AMERICAN BANKRUPTCY INSTITUTE

2018 Central States Bankruptcy Workshop

Consumer Track

An Individual Chapter 11 Case Is Not Just a Bigger 13

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CONCURRENT SESSION

2018

Selected Issues in Individual Chapter 11 Cases

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I. Property of the Estate and Changes Under BAPCPA

A. Summary of Changes

1. Prior to BAPCPA, § 541(a)(6) of the Bankruptcy Code applied equally to Chapter 7 and Chapter 11 cases, which excluded "earnings from services performed by an individual debtor after the commencement of the case" from the definition of "property of the estate".
2. This was particularly important to an individual Chapter 11 debtor's bankruptcy estate. *See Comput. Task Grp., Inc. v. Brotby (In re Brotby)*, 303 B.R. 177 (B.A.P. 9th Cir. 2003).
3. But this old definition was not without its issues. One problem in individual Chapter 11 cases was the difficulty Courts faced defining the portion of post-petition income derived from personal services, as opposed to income derived from pre-petition property.
    a. For example, if the debtor worked for a third-party employer and received a weekly paycheck, it was a simple matter to prorate the weekly pay between pre- and post-petition periods.
    b. On the other hand, if the debtor was a professional or small business owner, like a doctor, lawyer, or a sole proprietor, courts struggled to allocate the portion of post-petition income derived directly from the personal services of the individual debtor and the portion of post-petition income derived from business or estate assets. *See In re Fitzsimmons*, 725 F.2d 1208 (9th Cir. 1984).
4. Prior to the changes created by BAPCPA, if an individual debtor filed a petition under Chapters 11 or 13, and then later the case was converted to one under Chapter 7, the debtor could retain post-petition property in

the converted case—i.e., define such property as not being property of the estate in the converted case.

5. BAPCPA changed this result for Chapter 11 debtors.

   a. The major change in this respect was the addition of new § 1115(a)(1). It added language to Chapter 11 that is identical to that contained in § 1306(a)(1) which provides that any property of the kind specified in § 541 acquired after commencement of the case is property of the Chapter 11 estate. This makes post-petition income property of a Chapter 11 debtor's estate.

   b. The corollary to this change is that upon conversion of a case from Chapter 11 to Chapter 7, the post-petition property remains property of the Chapter 7 estate because § 348(f) applies only upon conversion from Chapter 13 to Chapter 7.

   c. So, Congress added § 1306(a)(1)-type language, but then failed to amend § 348(f) to make individual Chapter 11 cases fully analogous to Chapter 13 cases. Courts have struggled with this dichotomy between the treatment of Chapter 13 and Chapter 11 individual debtors.

6. After the amendments to the Bankruptcy Code in BAPCPA, § 1115 makes it clear that all property acquired after the commencement of a bankruptcy case, including earnings from services performed during the Chapter 11 case, is property of the estate.

7. But does the failure of Congress to amend § 348(f) mean that the inclusion of post-petition income is automatic?

   a. An argument can be made that once a debtor exercises the statutory right to convert to Chapter 7, Chapter 11 becomes inapplicable and only the rules governing Chapter 7 cases should be followed. Because debtors are immediately stripped of their role as Debtors-In-Possession upon conversion and, pursuant to § 348(a), the creation of the Chapter 7 estate requires using the date the original Chapter 11 petition was filed to determine property of the estate, the argument goes, all post-petition earnings would belong to the debtor because they are not considered property of the Chapter 7 estate under § 541(a)(6).

   b. But § 348(f) does not mention Chapter 11.

   c. Courts have been split on this.

B. Case Law

1. Minority View – Post-petition Chapter 11 property is not Chapter 7 property.

a. *Wu v. Markosian (In re Markosian)*, 506 B.R. 273 (BAP 9th Cir. 2014)

i. Facts: The debtors filed a Chapter 7 petition and the trustee moved to dismiss based on the debtors' high income and their ability to pay creditors. In response, the debtors converted the Chapter 7 case to Chapter 11. Over two years later the debtors were unable to confirm a plan because Mrs. Markosian had lost her job. The debtors re-converted their case back to Chapter 7, at which point the issue arose about whether the over $100,000 that Mr. Markosian had received from his employer while the debtors' case was still under Chapter 11 would be considered property of the debtors' re-converted Chapter 7 case. The debtors turned over the money to the trustee and subsequently filed a motion to determine their interest in it. The bankruptcy court denied the debtors' motion to exclude the property from the estate without prejudice but permitted a new motion to be filed addressing whether the bonus was property of their Chapter 11 estate pursuant to § 1115(a)(2), and if so, whether it subsequently became property of the Chapter 7 estate. Debtors also filed a motion to compel the trustee to return the money as either partially exempted property of the bankruptcy estate or as property excluded from the Chapter 7 estate upon reconversion to Chapter 7.

ii. Holding: The bankruptcy court found the money constituted earnings from personal services within the meaning of § 1115(a)(2) but concluded that it ceased to be property of the estate upon conversion to Chapter 7. The Trustee appealed.

iii. Reasoning: The bankruptcy court reasoned that 11 U.S.C. § 541(a)(6) excludes from the Chapter 7 definition of "property of the estate" earnings from services performed by individual debtors after the

