders, to the extent applicable. Bankruptcy Rules 1007(a)(1) and 7007.1 However, this obviously would not be applicable to an individual Chapter 11 debtor.

⁴¹ Bankruptcy Rule § 1007(c). The debtor must provide notice of such request to the U.S. Trustee.

⁴² *Id.* § 1116(3).

⁴³ *Id.* § 1116(2).

⁴⁴ Oftentimes the most time sensitive document requested for the IDI is proof of insurance.

⁴⁵ Although one would be hard-pressed to draft a more inclusive provision, the Bankruptcy Code goes farther still. Section 541(a) states that property of the estate also includes (i) interests of the debtor and his or her spouse in community property, (ii) property that the bankruptcy trustee recovers pursuant to certain avoidance powers, (iii) liens transferred to the estate by the Court under Bankruptcy Code §§ 510(c) and 551, (iv) certain property interests

cases, the debtor's post-petition earnings are also included in the property of the estate.⁴⁶ Similarly, in Chapter 11 cases, property of the estate also includes post-petition earnings from services performed by the debtor.⁴⁷ As discussed in depth below, the inclusion of these post-petition earnings as property of the Chapter 11 estate was a change effected by BAPCPA.

V. First Day Motions and Cash Collateral Issues

Typically, in a large corporate (i.e. complex) Chapter 11 Bankruptcy Case, the debtor files a multitude of "first day motions." The need for such a variety of motions is typically diminished in a smaller individual Chapter 11 Bankruptcy Case. However, certain motions may be helpful or required in certain instances. In a Chapter 13 case, first day motions are not as common, but are equally important such as where a creditor possesses a security interest in the debtor's cash collateral as discussed at length below. In operating its business upon commencement of a Chapter 13 case, the debtor must also be careful not to violate the limitations of Bankruptcy Code §§ 363(c) and 364.⁴⁸ The prudent attorney for both Chapter 11 and Chapter 13 business debtors should consider the necessity of the first day motions discussed below in order to ensure compliance with the limitations presented by the Bankruptcy Code in operating a business while in bankruptcy.

A. Maintenance of Pre-Petition Bank Accounts and Payment of Pre-Petition Wages

In a Chapter 13 case, the individual may maintain its pre-petition bank accounts, but the same is not true in an individual Chapter 11 case. Upon filing of a Chapter 11 bankruptcy case, an individual becomes a debtor-in-possession ("DIP"). An individual Chapter 11 debtor, like any other DIP, is required to close pre-petition bank accounts and open new post-petition bank accounts commonly referred to as "DIP accounts." Under certain circumstances, a debtor may obtain permission from the Court to maintain pre-petition bank accounts.⁴⁹ In this event, the debtor should file a motion requesting approval from the Court to do so at the outset of the case. The debtor's attorney should normally consult with the U.S. Trustee in order to determine the U.S. Trustee's position and obtain concurrence, if possible, with respect to the debtor's request to maintain pre-petition bank accounts.

An individual debtor may have employees, especially if the individual debtor operates a business as a sole proprietor. When an individual Chapter 11 debtor files a case owing wages to employees on the petition date, the debtor may seek permission to pay pre-petition wages.

acquired by the debtor within 180 days after the commencement of the case due to inheritance or a divorce decree, and (v) rents, proceeds, products or profits from property of the estate.

⁴⁶ Bankruptcy Code § 1306(a)(2).

⁴⁷ *Id.* § 1115(a)(2).

⁴⁸ *Id.* § 1304(c).

⁴⁹ See, e.g. *In re Grant Broad, Inc.*, 75 B.R. 819 (E.D. Pa. 1987).

Corporate Chapter 11 debtors typically file such a request to pay pre-petition wages along with the myriad of “first day motions.” The relief is often requested under the “emergency” and “necessity of payment” doctrine and further buttressed by the debtor’s arguments that unpaid wages otherwise would be treated as a priority claim under Bankruptcy Code § 507, and also by the adverse impact of nonpayment of pre-petition wages on the debtor’s post-petition operations.⁵⁰ In a Chapter 13 case, the debtor must also seek permission from the Bankruptcy Court before paying pre-petition wages.⁵¹ Courts often permit such payments so that debtors may maintain an effective workforce.⁵²

B. Cash Collateral and Adequate Protection

In many Chapter 11 and Chapter 13 business cases (in which the debtor is self-employed), the debtor will have one or more creditors who possess a security interest in the debtor’s “cash collateral.” Accordingly, the debtor will have to clear several procedural hurdles before he or she can continue to use the cash collateral, which is often the lifeblood of his or her business. “Cash collateral” includes a debtor’s cash on hand and deposit accounts (bank accounts) in which a non-debtor (i.e. a creditor) has an interest.⁵³ When a creditor holds a lien upon these items, the debtor’s use of the same is restricted. In this event, the debtor may not use “cash collateral” unless – (a) the creditor holding a security interest in such cash collateral consents to such use, or (b) the Court authorizes the debtor’s use of cash collateral.⁵⁴ This is so despite the fact that Bankruptcy Code §§ 1108 and 1304(b) authorize the debtor to operate the business in the ordinary course.

The most common course of action for a debtor is to seek authorization from the Court to use its cash collateral.⁵⁵ The Court, however, can only authorize such use if the debtor provides adequate protection to the secured creditor.⁵⁶ Bankruptcy Code § 361 states that “adequate protection” may be provided in the form of (i) a cash payment or periodic cash payments as are necessary to prevent a decrease in the value of a secured creditor’s interest in its collateral; (ii) an

⁵⁰ See generally *In re Tower Automotive*, Case No. 05-10578 (Bankr. S.D.N.Y. February 3, 2005).

⁵¹ *In re Lively*, 266 B.R. 209, 213 (Bankr. N.D. Okla. 1998) (citing *In re Quality Interiors, Inc.*, 127 B.R. 391, 396 (Bankr. N.D. Ohio 1991)).

⁵² *Id.*

⁵³ See generally Bankruptcy Code § 363(a) for the complete definition of “cash collateral.” Perhaps the most common example is the circumstance where a lender holds a lien on the debtor’s income-producing real property (and its rents). Such a creditor will hold a security interest in the debtor’s rent proceeds as cash collateral.

⁵⁴ Bankruptcy Code § 363(c)(2).

⁵⁵ Even if the debtor obtains consent from the creditor holding the security interest, the debtor will nonetheless file a motion for approval of the agreement reached between the parties pursuant to Bankruptcy Rule 4001(d).

⁵⁶ See Bankruptcy Code § 362(d) (requiring the Court to grant relief from the automatic stay to a creditor upon a showing of “cause,” which includes “the lack of adequate protection of an interest in property of such party...”); and Bankruptcy Code § 363(e) (upon request of the secured creditor, the Court shall prohibit or condition the debtor’s use, sale or lease of the creditor’s collateral as is necessary to provide adequate protection to the creditor).

additional or replacement lien to prevent the same decrease in value; or (iii) such other relief that will allow the creditor to realize the “indubitable equivalent”⁵⁷ of its interest in the collateral. If the value of the collateral greatly exceeds the amount of the creditor’s claim, the Court may find that the creditor is adequately protected and that no further protection is necessary so long as a substantial “equity cushion” is maintained.⁵⁸

For the most part, and with certain exceptions discussed below, cash collateral issues are the same in Chapter 11 and Chapter 13. Debtor’s counsel should interrogate the debtor and conduct a pre-petition search of the public records in order to determine whether creditors hold valid perfected security interests in the debtor’s accounts receivable, rents, etc., in order to determine whether a cash collateral issue exists. If a cash collateral issue exists, then the debtor cannot spend any such money upon the filing of the case. Therefore, it is incumbent upon debtor’s counsel to file a motion to use cash collateral at the outset of the case. Bankruptcy Courts are usually receptive to hearing motions to use cash collateral on an emergency basis and therefore on very short notice to creditors. If the debtor appropriately requests emergency relief, the first hearing is considered an “interim hearing”; however, the Court will hold a final hearing if at least a 14 days’ notice of the hearing is provided.⁵⁹

BAPCPA made several changes in Chapter 13 cases with regard to protection for creditors holding claims secured by a debtor’s personal property.⁶⁰ First, Section 1325 was amended to condition confirmation of the debtor’s Chapter 13 Plan on the delivery of minimum payment amounts to such secured creditors.⁶¹ Specifically, a Plan may only be confirmed if the amount of the equal monthly payments⁶² to such creditors is sufficient to provide them with adequate protection during the entire term of the Plan.⁶³ BAPCPA added the requirement that such payments be in equal amounts and paid monthly in order to prevent debtors from using irregular payment structures and proposing a large balloon payment at the end of the Plan that likely will go unpaid.⁶⁴

The second major modification regards pre-confirmation adequate protection and

⁵⁷ The “indubitable equivalent” prong is the subject of much discussion and is beyond the scope of this paper. For further reference, see 3-361 Collier on Bankruptcy ¶ 361.03[4] (16th ed. 2013).