commencement of the case. Therefore, by operation of 11 U.S.C. § 348(a), personal service income that comes into the debtors' Chapter 11 estate is recharacterized as property of the debtor under § 541(a)(6) when the case is converted to Chapter 7. The 9th Circuit Bankruptcy Appellate Panel ("BAP") agreed and rejected other courts' decisions (that relied on Congress' failure to enact a provision parallel to § 348(f)(1)(A) for Chapter 11 debtors to justify making post-petition property part of converted chapter 7 estates). The BAP reasoned that the other courts' decisions failed to consider the impact of § 348(a) and such failure resulted in § 348(f)(1)(A) having no independent effect, despite the statute's plain language that makes it applicable to all case conversions. The BAP reasoned that treating converted Chapter 11 cases differently from converted Chapter 13 cases attempts to divine Congressional intent from Congressional silence, which the panel characterized as, ". . . an enterprise of limited utility that offers a fragile foundation for statutory interpretation." *Markosian*, 506 B.R. at 277. Instead, the panel stated it considered the context of § 348(f)(1)(A). Moreover, Congress amended § 348 in 1994 to add subsection (f)(1)(A), well before it enacted 11 U.S.C. § 1115, which broadened the definition of "property of the estate" in a Chapter 11 case to include post-petition earnings. The legislative history of 11 U.S.C. § 348(f)(1)(A) reveals that an amendment was needed to resolve a split among courts concerning whether a Chapter 13 debtor's post-petition earnings remained property of the estate upon conversion to Chapter 7. The BAP then determined that because the amendment was for this specific purpose, the fact that Congress did not enact a parallel provision to § 348(f)(1)(A) for Chapter 11 case conversions when it enacted § 1115 held little, if any, significance because there was no split of authority yet to be resolved. Ultimately, the BAP found there was no reason to treat Chapter 11 debtors differently from Chapter 13 debtors in this context.

2. Majority View – Post-petition Chapter 11 property is Chapter 7 property

   a. *In re Meier*, 528 B.R. 162 (Bankr. N.D. Ill. 2015)

      i. Facts: The debtor filed for bankruptcy relief under Chapter 11 and, after a lengthy litigation battle in both bankruptcy and state court, voluntarily converted his case to Chapter 7. After conversion, the debtor filed a final Chapter 11 report which identified $98,004.23 in his DIP account and identified it as "not property of the estate." A creditor filed a motion to compel turnover of the DIP account funds to the trustee, in which the trustee joined. The debtor argued that a Chapter 11 debtor's post-petition personal services income does not become property of the Chapter 7 estate upon conversion to Chapter 7 or, alternatively, even if it does become estate property, a percentage would be exempt under an applicable Illinois statute.

      ii. Holding: Under § 1115(a)(2), property of a Chapter 11 estate includes earnings from services performed by debtor after the commencement of his case but before conversion to Chapter 7. Section 348(f)(1) does not apply to a conversion from Chapter 11 to Chapter 7. Thus, post-petition personal service income of a Chapter 11 debtor is property of the Chapter 7 estate upon conversion and the court ordered the funds to be turned over to the trustee. (The Illinois statute was also held to be inapplicable.)

      iii. Reasoning: The Court based its decision on two cases: the *Markosian* case and *In re Lybrook*, 951 F.2d 136 (7th Cir. 1991). In *Lybrook*, the debtors initially filed under Chapter 13 but converted to Chapter 7 about 15 months later. After the petition date but before conversion, the debtors inherited $70,000 worth of farm land which the trustee sought to have turned over to the Chapter 7 estate. The debtors argued that the inheritance was post-petition and should not be part of the Chapter 7 estate under § 348, which provides that conversion of a case from one chapter to another does not affect the petition's

filing date. The 7th Circuit agreed that the debtors' reading of § 348 was plausible, but determined the better interpretation was that conversion from Chapter 13 to Chapter 7 does not affect the bankruptcy estate, but merely assures the continuity of the case for purposes of filing fees, preferences, statutes of limitations, and so forth. The 7th Circuit held that "a rule of once in, always in is necessary to discourage strategic, opportunistic behavior that hurts creditors without advancing any legitimate interest of debtors." *Id*. at 137. After also examining the *Markosian* opinion, the *Meier* court disagreed with the 9th Circuit BAP's statement that when Congress added § 1115(a)(2), it neglected to fix § 348(f) because there was no reason to treat Chapter 11 and Chapter 13 debtors differently. The court noted that when § 348(f)(1) was enacted in 1994, Chapter 12 contained § 1207(a)(2), its own equivalent to § 1306(a)(2), which had been enacted in 1986. Because § 348(f)(1), added in 1994, only affects conversions from Chapter 13 (and not from Chapter 12), Congress did not intend to reject the rule in *Lybrook* generally instead of only in Chapter 13. As a result, there is only an express statutory command regarding conversions from Chapter 13, namely § 348(f)(1), but there is no such statute for Chapter 11. The *Meier* court also adopted much of the reasoning used by the 7th Circuit in *Lybrook*.

II. Use of Post-Petition Income and the Ability to Pay "ordinary living expenses" in Individual Chapter 11 Cases

A. Overview

1. The inclusion of post-petition earnings as property of the estate has additional ramifications for the individual debtor and significantly changed individual Chapter 11 practice since BAPCPA went into effect.

   a. Issues concerning a debtor's claims for exemptions are typically much more critical and contested because of their impact on the ability to successfully confirm a plan.

b. The inclusion of post-petition earnings as property of the estate also implicates the § 363 use of estate property and cash collateral post-petition. This section governs the circumstances under which a debtor may use wages to fund business operations, pay secured debt, and meet lifestyle needs. The implication of § 1115(a) are felt in numerous ways.

i. How does a debtor pay its normal and necessary living expenses post-petition?

ii. Are these included under "ordinary course of business"?

iii. May exempt property be used to fund a plan? To pay living expenses?

2. To review, once property is considered "property of the estate," it can only be used by a DIP pursuant to some authority provided for in the Code or by order of the bankruptcy court. Such authority is typically found within § 363, which authorizes the DIP to use property of the estate other than cash collateral in the ordinary course of business without a hearing. Conversely, under § 363(b)(1), property of the estate can only be used "other than in the ordinary course of business" after notice and a hearing, with approval of the bankruptcy court.

3. Section 1129(a)(15) of the Code requires, as a condition of confirmation, that debtors distribute an amount equal to five years of their projected disposable income (now property of the estate) under a reorganization plan. In other amendments applying primarily to Chapter 7 cases, Congress adopted the "means test" to ensure that, ". . . debtors repay creditors the maximum they can afford." *Ransom v. FIA Card Servs., N.A.*, 131 S. Ct. 716, 721 (2011). As a policy matter, the means test may inform policy arguments in this area.

4. The upshot of this requirement is that Section 1129(a)(15) gives unsecured creditors the ability to object to confirmation if an individual Chapter 11 debtor fails to devote post-petition disposable income to the funding of the plan of reorganization. Dissenting creditors who are not being fully paid under the plan are effectively given an absolute veto power over plan confirmation unless the debtor contributes an amount equal to all his/her projected disposable income to funding the proposed plan. *See In re Friedman*, 466 B.R. 471 (B.A.P. 9th Cir. 2012).

5. The practical effect of this scheme means individual debtors must either propose a plan that pays the full allowed amount of creditor claims, or the plan must provide for the debtor to devote projected disposable income to fund plan payments for a five-year plan period or during the period for which the plan provides payments, whichever is longer. *See* § 1129(a)(15).

6. To invoke this provision, an unsecured creditor must affirmatively oppose the plan based on a legal argument under the Code. *See, e.g.*, *In re Shat*, 424 B.R. 854 (Bankr. D. Nev. 2010).

7. All the foregoing is well and good, but debtors must continue to eat, pay rent or mortgage payments, and otherwise support a life style during the plan period—most often for five years. Just as in Chapter 13 analysis, if the plan cannot sustain some sort of life for the debtor, the likelihood of a successful plan period is severely reduced.

8. While Congress determined that future income is property of the estate unless otherwise exempt, Congress did not provide guidance as to how property could be used by the debtor during the pendency of an individual Chapter 11 case. "Ordinary course of business" may be straightforward in a corporate chapter 11 reorganization case but is less than clear when applied to individual Chapter 11 debtors.

9. The remedies created appear to be *ad hoc*.

   a. Some courts have resolved the issue by entering first-day orders that allow an individual debtor to continue to make ordinary living expenses.

   b. Absent the entry of such an order, an individual debtor or debtor's counsel may choose to seek approval of an expense budget that is similar to procedures in connection with seeking use of cash collateral, to minimize any issues that may arise at confirmation as to the reasonableness of an expense.

   c. Without legislative guidance, courts have adopted a case-by-case analysis as to the reasonableness of an individual Chapter 11 debtor's expenditures.

B. <u>Case Law – Not very Instructive (Piggish behavior penalized)</u>

1. *In re Draiman*, 450 B.R. 777 (Bankr. N.D. Ill. 2011)

   a. <u>Facts</u>: The debtor filed under Chapter 11, while continuing in possession of his assets, conducting his business, and

managing his financial affairs as a DIP. Apparently, pre-petition the debtor had a lavish lifestyle. The court noted that the debtor, ". . . had chosen not to tighten his belt during the course of his Chapter 11 case." His expenditures included: household expenses (not including his mortgage, food, utilities, cable TV, or telephone) of $10,358.68 in one month; $7,354.22 and $11,559.25 on food in just two months; entertainment expenses of $6,424.24 and $12,724.71 in two different months; a vacation to Hawaii with a stay at the Ritz-Carlton; expensive shopping trips to women's clothing stores despite not being married and not having any dependents; and two trips to a casino. The debtor sought confirmation of a plan, but a creditor objected, arguing, *inter alia*, that the plan was not proposed in good faith.

b. Holding: For several reasons, including the debtor continuing to live a lavish lifestyle, the creditor's objections to confirmation were sustained in part and the proposed plan was denied.

2. Reasoning: The court found that the debtor's casino gambling and purchases at women's clothing stores, when he did not have a spouse or other female dependents, demonstrated a "complete lack of regard for repayment of his creditors" and was "offensive to the integrity of the bankruptcy system." Gambling with estate money is inherently contrary to the fiduciary standards owed by a DIP. Not only is it far too risky to gamble at casinos where the games are structured to favor the house, but the Chapter 11 DIP holds its power in trust for the benefit of creditors and has a duty to protect and conserve estate property for their benefit. Since the debtor chose selfish pursuits over his fiduciary duty to the estate and his creditors, the Court sided with the creditor and rejected the proposed plan.

3. Interpreting anything from this case, other than "pigs get eaten", is risky, and there is precious little guidance beyond this in the case law.

III. Absolute Priority Rule Issues

A. Overview

1. The Absolute Priority Rule (the "APR") is a bedrock concept that governs virtually every other policy consideration underlying the Bankruptcy Code.

Chapter 11 is no exception and is deeply guided by the requirement that the plan be "fair and equitable" (read, it follows the APR).

2. As a general proposition (and absent a consensual plan confirmation under § 1129(a)), the APR requires the payment of allowed claims or classes of claims that are granted priority under § 507(a), to be paid in full before any payment may be made to an allowed claim or class of claims that hold an inferior classification. The essence of the APR is this, and it guides and informs plan negotiations, out of court settlements and restructurings, and a host of other commercial transactions all the way to the initial structuring of debt obligations.

3. In chapter 11, the APR is played out, in part, under §§ 1129(a)(1), (7)(A)(2), (8)(B), (9), (15) and 1129(b). For purposes of our discussion about individual Chapter 11 cases, the provisions of § 1129(b) are most often invoked.

4. The problem almost always arises when a plan provides for less than full payment to unsecured creditors, while also proposing that the equity security holders retain their ownership interest.

5. Section 1129(b)(2)(B)(ii) provides that absent payment in full through the plan of reorganization to creditors, the holder of any claim or interest that is junior to the unsecured claims, including the equity interest of the debtor, must not receive anything of value under the plan attributable to its junior interest. *See* 11 U.S.C. § 1129(b)(2)(B)(ii); *See also Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988). In short, unless all creditors are paid in full, the stockholders lose their ownership interest in the debtor.

6. Originally created by courts who were interpreting the former Bankruptcy Act, the APR was intended to prevent shareholders from receiving a distribution in Chapter 11 if the plan was being crammed down on a dissenting class of creditors holding a higher priority under the APR. When Congress codified the APR in the 1978 Bankruptcy Code (see above), it meant that individuals in Chapter 11 using cramdown could not keep property.