⁵⁸ Orix Credit Alliance v. Delta Resources, 54 F.3d 722, 727 (11th Cir. Ala. 1995).

⁵⁹ See Bankruptcy Rule 4001(b) generally with respect to filing and service of cash collateral motions.

⁶⁰ For a detailed discussion of the changes to these Sections effected by BAPCPA, refer to In re Brown, 348 B.R. 583 (Bankr. N.D. Ga. 2006).

⁶¹ Bankruptcy Code § 1325(a)(5)(iii).

⁶² Section 1325(a)(5)(iii)(I) requires that, if the property to be distributed to creditors under this Section is in the form of periodic payments, the payments must be in equal monthly amounts.

⁶³ Bankruptcy Code § 1325(a)(5)(iii)(II).

⁶⁴ In re Erwin, 376 B.R. 897 (Bankr. C.D. Ill. 2007). But see In re Cooper, 2009 Bankr. LEXIS 3737, *7 (Bankr. M.D. Fla. 2009)(allowing a balloon payment on the 60th month and finding that 11 U.S.C. §1325(a)(5)(B)(iii) is not applicable where a debtor’s plan provides for unequal periodic payments to cure a long term secured debt arrearage complies with 11 U.S.C. §1322(b)(5)).

requires the debtor to begin making adequate protection payments *directly* to secured creditors holding purchase money security interests in the debtor's personal property within 30 days of the petition.⁶⁵ The amount of the payments may be determined by the amount of the collateral's depreciation and expert testimony may not be necessary to establish this value.⁶⁶ The debtor is entitled to a credit against its Plan payments to such secured creditor by the amount of the pre-confirmation adequate protection payments.⁶⁷ It should be noted that failure to timely commence making payments under Section 1326 constitutes grounds for dismissal or conversion under Section 1307(c)(4).

C. Payment of Ordinary Living/Household Expenses

As discussed above, the debtor cannot use cash collateral without permission of the Court where a creditor holds a lien on such property of the estate. Under these circumstances, there is no question that the debtor must seek leave of Court to spend such money. A more interesting question arises where the debtor does not have a definitive "cash collateral" problem, but rather the debtor simply wants to spend money even where the funds on hand do not represent collateral of any creditor.

Bankruptcy Code § 1303 expressly grants all Chapter 13 debtors permission, exclusive of the trustee, to use, sell, or lease property of the estate as long as it is done in accordance with certain subsections of Section 363. Section 1304 allows a Chapter 13 business debtor to use property of the estate in the ordinary course of operating a business without notice and a hearing unless the debtor needs to use cash collateral. Additionally, the right of the debtor to use or lease property of the estate in the ordinary course of his or her affairs is implicit in Section 1306(b). This Section says that a debtor shall remain in possession of all property of the Chapter 13 estate. This all seems to suggest that a Chapter 13 business debtor may expend property of the estate to pay household expenses and maintain an ordinary existence. However, the Code "provisions do not by their terms permit a Chapter 13 debtor to use property of the estate for personal, family, or household purposes. Nevertheless, the debtor's right to possession of property carries with it the implied right to use property during the pendency of the case." *W. Homer Drake, Paul W. Bonapfel and Adam M Goodman, Chapter 13 Practice and Procedure* § 6:4 (2d ed. 2013).

An individual Chapter 11 debtor may also operate its business in the "ordinary course;" otherwise stated, a debtor-in-possession may conduct any transaction which is in the "ordinary course of business" without leave of the Bankruptcy Court.⁶⁸ However, the question arises as to

⁶⁵ Bankruptcy Code § 1326(a)(1). Actually such payments must begin within 30 days of the earlier of the filing of the Plan or the Order for Relief, unless the Court orders otherwise. In function, this means within 30 days of the Petition. Though the Code requires direct payment to the secured creditor, at least some districts allow plans which provide for payment to the Chapter 13 trustee (not direct to the creditor) for the benefit of such secured creditor's adequate protection payment and funding of such. This area is therefore subject to a localized practice.

⁶⁶ *In re Robson*, 369 B.R. 377, 382 (Bankr. N.D. Ill. 2007) (holding that "adequate protection under § 1326 should be calculated using the amount [the collateral] depreciates in the first month following filing of the bankruptcy petition.").

⁶⁷ Bankruptcy Code § 1326(a)(1)(C).

⁶⁸ A debtor-in-possession has the rights and duties of a trustee. Bankruptcy Code § 1107(a). Furthermore, the Trustee (i.e. the debtor-in-possession) may "operate the debtor's business" unless the bankruptcy court orders otherwise after notice and a hearing. Bankruptcy Code § 1108.

whether an individual debtor's payment of ordinary non-business expenses, such as household expenses, represents operation of a business in the ordinary course. In this instance, an individual Chapter 11 debtor is maintaining an ordinary existence, but doing so within a Chapter 11 case represents a "square peg in a round hole."

Prior to the 2005 enactment of BAPCPA, an individual Chapter 11 debtor's post-petition earnings did not constitute property of the estate. However, BAPCPA's codification of Bankruptcy Code § 1115(a)(2) provides that where "the debtor is an individual, property of the estate includes . . . 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, Chapter 12, or Chapter 13, whichever occurs first." Prior to the enactment of this provision under BAPCPA, an individual Chapter 11 debtor could assert that it had a relatively unfettered right to use its post-petition earnings to pay household or other personal expenses because such post-petition earnings did not constitute property of the estate. Now, under the post-BAPCPA Bankruptcy Code, the debtor is constrained to make such an argument. Rather, a debtor's use of cash on hand, even though it represents the debtor's post-petition earnings, constitutes use of property of the estate.

As stated above, the debtor may use property of the estate in the ordinary course of business, but usage of such cash on hand to pay household bills such as utilities, mortgage payments, purchases of food and clothing, etc., may be distinguished. Whether or not such expenditures represent ordinary course of business disbursements represents an open issue. The debtor's position typically is that it is in the ordinary course of business that an individual pays reasonable and necessary household expenses. In response, a creditor's attorney might argue that payment of household expenses does not represent a business transaction or expense.

At least two post-BAPCPA Courts have published decisions regarding an individual debtor's use of post-petition earnings as estate property. In In re Goldstein, the Bankruptcy Court for the Central District of California held that the Bankruptcy Code did authorize use of estate property in the form of post-petition earnings to pay reasonable and necessary expenses that are in the ordinary course of business.⁶⁹ According to the Court in Goldstein, the Bankruptcy Code "authorizes the debtor to buy bread and probably to purchase a ticket to travel to a court hearing." However, the hiring of divorce counsel is not typically a transaction in the ordinary course of business.⁷⁰

In a 2013 case, a Bankruptcy Court provided the clearest opinion yet that an individual Chapter 11 debtor is entitled to use post-petition income to pay living expenses. In re Seely, 492

⁶⁹ In re Goldstein 383 B.R. 496, 499 (Bankr. C.D. Cal. 2007). An unpublished decision from the Bankruptcy Court for the District of Nevada established that the debtor is authorized to pay ordinary course living expenses. See In re Robert Lynn Horne, Case No. BK-S-07-15280 (Bankr. D. Nev.). In the Horne case, the debtor filed a motion requesting the Court's authorization to pay ordinary living expenses. In such motion, the debtor acknowledged the provisions of Bankruptcy Code § 1115 and asserted that the debtor should be entitled to use estate property to pay "ordinary living expenses." The Horne Court authorized the debtor to pay budgeted expenses.

⁷⁰ Goldstein, 383 B.R. at 499; see also In re Villalobos, 2011 Bankr. LEXIS 4329 (9th Cir. 2011) for an unpublished decision discussing the possible standards under which this question could be analyzed.