7. This is fairly settled when the debtor is a company. It was not at all clear what § 1129(b) meant in the context of an

individual Chapter 11. There is no way—physically or legally—to separate the "equity security holder" from the person. So, how does an individual debtor "cram down" a plan?

8. Prior to BAPCPA, when an unsecured creditor class objected to an individual Chapter 11 plan of reorganization that did not pay them in full, the plan had to satisfy the APR by meeting the "fair and equitable" requirement under the Code. But that requirement applied only to property of the estate, meaning property that existed prior to the filing of the petition.

9. Once the fair and equitable test was met, it required individual Chapter 11 debtors to use assets that were property of the estate on the petition date to fund their plan of reorganization, while not requiring them to devote any of their post-petition earnings to pay unsecured creditor's claims. This included virtually all the debtor's pre-petition assets, including pre-petition business assets that the individual debtor needed to continue in business.

10. BAPCPA amended §§ 1129(b)(2)(B)(ii) and 1115(a) of the Code. To some observers, Congress intended to change the rule by amending § 1129(b)(2)(B)(ii) to create an exception to the APR for individuals. As noted above, BAPCPA at the same time added the entirely new § 1115, which brings property that was acquired after bankruptcy into the estate, including earnings from services rendered post-petition. The controversy created by the amendments turns on the reference in § 1129(b)(2)(B)(ii) to, ". . . the debtor may retain property included in the estate under § 1115. . , " and whether the reference in § 1115(a) to, ". . . in addition to the property specified in section 541. . ." is to be read in conjunction with § 1129 to permit the debtor to retain all property of the estate — both the pre-petition property as well as post-petition personal service earnings and other post-petition property — or to retain just post-petition earnings and property.

11. The new clauses in subsection (B)(ii) plainly create an exception to the APR that apply only to a Chapter 11 "case in which the debtor is an individual." 11 U.S.C. § 1129(b)(2)(B)(ii). But, courts must decide what is the exception's scope. Or, put another way, what property

may an individual Chapter 11 debtor retain without running afoul of the APR?

a. Courts applying the narrow view of the exception hold, ". . . that the BAPCPA amendments merely have the effect of allowing individual Chapter 11 debtors to retain property and earnings acquired after the commencement of the case that would otherwise be excluded under § 541(a)(6) & (7)." *See Maharaj v. Stubbs & Perdue, P.A. (In re Maharaj)*, 681 F.3d 558 (4th Cir. 2012). Under this view, an individual debtor may not cram down a plan that would permit the debtor to retain prepetition property that is not excluded from the estate by § 541 but may cram down a plan that permits the debtor to retain only post-petition property.

b. Courts applying the broader view of the exception hold that by including in § 1129(b)(2)(B)(ii) a cross-reference to § 1115 (which in turn references § 541), Congress intended to include the entirety of the bankruptcy estate as property that the individual debtor may retain post-confirmation, thus effectively abrogating the APR in Chapter 11 for individual debtors. *Id.*

B. Case Law

1. Majority of Courts: The Narrow View

a. *Zachary v. Cal. Bank &Trust*, 811 F.3d 1191 (9th Cir. 2016)

b. Facts: Two debtors filed an individual Chapter 11 petition. The Debtors' plan placed their largest unsecured creditor, California Bank & Trust ("California Bank"), into its own class of unsecured creditors and proposed to pay it $5,000 on its claim of nearly $2,000,000. California Bank's claim was thus "impaired under the plan" pursuant to § 1129(a)(8)(B). California Bank voted against the plan and objected to the plan, arguing the plan violated the APR. The bankruptcy judge sustained the Bank's objection to the plan, holding that, ". . . the absolute priority rule still prevails. . . " in

individual Chapter 11 bankruptcies. The debtors appealed.

c. Holding: The Court adopted the narrow view, as discussed above, holding that the BAPCPA amendments did not impliedly repeal the APR. The Court allowed individual Chapter 11 debtors to cram down a plan that permitted the debtor to retain post-petition property, but would not allow a plan that permitted the debtor to retain pre-petition property that was not excluded from the estate by § 541.

d. Reasoning: The 9th Circuit considered a prior 9th Circuit B.A.P. opinion that took the broader view discussed above. In *In re Friedman*, 466 B.R. 471 (B.A.P. 9th Cir. 2012), the debtors were individuals and their largest unsecured creditor voted against their proposed plan on the grounds it violated the APR by leaving their ownership interests in valuable property untouched, while paying unsecured creditors only $634 a month. The bankruptcy court agreed with the creditor and concluded the APR applied to individual Chapter 11 plans, but the B.A.P. overruled the decision, finding that a plain reading of §§ 1115 and 1129(b)(2)(B)(ii) together mandated the APR was not applicable in individual Chapter 11 debtor cases. In *Zachary*, the 9th Circuit rejected the reasoning used in *Friedman*. Instead, the Court adopted the 6th Circuit's reasoning in *Ice House Am., LLC v. Cardin*, 751 F.3d 734 (6th Cir. 2014), finding the critical language in § 1129(b)(2)(B)(ii) is that the debtor may retain property included in the estate under § 1115. It held that the key word in the change to § 1129(b)(2)(b)(ii) was "included." "Include," it held, is a transitive verb, which means it shows action, either upon someone or something and the action described by "include" is either ". . . to take in as a part, an element, or a member. . . " or ". . . to contain as a subsidiary or subordinate element." The first definition describes genuine action—grabbing something and making a part of a larger whole—whereas the second definition lends itself, more dryly, to a description of things that are

already there. The Court held that the first definition is plainly the better fit in § 1129(b)(2)(B)(ii): converted into the active voice, § 1129(b)(2)(B)(ii) refers to property that § 1115 includes in the estate, which naturally reads as ". . . property that § 1115 takes into the estate. . ," rather than as ". . . property that § 1115 contains in the estate." Using this definition, § 1129(b)(2)(B)(ii) provides, ". . . the debtor may retain property that § 1115 takes into the estate." This, the Court reasoned, means what § 1115 takes into the estate is property that the debtor acquires after the commencement of the case, and it is only that property which the debtor may retain when his unsecured creditors are not fully paid.

2. Minority of Courts: The Broader View

   a. *In re Anderson*, No. 11-61845-11, 2012 Bankr. LEXIS 3539 (Bankr. D. Mont. Aug. 1, 2012)

   b. Facts: The debtor filed for Chapter 11 relief after pleading guilty to issuing a bad check. His proposed plan paid the victims of his bad checks in full, but only paid other unsecured creditors a portion of what they were owed. A creditor filed an objection to confirmation of the debtor's plan, claiming, *inter alia*, that the plan impermissibly favored the victims of the bad checks and violated the APR.

   c. Holding: The court overruled the creditor's objections, finding the plan was accepted by creditors that held at least two-thirds in amount and more than half in number of the allowed claims in each class. The debtor's proposal to pay the victims in full while paying other unsecured claimants less than what they were owed was permissible under § 1122(a) because paying those victims was a requirement of the debtor's sentence for issuing a bad check.

   d. Reasoning: Citing the reasoning used in *Friedman*, the Court discussed the requirements for confirmation of a plan of reorganization as set out in § 1129 and found the APR is not applicable in Chapter 11 bankruptcy cases where the debtor is an individual. The Court sighted two reasons for this:

i. If a plan proponent can demonstrate that every requirement contained in § 1129(a)(1) through (16) has been met, including (8) (that requires the consent of each class of creditors), a plan can be confirmed over such an objection.

ii. Alternatively, under § 1129(b) a plan may still be confirmed by a bankruptcy court if: (1) the fifteen remaining paragraphs of § 1129(a) are met, and (2) the plan is, among other things, "fair and equitable." The Court apparently assumed that the type of property retained by the debtor was not important, and instead turned to the question of "unreasonable discrimination" in the classification of claims.

iii. This case demonstrates what happens so often in this area: either the parties failed to raise the issue of which property may be retained by the debtor, or the court decides that other grounds are more important to the outcome. This case is about all we have to go on respecting the broader view.

Section 1129(a)(15) and Discharges in Individual Chapter 11 Cases

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I. Analyzing Section 1129(a)(15).

(15) In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan –

(A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

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

11 U.S.C. § 1129(a)(15).

Practice Pointer: The two best ways to avoid an objection based on Section 1129(a)(15) are to propose a 100% payment plan or avoid a rejecting vote from an unsecured creditor.

Interpreting the Meaning of Section 1129(a)(15)(B)

Section 1129(a)(15)(B) relies on a cross-reference to a chapter 13 provision, section 1325(b)(2), for the definition of "projected disposable income." However, it does not incorporate Section 1325(b)(1)(B), which requires a chapter 13 debtor to pay *all* of his or her projected disposable income to *unsecured creditors* if there is a rejecting vote from an unsecured creditor.

In fact, Section 1129(a)(15)(B) does not contain such a requirement. Courts interpreting this section have uniformly held that "the value of the property to be distributed under the plan" means *all* property to be distributed under the plan, which includes distributions to administrative, priority, secured, and unsecured creditors. *See In re Gbadebo*, 431 B.R. 222 (Bankr. N.D. Cal. 2010) (the § 1129(a)(15)(B) requirement goes to the amount paid to all creditors under the Plan); *In re Pfeifer*, 2013 WL 5687512 (Bankr. S.D.N.Y. Oct. 18, 2013) (§

1129(a)(15)(B) was satisfied where distributions were to be made from a post-confirmation trust funded out of recoveries from avoidance actions and proceeds of asset sales in an amount greater than debtor's assumed projected disposable income); *In re Johnson*, 580 B.R. 742 (Bankr. S.D. Ohio 2016) (even under most conservative approach, debtor's projected disposable income of $4.4M is less than the $5.1M in plan disbursements under the debtor's plan).

Practically speaking, an individual chapter 11 debtor will almost always have one or more classes of administrative, priority, secured or unsecured creditors that they will be making substantial payments to as part of a plan. As long as the sum of these distributions is greater that the debtor's projected disposable income during the first five years of the plan, the debtor will satisfy the Section 1129(a)(15)(B) requirement.

II. Discharge of Individual Debtors.

Prior to passage of BAPCPA, confirmation of a plan discharged an individual chapter 11 debtor under the provisions of Section 1141(d). BAPCPA amended Section 1141(d) by deleting this provision, as it applied to individual debtors, and adding a new subsection, which reads as follows:

> (5) In a case in which the debtor is an individual –
>
> > (A) unless after notice and a hearing the court orders otherwise ***for cause***, confirmation of the plan does not discharge any debt provided for in the plan until the court grants a discharge on ***completion of all payments under the plan***.

11 U.S.C. § 1141(d)(5)(A) (emphasis added).

A. What Constitutes "Cause" for an Immediate Discharge?

Only one reported case in which a bankruptcy court granted a debtor's request for an immediate discharge at confirmation: *In re Sheridan*, 391 B.R. 287 (Bankr. E.D.N.C. 2008).

Facts of *Sheridan*:

- Debtor was an attorney specializing in construction law making $100K annually.
- Debtor had over $1M in general unsecured debt, mostly from failed real estate business he had on the side.
- Only impaired class in debtor's plan was general unsecured creditors.
- The plan provided general unsecured creditors would be paid their pro-rata share of monthly installments of a $20K note, paid over 5 years at 6% per annum.

- The note was secured by second mortgage on debtor's primary residence, which had over $50K of equity at plan confirmation.

Holding of *Sheridan:*

- Court held that debtor met his burden to show "cause" for an immediate discharge.
- The court based its decision on the "strong likelihood that the debtor will make all of his plan payments" and the "assurance, in the form of collateral, that creditors will receive the amount they have been promised even if the plan payments are not made."