B.R. 284 (Bankr. C.D. Cal. 2013). In Seely, the case had been converted to Chapter 7 and the Chapter 7 trustee sought turnover of cash generated by the debtor while the case was in Chapter 11. The Seely Court held 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.” Id.

Certain decisions published pre-BAPCPA may also serve as authority for resolution of this post-BAPCPA conundrum. In the pre-BAPCPA cases, courts were required to rule upon the debtor’s use of estate property to pay the individual debtor’s living expenses.⁷¹ These cases are analogous because they involve the individual debtor’s use of estate property to pay living expenses; so such cases may be appropriately considered when a post-BAPCPA individual debtor seeks to use post-petition earnings which now constitute estate property. In these published decisions, the Court did authorize use of estate property to pay ordinary living expenses. In short, this is an area which remains unsettled and a shade of grey. The individual in Chapter 11 again seems not quite a round peg in a round hole.

VI. Employment of Professionals and Other Operational Issues

A. Professionals

In Chapter 13 cases, the debtor’s attorney may be employed without formal authorization or approval from the Court. However, in Chapter 11, the debtor must obtain the Court’s authorization and approval to employ professionals.⁷² Therefore, the debtor’s attorney typically files an application for approval of its employment at the outset, if not on the first day of the case.⁷³ Under BAPCPA, the Court should not approve the debtor’s request for employment of a professional until 21 days after the petition date unless exigent circumstances exist.⁷⁴ The resulting procedure in many jurisdictions is that the debtor files the application to employ attorneys and other required professionals on the first day of the case but the order approving such application is not entered until after the 21st day of the case. The debtor is typically informed of these requirements regarding professionals by the U.S. Trustee at the IDI. This procedure serves as a reminder of what has hopefully been the debtor’s prior understanding through conversations and advice of counsel.⁷⁵

⁷¹ See generally In re Keenan, 195 B.R. 236 (Bankr. W.D.N.Y. 1996); and In re Bradley, 185 B.R. 7 (Bankr. W.D.N.Y. 1995).

⁷² Bankruptcy Code § 327.

⁷³ See Bankruptcy Rule 2014 for the procedural requirements.

⁷⁴ See Bankruptcy Rule 6003.

⁷⁵ Again, a Chapter 11 debtor serves as a debtor-in-possession under the provisions of Bankruptcy Code § 1107. As such a debtor-in-possession, the debtor has the rights and obligations of a Trustee. A bankruptcy trustee “with the Court’s approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate and who are disinterested persons, to represent or assist the trustee in carrying out the trustee’s duties” Bankruptcy Code § 327(a). In short, because a Trustee must obtain court approval to employ professionals, so must an individual Chapter 11 debtor.

The types of professionals which the debtor must obtain court approval to employ include attorneys, accountants, appraisers, real estate brokers, and auctioneers. A full discussion of the procedures and limitations on who may be employed by a debtor is outside the scope of this presentation. However, the colloquial rule of thumb is that such a professional should not have a “conflict of interest.” More specifically, the Bankruptcy Code provides that such prospective professionals should be “disinterested” and “not hold or represent an interest adverse to the estate.”⁷⁶ Therefore, the prospective individual Chapter 11 debtor’s attorney should perform a conflicts check and be aware of and otherwise analyze any potential conflicts of interest regarding representation of the debtor in the Chapter 11 case.⁷⁷ The most important aspect of the employment process lies in a full disclosure of contacts between the professional and the debtor, creditors, and other parties in interest. Professionals should make such disclosure in their applications for employment and supplement or amend to the extent required.

B. Operating Reports

The Chapter 11 debtor is required to file what are commonly referred to as Monthly Operating Reports (sometimes abbreviated “MORs”). The Monthly Operating Report is filed on a form provided by the United States Trustee. The MOR includes a cash flow statement which reflects the debtor’s actual income and expenses on a cash basis. As these operating requirements are imposed upon any Chapter 11 debtor, an individual debtor must likewise comply. The U.S. Trustee has MOR report forms which are applicable to individual debtors and shortened forms for small business debtors. In addition, BAPCPA added specific reporting requirements for Chapter 11 debtors in “small business cases.”⁷⁸

As discussed above, the Chapter 13 business debtor is also required to file periodic operating reports with the court, the United States trustee and taxing authorities.⁷⁹ Section 704(a)(8) states that the reports must include summaries of the operations of the business, including a statement of receipts and disbursements, and any other information the UST or court required. The court may determine the form and frequency of the reports.

⁷⁶ See generally Bankruptcy Code § 327.

⁷⁷ Bankruptcy Code § 101(14) defines disinterested person. Prospective debtor professionals should be conscious of the source of payments (i.e. payments from non-debtor sources) as well as the timing of a debtor’s pre-petition payments made to professionals. A professional’s receipt of payments which constitute preferential transfers under Bankruptcy Code § 547 may be cause for disqualification.

⁷⁸ Specifically, Bankruptcy Code § 308(b) provides as follows: A debtor in a small business case “shall file periodic financial and other reports containing information including – (1) the debtor’s profitability; (2) reasonable approximations of the debtor’s projected cash receipts and cash disbursements over a reasonable period; (3) comparisons of actual cash receipts and disbursements with projections and prior reports; (4) whether the debtor is – (A) in compliance in all material respects with post-petition requirements imposed [by the Bankruptcy Code and Bankruptcy Rules]; and (B) timely filing tax returns and other required governmental filings and paying taxes and other administrative expenses when due”

⁷⁹ Bankruptcy Code § 1304(c) (incorporating Bankruptcy Code § 704(a)(8)).

C. Trustee Fees

Determination of whether to file Chapter 11 or 13 should include some assessment of the trustee fees which will need to be paid. The Chapter 13 debtor pays trustee's fees on disbursements made to creditors during the entire term of the Plan.⁸⁰ The percentage fee paid to a Chapter 13 Trustee varies by district. A Chapter 11 debtor must pay a quarterly fee to the U.S. Trustee.⁸¹ This quarterly fee represents a financial burden upon the typical debtor in a smaller case. The U.S. Trustee fee is calculated pursuant to a statutory formula applied nationwide and is based upon the debtor's actual disbursements made each quarter.⁸² The Chapter 11 debtor continues to pay the U.S. Trustee's quarterly fee until entry of a Final Decree, conversion, or dismissal. The continued obligation to pay U.S. Trustee fees represents an incentive for a debtor to promptly close the case at the earliest opportunity.

D. Attorneys' Fees and Compensation

As discussed above, Bankruptcy Code § 327(a) authorizes the Chapter 11 debtor to employ bankruptcy counsel so long as the firm and its attorneys do not "hold or represent an interest adverse to the estate..." Compensation of the debtor's attorney, as with other professionals, is governed by Bankruptcy Code § 330 and Bankruptcy Rule 2016. Section 330 allows for the award of "reasonable compensation for actual, necessary services" performed by the attorney or firm. In determining the reasonableness of the amount so requested, the Court considers (i) time spent on the case, (ii) rates charged, (iii) whether the services were necessary, (iv) whether the services were completed within a reasonable amount of time, (v) the practitioner's skill and expertise, and (vi) whether the compensation is reasonable when compared to rates charged by comparable practitioners.⁸³

Oftentimes, the practitioner will obtain a retainer or fee from the debtor prior to filing the petition, but the attorney cannot pay herself from this money during the pendency of the case without authorization from the Court. If the case is unusually complicated and expected to remain in the pre-confirmation stage for an extended time (as with many Chapter 11 cases), debtor's counsel should consider an interim fee application. Section 331 allows a practitioner to apply to the Court for interim compensation 120 days after the petition date.⁸⁴

⁸⁰ Bankruptcy Code § 1326(b).

⁸¹ See 28 U.S.C. § 1930(a)(6).

⁸² 28 U.S.C. §§ 586 and 1930(a)(6).

⁸³ Bankruptcy Code § 330(a)(3); see also *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974) (identifying 12 factors to be considered in determining the reasonableness of an attorneys' fee: (1) the time and labor required; (2) the novelty and difficulty of the questions; (3) the skill required to perform the legal services properly; (4) the preclusion of other employment by the attorney due to the acceptance of the case; (5) the customary fee; (6) whether the fee is fixed or contingent; (7) time limitations imposed by the client or other circumstances; (8) the amount involved and the results obtained; (9) the experience, reputation, and ability of the attorneys; (10) the "undesirability" of the case; (11) the nature and length of the professional relationship with the client; and (12) awards in similar cases).