All other courts deciding the issue have held that debtors have failed to show sufficient "cause" under Section 1141(d)(5)(A) to entitle them to an immediate discharge. *See In re Belcher*, 410 B.R. 206 (Bankr. W.D. Va. 2009) (avoiding UST fees and reporting requirements did not qualify as "cause" for immediate discharge under § 1141(d)(5)(A)); *In re Beyer*, 433 B.R. 884 (Bankr. M.D. Fla. 2009) (avoiding potential future cancellation of debt income due to surrender of properties is not sufficient "cause" for immediate discharge under § 1141(d)(5)(A)); *In re Detweiler*, 2012 WL 5935343 (Bankr. N.D. Ohio Nov. 27, 2012) (debtor potentially needing discharge to refinance debt in the future is not sufficient "cause" for immediate discharge under § 1141(d)(5)(A)).

B. Administratively Closing a Case at Confirmation.

- The Bankruptcy Code states that "[a]fter an estate is ***fully administered*** and the court has discharged the trustee, the court shall close the case." 11 U.S.C. § 350(a) (emphasis added).
- In the years following passage of BAPCPA, and often prompted by an objection from the U.S. Trustee, some courts held that a case cannot be "fully administered," and thus closed, until the debtor completes all payments under a plan and receives a discharge. *See In re Ball*, 2008 WL 2223865 (Bankr. N.D. W. Va. May 23, 2008); *In re Belcher*, 410 B.R. 206 (Bankr. W.D. Va. 2009); *In re Shotkoski*, 420 B.R. 479 (8th Cir. B.A.P. 2009).
- However, in 2010, the U.S. Trustee's office reconsidered its position and began allowing cases to be administratively closed, subject to re-opening to request a discharge, as long as the plan has been "fully administered."[1] The rationale for this

[1] In determining whether a case is "fully administered," most courts consider the factors listed in the Advisory Committee Note to Fed. R. Bankr. P. 3022: (1) whether the order confirming the plan has

decision is set forth in an ABI article written by Walter W. Theus, who at the time was the Executive Director of the U.S. Trustee's office. Walter W. Theus, Jr., *Individual Chapter 11 Cases: Case Closing Reconsidered* (2010), *available at* https://www.justice.gov/sites/default/files/ust/legacy/2011/07/13/abi_201002.pdf.

- The prevailing trend since the U.S. Trustee clarified its position has been to allow debtors to administratively close the case to avoid quarterly reporting requirements and U.S. Trustee fees during the pendency of their plan. *In re Johnson*, 402 B.R. 851 (Bankr. N.D. Ind. 2009); *In re Necaise*, 443 B.R. 483 (Bankr. S.D. Miss. 2010); *In re Mendez*, 464 B.R. 63 (Bankr. D. Mass. 2011).

C. Re-Opening a Case for Discharge.

- The Bankruptcy Code states that "[a] case may be reopened in the court in which such case was closed to administer assets, to accord relief to the debtor, or for other cause." 11 U.S.C. § 350(b).
- The debtor may want re-open the case for a discharge order so he or she is able to refinance existing debt or obtain credit for future purchases. Many lenders are unfamiliar with nuances and differences between individual chapter 7, 11, and 13 cases and will require a discharge order before they are willing to extend credit. If creditor sells debt to another entity post-confirmation, debtor also may want a discharge order to defend against a collection action.
- A debtor does not need to wait to complete ***all payments*** under his or her plan in order to move for a discharge. This requirement generally does not apply to long-term debts like a thirty year mortgage. *In re Brown*, 2008 WL 4817505, at *1 (Bankr. D.D.C. Oct. 29, 2008). Similar to a chapter 13 case where a debtor is making monthly mortgage payments that fall outside of the plan, "Congress likely did not intend for § 1141(d)(5) to delay entry of a chapter 11 debtor's discharge pending the debtor's completion of all remaining regular monthly payments that the debtor

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become final, (2) whether deposits required by the plan have been distributed, (3) whether the property proposed by the plan to be transferred has been transferred, (4) whether the debtor or the successor of the debtor under the plan has assumed the business or the management of the property dealt with by the plan, (5) whether payments under the plan have commenced, and (6) whether all motions, contested matters, and adversary proceedings have been finally resolved.

obligates herself to pay under a confirmed chapter 11 plan." *Id.* These types of payments will often last for many years, and the *Brown* court did "not believe that [§ 1141(d)(5)(A)] was written with those types of payments to mortgagees in mind." *Id.*

Pre-Filing Considerations, Choice of Chapter, Representation/Conflict Issues

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Introductory Data

Percentage of Chapter 11 Filings: Approximately 30% of Chapter 11 cases are filed by "individuals", a percentage that has risen since the enactment of BAPCPA.

Debt Limits: Approximately 60% of individual Chapter 11 debtors are above the Chapter 13 debt limits; studies show that a *substantial* raise in the debt limits would be required to materially change this number.

Marital Status: Approximately 70% of Individual Chapter 11 cases are filed by married debtors, but only about 40% are joint filings.

Small Business Cases: Approximately 15% of individual Chapter 11 filings are designated "small business debtor" cases – note that in order to be a small business debtor must continue to be engaged in "commercial or business" activities, not just have low debt amounts.

Representation: Approximately 10% are filed pro se, another 40% by an attorney with only one or two recent bankruptcy filings. Therefore, about half of individual Chapter 11 debtors are pro se or represented by an attorney with limited bankruptcy experience.

Source: **ABI Individual Chapter 11 Study** (2016) [Studied period of 2010 to 2013]

Usual Representation Goals

Client: Free of as much debt as possible, retain as many assets as possible, at the lowest cost possible.

Attorney: Achieve the client's goals, consistent with the rules of ethics and other fiduciary obligations mandated by the Bankruptcy Code, with the most efficient use of client's funds possible.

Choice of Chapter

I. Is Chapter 7 Available, And the Best Choice?

After consideration of out of court workouts, forbearance offers, loan modifications and other available options, if bankruptcy is the last and best option then what

chapter to file? The author believes that due to cost and speed the first choice for individuals in most situations is Chapter 7, followed by Chapter 13, with an individual Chapter 11 being the last option.

A. Potential Issue: Income Too High, Presumption of Abuse

A potential individual debtor may be subject to the [Official Form B122-A] "long form means test" due to household income being over the state median for the household. Based on the income and expense allowances under the official form, a "presumption of abuse" may eliminate Chapter 7 as an option due to a dismissal motion under Section 707(b). However, some practitioners overlook ways that an "above median" debtor may still qualify for Chapter 7.

1. Primarily Non-Consumer Debts:

If the debtor's debts are primarily (more than 50%) "non-consumer", then the debtor is not subject to a dismissal motion under Section 707(b). The following are considered "non-consumer" debts.

a. Business Debts: Defined as debts "[i]ncurred for a business venture or with a profit motive" *In re Terzo*, 502 B.R. 553 (Banr.N.D.Ill. 2013).

b. Corporate or other third-party guarantees, contingent or not, with a business purpose.

c. Income taxes and responsible person liability for trust fund taxes: *In re Grillot*, 578 B.R. 651 (Bankr.D.Kan. 2017).

d. Student Loans: Caselaw is split.

e. Tort Judgments

f. **Note**: Family Court Obligations (domestic support obligations, property settlement obligations, contempt orders) are generally considered **consumer** debts.

2. Special Circumstances

A debtor may "fail" the means test and the "presumption of abuse" may arise, but due to a change in circumstance or other reasons (which may be listed at the end of Form B122), the United States Trustee may decline to file a motion to dismiss the Chapter 7 case. Special circumstances can include medical problems, anticipated permanent reduction in income, or one time income events that skewed the test.

3. The Debtor May "Pass" the Means Test

Some above-median income individual debtors will actually "pass" the Form B122-A disposable monthly income test and no "presumption of abuse" may arise, due to allowed expenses on the form. This is especially true of debtors that have very high priority claim creditors, such as support obligations or tax claims.

However, an individual debtor with primarily consumer debts who passes the means test may still face a motion to dismiss under the Section 707(b)(3) "totality of circumstances" test, based on ability to pay creditors or other reasons. *See In re Lowe*, 561 B.R. 688 (Bankr.N.D.Ill. 2016). Note that primarily non-consumer debt debtors are **not** subject to this additional creditor/United States Trustee remedy.

B. Potential Issue: Not Eligible for Chapter 7 Discharge

The individual debtor may not be eligible for a Chapter 7 discharge under Section 727 for a number of reasons:

1. Prior Case

If the debtor received a Chapter 7 or Chapter 11 discharge in a case filed within the past 8 years or a Chapter 13 discharge in a case filed with within the past 4 years, then Chapter 7 is not an option.

2. Potential Other Section 727 Issues

a. Questionable transfers during the past one year, that may be argued as evasion of a creditor

b. Failure to maintain records or explain losses

c. Conduct in another (such as corporate) bankruptcy case

3. Asset Loss

The individual debtor may have irreplaceable assets, such as ownership in a closely held corporation that provides employment, that are subject to loss in Chapter 7 (and cannot be easily valued). The debtor may also have a non-filing spouse who may be pursued by the Chapter 7 trustee on fraudulent conveyance or trust theories.

The individual debtor may still file a Chapter 7 case with the intention of settling with the Chapter 7 trustee on assets that may be valued, using available (if any) exempt funds such as retirement accounts, assets of a non-filing spouse or post-petition loans to fund the settlement.

II. Is Chapter 13 Available?

Before considering Chapter 13 as an option, a determination has to be made if the individual debtor is eligible for due to requirements of Section 109.

A. Potential Issue: Debt Limits Section 109(e)

Unlike Chapter 7 and Chapter 11, Chapter 13 has maximum debt limits which are subject to adjustment every three years pursuant to Bankruptcy Code Section 104, with the next change to occur April 1, 2019. The current debt limits are:

Secured: **$1,184,200** Unsecured: **$394,725**

Determination of whether or not a debtor is above or below the debt limits is generally based on the filed schedules, not the actual claims filed, so long as the schedules were filed in good faith. *In re Hansen*, 316 B.R. 505 (Bankr.N.D.Ill. 2004). If a secured debt is undersecured, the debt is bifurcated into secured and unsecured components for purposes of eligibility determination. *In re Day*, 747 F.2d 405 (7th Cir. 1984). Filing an individual Chapter 13 case in which the schedules show the debtor as ineligible due to the debt limits can result in sanctions by the court. *See In re Tabor*.Case No. 16-26544 (Unpublished, Bankr.N.D.Ill., April 11, 2018).

These "debt limits" appeared to be mandatory (and sanctionable if ignored), and Chapter 13 cases filed over the limits were subject to dismissal or conversion for "cause" on request of party in interest pursuant to Bankruptcy Code Section 1307(c) – until the past year when two bankruptcy courts in the Seventh Circuit declined to dismiss or convert (as discussed below).

1. Debts Not Included in the Limits

The following types of debts are not counted in the Section 109(e) totals:

a. Contingent Debts: Such as personal guarantees where the underlying debt is not in default. *In re Clore*, 547 B.R. 915 (Bankr.C.D.Ill. 2016).

b. Unliquidated Debts: A debt in legitimate dispute over amount, such as damages from a tort claim or alleged breach of fiduciary duty. *In re Pantazelos*, 540 B.R. 347 (Bankr.N.D.Ill. 2015).

2. A (New) Student Loan Exception

Two recent cases in the Seventh Circuit have raised interesting questions about the Chapter 13 debt limits, and whether the courts are bound to find them to be "cause" to dismiss or convert a Chapter 13 case. Both involved individual debtors with student loan debts that put them over the debt limits.

In re Patrola, 578 B.R. 414 (Bankr.N.D.Ill. 2017) (Judge Janet Baer) [**Note**: This opinion is currently on appeal, N.D.Ill. Case No. 18-02450]

> "Congress simply could not have intended to exclude otherwise eligible individuals from being Chapter 13 debtors solely because of educational debt that exceeds the limit." *Id.* at 421.