⁸⁴ See Bankruptcy Rule 2016. In order to obtain authorization from the Court, the attorney must file an application

With respect to Chapter 13 debtors' Attorneys, the Code also provides that the Court may award "reasonable compensation" for representing the debtor.⁸⁵ However, attorney compensation in Chapter 13 cases is generally subject to local rules and practice.

VII. The Plan Process

Confirmation of a Plan normally represents the desired end result in an individual Chapter 11 or 13 bankruptcy case. In certain corporate reorganization Chapter 11 cases, the initial strategy may be to file and prosecute a motion for sale of the debtor's assets under Bankruptcy Code § 363. However, in an individual Chapter 11 Case, as with a Chapter 13 case, the ultimate goal usually is confirmation of a Plan that defines the legal relationship between the debtor and its creditors moving forward. Through confirmation of a Plan, the debtor may restructure its debt payments and ultimately receive a discharge of debts. Through this process, an individual may receive a "fresh start."

A. Timing of Filing the Plan

With respect to a "regular" Chapter 11 debtor (i.e., one which is not a small business debtor), the Bankruptcy Code does not provide an absolute deadline by which the debtor must file a Plan. Different rules apply in a small business case. If the debtor's case constitutes a "small business case," then the debtor must file a Plan within 300 days of the petition date.⁸⁶ Further, the Court is actually directed to confirm (or presumably deny confirmation of) the Plan in a small business case within 45 days after the Plan is filed unless such deadline is extended.⁸⁷ The Court should only extend the 300 day deadline for filing the Plan and the 45 day deadline for ruling on Plan confirmation if the debtor "demonstrates by a preponderance of the evidence that it is more likely than not that the Court will confirm a Plan within a reasonable period of time."⁸⁸ The Court must grant any such extension before the original, existing deadline has expired and must further provide a new deadline at the same time the extension is granted.⁸⁹

A Chapter 13 Debtor must file a plan within 14 days of the petition [Bankruptcy Rule 3015(b)]. The Court may extend the time for cause shown and may be more accommodating in providing liberal extensions for debtors engaged in business.⁹⁰ If a debtor fails to file a Plan in a

pursuant to Bankruptcy Rule 2016 and provide all parties in interest with at least 21 days' notice of a hearing on the fee application.

⁸⁵ Bankruptcy Code § 330(a)(4)(B)

⁸⁶ Bankruptcy Code § 1121(e)(2).

⁸⁷ *Id.* § 1129(e).

⁸⁸ *Id.* § 1121(e)(3)(A).

⁸⁹ *Id.* § 1121(e)(3)(B) & (C).

⁹⁰ Bankruptcy Rule 3015(b).

timely manner, the Court may dismiss the case or convert the case to Chapter 7.⁹¹

B. The Exclusivity Period in Chapter 11 Cases

In a regular, non-small business Chapter 11 case, the Bankruptcy Code provides that only the debtor may file a Plan at the outset of the case during the “exclusivity period.”⁹² The exclusivity period during which only the debtor may file a Plan in such cases is 120 days from the Order for Relief.⁹³ There is also a separate 180 day exclusive period (running from the Order for Relief) for seeking acceptance of a Plan filed within the 120 day period.

Otherwise stated, other non-debtor parties may file a Plan and the exclusive period is effectively terminated if the debtor has not filed a Plan which has been “accepted” within 180 days after the Order for Relief.⁹⁴ The bankruptcy court may extend the 120 day exclusive period for filing the Plan and the 180 day exclusive period for obtaining “acceptance” of a Plan, but the request for such extension must be filed within the deadlines.⁹⁵ The Court may not extend the 120 day exclusive period for filing a Plan beyond 18 months from the Order for Relief; and the bankruptcy court may not extend the 180 day exclusive period for obtaining acceptance of the Plan beyond 20 months after the Order for Relief.⁹⁶

In a small business Chapter 11 case, the exclusivity rule is different. There, the debtor’s exclusive time for filing a Plan is 180 days, unless the Court extends it.⁹⁷ However, the Court presumably would not extend the debtor’s exclusive period for filing a Plan beyond the 300 day deadline for filing a Plan (by any party) discussed above unless the 300 day deadline is likewise extended. The Court may convert the case to Chapter 7 or dismiss the case if the debtor fails to obtain confirmation to the Plan within the required time periods.⁹⁸

In a Chapter 13 case, the debtor has the exclusive right to file a Plan.⁹⁹ This is consistent

⁹¹ Bankruptcy Code § 1307(c)(3).

⁹² *Id.* § 1121(b).

⁹³ *Id.* § 1121(b)(1).

⁹⁴ Bankruptcy Code §1121(c)(3).

⁹⁵ *Id.* §1121(b)(1).

⁹⁶ Bankruptcy Code § 1121(d)(2)(A) & (B). If a Trustee is appointed, then exclusivity no longer applies. Bankruptcy Code § 1121(c)(1). The Court may eliminate or reduce the debtor’s exclusive period upon request by a party. Bankruptcy Code § 1121(d)(1).

⁹⁷ Bankruptcy Code § 1121(e).

⁹⁸ *Id.* § 1112(b)(4)(J).

⁹⁹ *Id.* § 1321; H.R. Rep. No. 595, 95th Cong., 1st Sess. 143 (1977), *reprinted in* App. Pt. 4(d)(i) *infra*; S. Rep. No. 989, 95th Cong., 2d Sess. 141 (1978), *reprinted in* App. Pt. 4(e)(i) *infra*. Contrary language elsewhere in the House Judiciary Committee Report is a typographical error and should read, “creditors may not file a plan under any circumstances.”

with the voluntary nature of Chapter 13 relief. A Chapter 13 debtor may seek the assistance of a Chapter 13 Trustee for advice in filing a Plan,¹⁰⁰ but the Chapter 13 Trustee may not file a Plan. A creditor is also not permitted to file a Plan in any circumstance in a Chapter 13 case.¹⁰¹

C. The Disclosure Statement in Chapter 11 Cases

A Chapter 11 debtor must file a Disclosure Statement along with the Plan.¹⁰² The purpose of the Disclosure Statement is to provide “adequate information” to creditors to allow them to determine whether to vote to accept or reject the Plan. The Official Forms now contain an optional Form Plan and Form Disclosure Statement for Small Business Cases.¹⁰³ These templates may be used as a starting point for preparation of a Disclosure Statement and Plan in an individual case, regardless of whether or not the individual Chapter 11 debtor’s case constitutes a small business case. No such disclosure statement requirement exists in a Chapter 13 case, and the debtor is not required to submit any sort of disclosure statement in connection with the Chapter 13 Plan.

In a regular Chapter 11 case (i.e. a case which does not constitute a small business case), the debtor may not solicit votes seeking confirmation of a Plan until the Court has approved the Disclosure Statement.¹⁰⁴ In these cases, the debtor files the Plan and Disclosure Statement, and a hearing is set to consider approval of the Disclosure Statement. In the event that the bankruptcy court approves the Disclosure Statement, then the Plan is transmitted to creditors and the Court schedules a hearing on the confirmation of the Plan. This procedure requires two noticing procedures, both a 28 day notice of hearing on the Disclosure Statement, plus a 28 day notice of hearing on confirmation.¹⁰⁵

In a small business case, the process may be streamlined; the bankruptcy court may conditionally approve the Disclosure Statement and authorize the solicitation of votes on the Plan, subject to a final hearing on approval of the Disclosure Statement at the same time as the hearing on confirmation of the Plan.¹⁰⁶ During this “consolidated hearing,” the Court considers approval of both the Disclosure Statement and the Plan.

D. Content of the Plan (and Classes of Claims)

¹⁰⁰ See Bankruptcy Code § 1302(b)(4).

¹⁰¹ Bankruptcy Rule 3015(d).

¹⁰² An exception exists in small business cases where the court may determine that the Plan itself provides sufficient information. Bankruptcy Code § 1125(f)(1).

¹⁰³ The Standard Official Forms Number 25A and 25B contain the form Disclosure Statement and Plan for small business cases.

¹⁰⁴ Bankruptcy Code § 1125(b).

¹⁰⁵ Bankruptcy Rule 2002(b).

¹⁰⁶ Bankruptcy Code § 1125(f)(3).

1. Chapter 13 Plan

A Chapter 13 Plan should contain detailed information about the treatment that creditors will receive under the Plan in terms of payment or other relief, the length of the Plan, and the debtor's source of funding for the Plan payments to be made. The term, otherwise known as the "applicable commitment period," of a Plan may not be less than 3 years and not more than 5 years.¹⁰⁷ In contrast, a Chapter 11 Plan has no such term requirements.

Section 1322(a) contains mandatory requirements for every Plan. Specifically, the Plan must provide for (i) the debtor's submission of all or part of its future income to the Trustee as is necessary to fund the Plan; (ii) full payment of all § 507 priority claims unless the holder agrees to a different treatment; and (iii) the same treatment to all claims within a class.¹⁰⁸ Bankruptcy Code § 1322(b) contains permissive provisions that may also be included in a Plan. Namely, a Plan may (i) designate classes of unsecured claims so long as the plan does not "unfairly discriminate" against any class; (ii) modify the rights of holders of secured claims other than a claim secured by the debtor's principal residence; (iii) provide for the curing of a default, including a default on a long term debt such as a mortgage, during the term of the Plan; and (iv) provide for the assumption, rejection or assignment of an executory contract or unexpired lease of the debtor.¹⁰⁹

Most importantly, as mentioned above, the Plan must describe the treatment of the debtor's creditors for the commitment period. Secured creditors must be paid the full amount of their claim or the present value of their collateral, whichever is less, unless they agree to a less favorable treatment or the debtor surrenders the collateral.¹¹⁰ There are two principal exceptions though: first, the Plan may not modify the rights of a creditor with a security interest solely in the debtor's principal residence,¹¹¹ and second, the Plan must provide for the payment of the full amount of a claim secured by a purchase money security interest in the debtor's personal vehicle if the vehicle was purchased within 910 days before the bankruptcy filing.¹¹² The latter is commonly referred to as a "910 claim."

The Plan must provide for payment in full to priority claims under Section 507(a).¹¹³

¹⁰⁷ *Id.* §§ 1322(d) & 1325(b)(4).

¹⁰⁸ *Id.* § 1322(a). However, this Section also allows less than full payment of domestic support obligations under Section 507(a)(1)(B) if the debtor commits all of its projected disposable income to the Plan for a period of 5 years. Bankruptcy Code § 1322(a)(4)

¹⁰⁹ For the complete list of permissive Plan sections, see Bankruptcy Code § 1322(b).

¹¹⁰ Bankruptcy Code § 1325(a)(5).

¹¹¹ *Id.* § 1322(b)(2).

¹¹² *Id.* § 1325(a).

¹¹³ *Id.* § 1322(a)(2).

Debtors often propose “composition plans” which provide for payment of less than 100% to general unsecured creditors (i.e., those creditors whose claims are neither entitled to priority nor secured). Payments to general unsecured creditors are regulated by two primary confirmation requirements. First, the creditors must receive as much under the Plan as they would if the debtor’s estate was liquidated through a Chapter 7 (the “liquidation test”).¹¹⁴ The second requirement, applicable if an objection is filed by a creditor or the Trustee, is that the debtor must pay all projected disposable income to unsecured creditors during the term of the Plan.¹¹⁵ Projected disposable income is discussed at length below.

2. Chapter 11 Plan

Under Bankruptcy Code § 1123(a), a Chapter 11 Plan “classifies” claims by placing different claims in different classes. A Plan may classify substantially similar claims by class. A Plan may designate an administrative convenience class of unsecured claims.¹¹⁶ The Plan shall designate classes of claims and interests other than administrative and tax claims. The Plan must specify the treatment of each class of claims and whether it is impaired not impaired. The Plan must provide the same treatment for each claim in a particular class unless the claimant agrees to a less favorable treatment.¹¹⁷

Here, BAPCPA again added a specific provision relating to individual Chapter 11 debtors. Specifically, BAPCPA added Bankruptcy Code § 1123(a)(8), which provides as follows: in a case in which the Chapter 11 debtor is an individual, the Plan shall “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.” This language is best considered within the context of the “absolute priority rule” relating to individual Chapter 11 cases, which is discussed below. The author is unaware of any cases which specifically hinge upon the verbiage of Bankruptcy Code § 1123(a)(8) outside the context of the absolute priority rule.

The items discussed above constitute content requirements for a Chapter 11 Plan as listed in Section 1123(a), but there are also a number of permissive provisions that a Plan may include as well. As set forth in Bankruptcy Code § 1123(b), the Plan may: (i) impair or leave unimpaired any class of claims, (ii) provide for the assumption, rejection, or assignment of executory contracts or leases not previously rejected, (iii) provide for the settlement of any claim, or (iv) provide for the liquidation of property and distribution of proceeds among holders of claims. Most importantly, the Plan may modify the rights of holders of secured claims and unsecured claims.¹¹⁸ In other words, provided that the Plan is confirmable based upon the requirements to

¹¹⁴ Id. § 1325(a)(4).

¹¹⁵ Id. § 1325(b).

¹¹⁶ Bankruptcy Code § 1121(a) & (b).

¹¹⁷ Bankruptcy Code § 1123(a)(4). Bankruptcy Code § 1123 generally sets forth the requirements regarding the “contents” of the Plan.

¹¹⁸ The Plan may “modify the rights of holders of secured claims, other than a claim secured only by a security

be discussed below, the Plan may provide for a payment of unsecured creditors on a discounted basis. Also, the Plan may modify the rights of secured creditors by bifurcating the claim into a secured and unsecured claim if the creditor is undersecured. Importantly, the prohibition on modification of residential mortgage claims applies in a Chapter 11 case just as it does in Chapter 13.¹¹⁹

E. Confirmation of the Plan

1. Chapter 13 Confirmation Requirements

Bankruptcy Code § 1325 contains the specific requirements for confirmation of a Chapter 13 Plan. All of the content requirements discussed above must be included in the Plan, and in order for the Plan to be confirmed by the Court, (i) all required fees under 28 U.S.C. § 1930 must have been paid; (ii) the Plan must have been proposed in good faith; (iii) the Plan must satisfy the liquidation test discussed above; (iv) the debtor must be current on postpetition domestic support obligations; and (v) the debtor must be able to satisfy all of its requirements under the Plan in providing payment and any other treatment to its creditors (i.e. the plan must be feasible).¹²⁰

Although creditors in a Chapter 13 case cannot file a Plan and do not have the right to vote on the Plan, the Bankruptcy Code does allow unsecured creditors to object to a debtor's Plan. Section 1325(b) provides that if the trustee or the holder of an allowed unsecured claim objects to the Plan at or before confirmation, the Court may not confirm the Plan unless the debtor proposes to pay all of the debtor's "disposable income" for a specified amount of time or until the unsecured claims are paid in full, whichever is earlier. Projected disposable income is calculated using Official Form 22C filed with the petition.

Section 1325(b)(2) defines "disposable income" as current monthly income received by the debtor¹²¹ less amounts reasonably necessary to be expended: (i) for the maintenance or support of the debtor or dependent of the debtor, (ii) for a domestic support obligation payable post-petition, (iii) for charitable contributions that do not exceed 15% of the debtor's annual gross income, and (iv) in the case of a business debtor, for the payment of amounts necessary for the continuation, preservation, and operation of its business. In *Hamilton v. Lanning*, the U.S. Supreme Court considered calculation of a Chapter 13 debtor's projected disposable income and held that the Bankruptcy Court may account for changes in the debtor's income that are known or virtually certain at the time of confirmation.¹²²

interest in real property that is the debtor's principal residence" Bankruptcy Code § 1123(b)(5).

¹¹⁹ *Id.*

¹²⁰ Bankruptcy Code § 1325(a). Refer to Section 1325 for the full list of confirmation requirements for a Chapter 13 Plan. With regard to the last requirement, the debtor must detail the sources of funding for the Plan payments in order to demonstrate that the Plan is feasible as proposed. *Id.* § 1322(d).

¹²¹ 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.

¹²² 560 U.S. 505, 524 (2010). This holding would presumptively or arguably also apply to an individual Chapter 11

2. Chapter 11 Confirmation Requirements

As stated above, the presumptive goal of the individual Chapter 11 debtor is to obtain confirmation of a reorganization/repayment Plan. Bankruptcy Code § 1129 sets forth the requirements for confirmation. The following do not represent all of the stated requirements, but are intended to represent the major issues and oft-encountered stumbling blocks:

The Plan must otherwise comply with the other provisions of the Bankruptcy Code.¹²³ The Plan must be proposed in “good faith.”¹²⁴ The individual Chapter 11 debtor’s post-petition domestic support obligations must be current and the debtor must have filed all tax returns which are due.¹²⁵ The Plan must provide for a payment of priority tax claims in equal installments, with interest, so that such tax claims are paid within 5 years after the petition date.¹²⁶

The Plan must provide for a payment of other priority claims in full on the effective date of the Plan unless the class accepts deferred cash payments which must include interest. This provision may constitute a stumbling block for an individual Chapter 11 debtor with domestic relations problems.¹²⁷ The Plan must also meet the “best interest of creditors test” which is also sometimes referred to as the “liquidation test.”¹²⁸ In short, creditors must receive at least as much under the Plan as they would receive in a Chapter 7 liquidation.

BAPCPA also added a specific Section 1129(a) provision applicable to individual Chapter 11 debtors. Bankruptcy Code § 1129(a)(15) provides that in an individual Chapter 11

debtor.

¹²³ Bankruptcy Code § 1129(a)(1) & (2).

¹²⁴ Bankruptcy Code § 1129(a)(3). In finding lack of good faith, courts have looked to whether the debtor intended to abuse the judicial process and purpose of the reorganization. See *In re Albany Partners Ltd.*, 749 F.2d 670 (11 Cir. 1984).

¹²⁵ Bankruptcy Code § 1129(a)(14) provides that if the debtor “is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, the debtor has paid all amounts payable under such order or such statute for such obligation that first became payable after the date of the filing of petition.” Again, this is a BAPCPA provision which was enacted specifically to govern individual Chapter 11 debtors.

¹²⁶ Bankruptcy Code § 1129(a)(9)(C).

¹²⁷ *Id.* § 1129(a)(9)(B). Specifically a child support or alimony obligation (i.e. domestic support obligation) is entitled to priority status under Bankruptcy Code § 507(a)(1). So an individual debtor who files a Chapter 11 owing support arrearages must pay them in full on the effective date of the Plan unless the spouse agrees to accept payments over time. Relations between the debtor and the former or soon-to-be former spouse may not be amicable. If this is the case and the debtor does not have the ability to cure all arrearages on the effective date, then plan confirmation becomes problematic.

¹²⁸ *Id.* § 1129(a)(7)(A)(ii). Specifically, Bankruptcy Code § 1129(a)(7)(A)(ii) provides that with respect to an impaired class of claims, the class will “receive or retain under the Plan on account of such claim or interest property of a value, as of the effective date of the Plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under Chapter 7”

debtor case, where the holder of an allowed unsecured claim objects to confirmation of the Plan, and the Plan is not a 100% payment Plan, “the value of the property to be distributed under the Plan [must be] not less than the projected disposable income of the debtor . . . 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.”¹²⁹ “Disposable income” is defined by Bankruptcy Code § 1325(b)(2) and calculated on a monthly basis. Disposable monthly income is income received by the individual debtor (other than child support, foster care, or disability payments for a dependent child) less expenses reasonably necessary for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation payable post-petition.¹³⁰

i. Voting in Chapter 11

In a Chapter 11 case, the Plan is submitted to creditors for a vote. Each creditor holding a claim or interest is entitled to vote to accept, or in the alternative, to reject the Plan. A class of creditors is deemed to have accepted the Plan if both more than half in number of voting creditors and at least two thirds in amount of claims held by voting creditors (based upon the amount of the claims) have voted to accept the Plan.¹³¹ The bankruptcy court may confirm the Plan if each (i.e. every) class of claims has voted to accept the Plan or any non-accepting class is not impaired under the Plan.¹³² In the event that all of the classes do not vote to accept the Plan and any such non-accepting class is impaired under the Plan, then the bankruptcy court may still confirm the Plan. This is commonly referred to as a “cram down” which is discussed below.

ii. Cram Down in Chapter 11

The bankruptcy court may confirm the Chapter 11 Plan if every class of claims has voted to accept the Plan or such non-accepting class is otherwise unimpaired. In the event that an impaired class has not voted to accept the Plan, then the plan proponent may request the Court to confirm the Plan nonetheless. This effort to “cram down” confirmation of the Plan over the non-acceptance of an impaired class is governed by the provisions of Bankruptcy Code § 1129(b). Please note that the Court may not confirm the Plan, even by cram down, unless at least one class

¹²⁹ “Projected disposable income” is defined in Bankruptcy Code § 1325(b)(2). This is an oft-cited indication that, in enacting BAPCPA, Congress intended individual Chapter 11 cases to look and act more like Chapter 13 Bankruptcy cases. Importantly, Section 1129(a)(1) cross-references Section 1325(b)(2) and not Section 1325(b)(3), which links expenses to IRS standards rather than actual expenses. In a Chapter 11, unlike a Chapter 13, there is no requirement that payments extend for a minimum or maximum period of time. Bankruptcy Code § 1129(a)(15) only requires that the value of the property distributed be not be less than the debtor’s disposable income for 5 years from the first payment under the Plan (or longer if plan payments extend for more than 5 years). Thus, if the debtor uses property from sources such as gifts, exempt property or other money not included in disposable income to fund the payments to unsecured creditors, the actual payment period may be shorter than 5 years.

¹³⁰ Expenses may include charitable contributions limited to 15% of the debtor’s gross annual income for the applicable year. If the individual debtor is engaged in business, deduction is allowed for payments necessary for the continuation, preservation, and operation of the business. See also Hamilton v. Lanning, 560 U.S. 505 (2010).

¹³¹ Bankruptcy Code § 1126(c).

¹³² Id. § 1129(a)(8).

of impaired claims has voted to accept the Plan without including acceptance by “insiders” within such accepting class.¹³³

The debtor, who is presumably the Plan proponent, may seek cram down confirmation of the Plan as to a secured creditor. The bankruptcy court may confirm the Plan over the rejection of the Plan by an impaired secured class if the Court determines that the Plan is “fair and equitable.”¹³⁴ In order to be “fair and equitable” as to a secured class, the Plan must provide that (i) the secured creditor retains its lien to the extent of its secured claim and will receive payments at least totaling the present value of its secured claim, (ii) the collateral is sold and the applicable lien attaches to the proceeds of the sale, or (iii) the secured creditor is provided with the “indubitable equivalent.”¹³⁵ Again, the Code authorizes bifurcation of a secured claim into a secured portion and an unsecured portion, provided that the secured portion of the claim receives interest.

The debtor, as the presumptive Plan proponent, may also seek cram down confirmation where an impaired class of unsecured creditors has not voted to accept the Plan. The bankruptcy court may confirm or “cram down” the Plan over the rejection of an unsecured creditor class. With respect to a non-accepting unsecured creditor class, the Plan must be “fair and equitable.” With respect to such unsecured creditor class, the Plan is not fair and equitable unless: (i) the Plan represents a 100% payment plan,¹³⁶ or (ii) the holders of claims or interests junior to the objecting class do not receive or retain anything on account of their claim or interest.¹³⁷ This is a codification of what is commonly referred to as the “absolute priority rule.” The absolute priority rule has long been a fundamental tenet of Chapter 11 practice. The application (or not) of the absolute priority rule to an individual Chapter 11 case is an issue which is currently in a state of flux and is discussed immediately below.

3. The Absolute Priority Rule for Individual Debtors

BAPCPA adopted new verbiage regarding what is colloquially referred to as the “absolute priority rule” for individuals seeking relief under Chapter 11. As discussed in part above, in order to “cram down” the Plan over a dissenting unsecured creditor class, the Court must find that the Plan is fair and equitable. In order to be fair and equitable regarding a dissenting class of unsecured creditors, the Plan must: (i) provide that holders of claims in such dissenting unsecured class retain property of value, as of the effective date of the plan, equal to allowed amount of such claim, or (ii) provide that the holder of any claim or interest that is

¹³³ Bankruptcy Code § 1129(a)(10).

¹³⁴ *Id.* § 1129(b).

¹³⁵ For the exact verbiage, please refer to Bankruptcy Code § 1129(b)(2)(A).

¹³⁶ Bankruptcy Code § 1129(b)(2)(B) 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.”

¹³⁷ Except that an individual Chapter 11 debtor “may retain property included in the estate under Section 1115, subject to requirements of subsection (a)(14)” Bankruptcy Code § 1129(b)(2)(B)(ii). This exception to the absolute priority rule for individuals is discussed later.

junior to the claims of such class will not receive or retain any property under the Plan on account of such junior claim or interest, “*except that in a case where the debtor is an individual, the debtor may retain property included in the estate under [Bankruptcy Code] § 1115, subject to the requirements of subsection (a)(14).*”¹³⁸ The italicized portion of such statutory language represents the new addition to Chapter 11 under BAPCPA which is specifically designed to control individual Chapter 11 cases. Prior to the enactment of BAPCPA, a split of authority existed regarding the proper application of the absolute priority rule in individual Chapter 11 cases and this split has continued in the post-BAPCPA era.

Post BAPCPA, Courts usually have adopted one of two positions. Some Courts adopted the “broad view” which stands for the proposition that when Congress included a cross reference to Section 1115 in Section 1129(b)(2)(B)(ii), it intended for the debtor to be able to retain the entirety of the bankruptcy estate and thus abrogated the absolute priority rule for individual debtors in Chapter 11. Other Courts adopted the “narrow view” which stands for the proposition that Congress did not intend to completely overturn the absolute priority rule and that BAPCPA amended the absolute priority rule “so that individual debtors could exclude from its reach only their post-petition earnings and post-petition acquisitions of property, i.e. property that was not already included in the Chapter 11 estate by § 541. *In re Lively*, 717 F.3d 406 (5th Cir. 2013). Under the narrow view, individual Chapter 11 debtors may retain post-petition earnings and property.”¹³⁹

Of the courts adopting the broad view,¹⁴⁰ some, including the U.S. Bankruptcy Appellate Panel for the 9th Circuit, have applied a “plain-meaning analysis” to determine that a “plain reading of [Bankruptcy Code] § 1129(b)(2)(B)(ii) and 1115 together mandates that an absolute priority rule is not applicable under individual Chapter 11 debtor cases.”¹⁴¹ On the other hand, three circuit courts have adopted the narrow view and held that the Chapter 11 absolute priority rule *does* apply in individual debtor cases.¹⁴² *In Lively*, the Fifth Circuit adopted the narrow view and stated that “the exception to the absolute priority rule plainly covers only the individual debtor’s post-petition earnings and post-petition acquired property.”¹⁴³

Outside of the 4th, 5th, 9th and 10th Circuits, the viability of confirming an individual Chapter 11 Plan remains a very judge-specific and jurisdiction-specific issue. Eventually, it is

¹³⁸ Bankruptcy Code § 1129(b)(2)(B)(ii).

¹³⁹ *In re Maharaj*, 681 F.3d 558, 563 (4th Cir. 2012).

¹⁴⁰ See *In re Friedman*, 466 B.R. 471 (9th Cir. BAP 2012); *SPCP Group, LLC v. Biggins*, 465 B.R. 316 (Bankr. M.D. Fla. 2011); *In re Shat*, 424 B.R. 854 (Bankr. D.Nev. 2010); *In re Johnson*, 402 B.R. 851 (Bankr. N.D. Ind. 2009); *In re Tegeder*, 369 B.R. 477 (Bankr. D. Neb. 2007); *In re Roedemeier*, 374 B.R. 264 (Bankr. D. Kan. 2007); *In re Bullard*, 358 B.R. 541 (Bankr. D. Conn. 2007).

¹⁴¹ *In re Friedman*, 466 B.R. 471, 482 (9th Cir. BAP 2012). See also *Biggins*, 465 B.R. at 322; *Tegeder*, 369 B.R. at 480.

¹⁴² *In re Lively*, 717 F.3d 406, 407 (5th Cir. 2013); *In re Stephens*, 704 F.3d 1279 (10th Cir. 2013); *In re Maharaj*, 681 F.3d 558 (4th Cir. 2012).

¹⁴³ *In re Lively*, 717 F.3d at 409.

expected that this issue will continue to bubble until it eventually reaches the Supreme Court, as a further split in the circuits may occur based upon the divergence developing in the lower courts. There is also an established history of U.S. Supreme Court attention to application of the absolute priority rule in Chapter 11 cases in general.¹⁴⁴ Until such time as all of the respective circuits have ruled or the U.S. Supreme Court provides a final determination, individual debtors in some jurisdictions must file cases with a level of uncertainty regarding the ability to confirm a Plan absent the accepting vote of all unsecured creditor classes.

4. The New Value Exception

If the absolutely priority rule applies to individual Chapter 11 debtors, then it follows that the exceptions which courts apply to the absolute priority rule in corporate cases apply to individual cases as well. The most widely debated and discussed exception to the absolute priority rule is known as the “new value exception” which provides that a junior class may still retain property where a senior class is receiving less than its allowed claims if the junior class provides “new value.” The new value exception finds its origin in Case v. Los Angeles Lumber Products Co., where the U.S. Supreme Court ruled that the corporate debtor’s shareholders had to contribute new value, specifically “money or money’s worth,” to the debtor in order to retain their equity interests in the reorganized debtor.¹⁴⁵ The exception has never been codified which leads to debate regarding the legitimacy of its application. Nonetheless, many courts hold that the exception is alive and well.

In order to utilize the new value exception to the absolute priority rule, a debtor must contribute property that is “(1) new, (2) substantial, (3) money or money’s worth, (4) necessary for a successful reorganization, and (5) reasonably equivalent to the value or interest received.”¹⁴⁶ The “new value” must also be “tangible, alienable, enforceable, and something of value to the creditors at the time the plan is confirmed.”¹⁴⁷ The contribution of a portion of the debtor’s future salary or earnings arguably would not satisfy the new value requirements just as “sweat equity” does not constitute new value to a corporate Chapter 11 debtor.¹⁴⁸

5. Section 1111(b) Elections

Chapter 11 debtors should be aware of the possibility that an undersecured creditor (that is, a creditor whose collateral is worth less than the amount of its allowed claim) may choose to make a Section 1111(b) election. Section 506(a) provides that an undersecured secured creditor’s claim is bifurcated in two parts: (1) a secured claim equal to the value of its collateral and (2) an

¹⁴⁴ See generally Bank of Am. Nat’l. Trust & Sav. Ass’n v. 203 N. LaSalle St. Partnership, 526 U.S. 434 (1998).

¹⁴⁵ 308 U.S. 106, 122 (1939).

¹⁴⁶ In re Bonner Mall Partnership, 2 F.3d 899, 908-09 (9th Cir. 1993).

¹⁴⁷ Northwest Bank Worthington v. Ahlers, 485 U.S. 197, 204 (1988).

¹⁴⁸ See Case, 308 U.S. at 122. Also, such post-petition earnings constitute property of the estate and therefore may not represent “new” value.

unsecured claim for the deficiency. However, Section 1111(b) allows an undersecured creditor to avoid bifurcation under Section 506(a) and elect to retain its lien for the full amount of its allowed claim and have its entire claim treated as secured under the plan.¹⁴⁹ In essence, the election provides an undersecured creditor with the opportunity to be paid the full amount of its claim.¹⁵⁰ Once a creditor makes the election, it will no longer have an unsecured claim included in the unsecured class and thus lose the opportunity to block confirmation of the plan in a capacity as an unsecured creditor.

A creditor must make the Section 1111(b) election before the “conclusion of the hearing” on approval of the disclosure statement.¹⁵¹ A creditor may not make a Section 1111(b) election if the value of the secured creditor’s lien on the collateral is “inconsequential.”¹⁵² Such elections can be common in a depressed economy where the value of the collateral has significantly decreased due to the state of the economy but the amount of the debt can remain high.¹⁵³ The election may enable creditors to prevent debtors from taking “unfair” advantage of a depressed economy. The possibility of a Section 1111(b) election may be an important consideration when deciding between filing Chapter 11 and Chapter 13 because Chapter 13 does not contain an equivalent provision.

VIII. Obtaining a Discharge and Closing the Case

Following confirmation of an individual debtor’s Plan, issues still exist regarding obtaining a discharge and the procedure for closing the case.

A. Chapter 13 Discharge

In a Chapter 13 Case, discharge occurs once the debtor has fully complied with and completed its Chapter 13 Plan.¹⁵⁴ With a few exceptions¹⁵⁵, a discharge under Section 1328 discharges the debtor from all debts included in the Plan. The Chapter 13 discharge is broader than a discharge that one may receive under the other chapters of the Bankruptcy Code because it encompasses types of debts that would be nondischargeable in Chapter 7, Chapter 11, or Chapter 12, such as obligations for “willful and malicious injuries.”¹⁵⁶ Before a court may grant a Chapter

¹⁴⁹ See Bankruptcy Code § 1111(b)(2).

¹⁵⁰ The creditor may not necessarily receive interest on the entire amount. Only the secured portion of the claim accrues interest. See generally *G.E. Credit Equities Inc. v. Brice Rd Devs, LLC*, 392 B.R. 274, 285 (B.A.P. 6th Cir. 2008).

¹⁵¹ Bankruptcy Rule 3014.

¹⁵² Bankruptcy Code § 1111(b)(1)(B)(i).

¹⁵³ See Jo Ann J. Brighton, *The Resurrection of Section 1111(b) in a Depressed Economy*, Norton Annual Survey of Bankr. L. (Feb. 2011).

¹⁵⁴ Bankruptcy Code § 1328.

¹⁵⁵ *Id.* § 1328(a).

¹⁵⁶ Collier on Bankruptcy ¶ 1328.01.

13 debtor a discharge, the debtor must provide proof that it completed a personal financial management instructional course pursuant to Section 1328(g).

B. Individual Chapter 11 Debtor Discharge

In a Chapter 11 Case filed by an entity (i.e. a non-individual debtor), discharge occurs at confirmation of the Plan unless the Plan provides for a liquidation of the debtor or ceasing of the debtor's business operations.¹⁵⁷ However, BAPCPA provided a new provision regarding the discharge for individual Chapter 11 debtors. Under the post-BAPCPA code, an individual debtor does not receive a discharge until the individual Chapter 11 debtor completes all payments under the Plan, unless the Court orders otherwise.¹⁵⁸ The Court may only grant the individual Chapter 11 debtor an "early" discharge (prior to completion of Plan payments) if three requirements are met. First, the debtor must have satisfied the "liquidation test" in that the property which has been distributed to unsecured creditors is at least the amount that would have been paid under Chapter 7.¹⁵⁹ Second, the Court must determine that the individual Chapter 11 debtor's modification of the Plan is not practical.¹⁶⁰ Third and finally, the Court must determine that "no reasonable cause" exists to believe that Bankruptcy Code § 522(q)(1) may be applicable to the debtor.¹⁶¹ In order to receive a discharge, an individual Chapter 11 must complete a post-petition financial management course.¹⁶²

C. Closing the Individual Chapter 11 Case

Following confirmation of the Plan, a debtor may seek to obtain a "Final Decree" which effectively closes the case. The debtor may seek a Final Decree closing the case if the debtor establishes that there has been "substantial consummation" of the Plan. Bankruptcy Code § 1101(2) defines substantial consummation as – (a) transfer of all or substantially all of the property proposed by the Plan to be transferred; (b) assumption by the debtor or by the successor

¹⁵⁷ Bankruptcy Code § 1141(b)(1).

¹⁵⁸ *Id.* § 1141(d).

¹⁵⁹ Bankruptcy Code § 1141(d)(5)(B)(i) states that the Court may grant a discharge to the debtor who has not completed payments under the Plan if – "the value as of the effective date of Plan of property actually distributed under the Plan on account of each 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."

¹⁶⁰ *See* Bankruptcy Code § 1141(d)(5)(B)(ii) which incorporates the provisions regarding modification of the Plan under Bankruptcy Code § 1127.

¹⁶¹ Please refer to Bankruptcy Code § 522(2)(1) for the full text. In general, Bankruptcy Code § 522(q)(1) relates to violations of federal security laws. In addition, Bankruptcy Code § 522(2)(1)(B)(iii) concerns debts arising from "any criminal act, intentional tort, or willful or reckless misconduct that causes serious physical injury or death to another individual in the preceding 5 years." The result seems to be that an individual debtor may not be entitled to an "early" discharge (i.e., prior to completion of plan payments) if the debtor owes a debt for an intentional tort occurring within 5 years.

¹⁶² Bankruptcy Code § 1141(d)(3)(C).

to the debtor under the Plan of the business or management of all or substantially all of the property dealt with by the Plan; and (c) commencement of distributions under the Plan. In other words, if a Plan provides for transfer of substantially all of the debtor's property, the debtor may not obtain a Final Decree until such has been effectuated. However, the real bellwether for a showing of substantial confirmation usually is whether the debtor has commenced distributions under the Plan. Once the debtor has commenced distributions under the Plan, a debtor may often show that "substantial consummation" exists and thereby obtain a Final Decree. A motivating factor in obtaining a Final Decree and closing the case is that the debtor no longer is required to pay United States Trustee's fees after the case is closed.

An open question exists as to whether a debtor may close the case prior to obtaining a discharge. It is the author's understanding that the policy of the United States Trustee is currently not to require a debtor to remain in an open, pending Chapter 11 case during the time that all Plan payments are being made. Therefore, it may be prudent for a debtor to seek closure of the case prior to obtaining entry of a discharge and later seek to reopen the case after Plan payments have been concluded and seek a discharge at that time. This procedure may vary by jurisdiction.

D. Post-Confirmation Plan Modifications

An individual Chapter 11 debtor may modify its Plan at any time after confirmation but before the completion of payments under the Plan, in order to (i) modify the amount of its Plan payments, (ii) modify the time period for such payments, or (iii) alter the amount of the distribution to a creditor to reflect a reduction in that creditor's claim from payments not provided in the Plan.¹⁶³ This provision is nearly identical to the Plan modification section in Chapter 13 cases, but does not include the health insurance provision of Section 1329(a)(4).

In a Chapter 13 case, pursuant to Section 1329(a), a Plan may be modified any time after confirmation and before completion of all payments under the Plan. The Code specifies that the debtor, the trustee, or a holder of an allowed unsecured claim may make a request to modify the Plan.¹⁶⁴ A Chapter 13 plan may be modified to adjust the amount of payments to claims in a particular class, to alter the time for payments, to change the distribution to a certain creditor who has received some amount outside of the Plan, and to reduce amounts due under the Plan by the actual amount spent by the debtor to purchase health insurance for itself.¹⁶⁵ The standards and requirements of Sections 1322(a) and (b), 1323(c) and 1325(a) apply to any modification of a Chapter 13 plan.¹⁶⁶ The applicable commitment period of the original plan will still apply to the modified plan, unless the court, for cause, approves a longer period.¹⁶⁷

IX. Conclusion

¹⁶³ Bankruptcy Code § 1127(e).

¹⁶⁴ *Id.* § 1329(a).

¹⁶⁵ *Id.* § 1329(a).

¹⁶⁶ *Id.* § 1329(b)(1).

¹⁶⁷ Bankruptcy Code § 1329(c).

It is impossible to cover all of the law, rules, and requirements of Chapter 13 and Chapter 11 in a presentation of this size and scope. To be sure, each Chapter would likely require its own multivolume treatise, of which there are many. Therefore, the effort has been to provide an outline of the applicable areas which are often encountered. Representing individual business debtors is often a worthwhile and rewarding experience. These individuals often have no other hope of reorganizing their affairs and obtaining a “fresh start” as Chapter 7 may have provided dire consequences. For many individual Chapter 11 debtors, Chapter 13 may not have been available or appropriate.

With respect to Chapter 11 cases, counsel unfamiliar with the nuances and intricacies of Chapter 11 should enter the arena with caution. Chapter 11 cases invariably offer unexpected issues and problems. This is especially true in individual Chapter 11 cases because of the inherent nature of representing square peg-like individuals (versus corporate entities) and the fact that BAPCPA did not completely fashion Chapter 11 into a vehicle easily susceptible to accommodating such individuals.