In re Fishel, Case No. 17-14180 (Unpublished, Bankr.W.D.Wis., March 30, 2018) (Judge Catherine Furay) [No appeal pending]

> "[T]here is no decision from the Seventh Circuit on lack of section 109(e) eligibility constitutes 'cause' under Section 1307 *and* whether dismissal is therefore mandated." (emphasis in original).
>
> "If the [Chapter 13] Trustee is correct, the only other option would be the filing of a Chapter 11. Such a course would be absurd for this true consumer debtor. The Chapter 11 process is inordinately expensive and cumbersome for a consumer debtor."

Whether this line of cases, which for now is limited to the Seventh Circuit, will survive or expand to other circuits will be an interesting issue for individual debtors. Another case recently issued by a different Wisconsin bankruptcy court declined to follow the rationale and the case was converted. *See In re Bailey-Pfeiffer*, Case No. 17-13506 (Unpublished, W.D.Wis., March 23, 2018) (Judge Brett H. Ludwig) [case was converted to Chapter 7 by debtor prior to the opinion].

B. Potential Issue: Regular Income Section 109(e)

Under Section 109(e), only an "individual with regular income" may be a debtor under Chapter 13. The term "individual with regular income" is defined under Section 101(30) as an individual "whose income is sufficiently stable and regular to enable such individual to make payments under a plan under chapter 13 of this title . . .".

This eligibility requirement is forward looking, and an individual cannot rely upon anticipated gifts or other uncertain types of income. *In re Durov*, Case No. 16-71699 (Unpublished, Bankr.C.D.Ill. 2017). It would appear to exclude an individual whose income previously came from a now closed business from Chapter 13; however, courts have considered various types of income including unemployment compensation and spousal support to be sufficient for Chapter 13 eligibility. *See In re Robinson*, 535 B.R. 437 (Bankr.N.D.Ga. 2015).

III. Is Chapter 13 A Better Option Than Chapter 11?

A. Less Cost/Expense

1. **Filing Fees**: $310.00, as compared to $1,717.00.

2. **Trustee Commission**: A Chapter 13 trustee charges a maximum (and generally lower) percentage of 10%, and only on distributions made by the Chapter 13 trustee and not on distributions made by the debtor directly ("outside the plan"). 28 U.S.C. §586(e). While a case is open (which can vary greatly in Chapter 11), the debtor is charged a fee by the United States Trustee on all distributions – including regular living expenses and direct payments on long term debt such as mortgage payments made each quarter calculated on a sliding scale. 28 U.S.C. §1930(a)(6).

In an individual case where the income and expenses are low, the Chapter 11 United States Trustee fee (which is a minimum of $325 per quarter, up to a quarterly total of $15,000 in debtor disbursements) may actually be less expensive than a Chapter 13

trustee. Also, the United States Trustee fees generally end upon confirmation of a Chapter 11 plan and a final decree being issued, whereas Chapter 13 trustee commissions continue past confirmation until the end of the plan.

3. **Attorney Fees**: Even if the attorney for an individual Chapter 13 debtor declines the district's "no look" fee (which averages around $4,000 to $4,500 nationwide) and bills hourly for a five year plan, there is little doubt that the attorney fees for an individual Chapter 11 case will be higher with its likely first day motions, monthly operating report requirements, plan, disclosure statement, balloting and other procedures. The average *allowed* attorney fees for an individual Chapter 11 case in 2013 were approximately $15,000. **ABI Individual Chapter 11 Study**, at page 72. (2016). As most debtor practitioners know, often the only fees received in a case will be from the pre-petition retainer. For even the "simplest" individual Chapter 11 case, a competent debtor practitioner will and should require a substantial pre-petition retainer.

B. The Chapter 13 "Super" Discharge

The discharge available in an individual Chapter 11 case, pursuant to Section 1141(d), is essentially identical to a Chapter 7 discharge. Pursuant to Section 1328(a), a completed Chapter 13 case discharges some additional categories of debts otherwise excluded by Section 523(a) – most significantly for individual debtors non-domestic support family court obligations under Section 523(a)(15), some tax penalties under Section 523(a)(7), and in limited circumstances claims for willful and malicious damages under Section 523(a)(6).

C. Absolute Right to Dismiss

While some splits have developed in the caselaw, a Chapter 13 debtor generally retains the absolute right to dismiss the case at any time. *See In re Williams*, 435 B.R. 552 (Bankr.N.D.Ill. 2010). If the debtor does not like the way a case if going or if an unforeseen circumstance occurs, this right can be very valuable to an individual debtor. The same is not true of an individual Chapter 11 case. Under Section 1112(b), the court is directed to convert a Chapter 11 case to Chapter 7 if conversion is in the "best interests of creditors and the estate". Normally, the United States Trustee or a creditor will successfully advocate for conversion rather than dismissal – despite the protests of a debtor – in a cash where assets are available for claimholders.

D. Third Party Stays

Pursuant to Section 1301, a Chapter 13 case provides a stay of creditor collection action against a third party under limited circumstances. This co-debtor stay only applies to consumer debts, and only remains in place if the debt in question is to be paid in full under the Chapter 13 plan, and only applies to co-debtor persons (not corporate entities). Even with these limitations, the Chapter 13 co-debtor stay is valuable in specific circumstances such as protection for a non-filing spouse in a home mortgage cure situation. Further, Chapter 13 allows an individual debtor to confirm a plan that separately classifies and fully pays co-signed unsecured debts even if other unsecured claimholders are receiving only a pro rata distribution. Section 1322(b)(1).

An individual Chapter 11 case has no such automatic co-debtor stay by statute. Instead an individual Chapter 11 debtor is normally left only with requesting equitable relief under Section 105(a) and carrying a difficult burden of proof, which varies from court to court, that an estate interest or prospect for a reorganization plan would otherwise be irreparably harmed. *See Gander v. Harris*, 442 B.R. 883 (N.D.Ill. 2011). The natural party an individual Chapter 11 debtor may seek to protect through equitable extension of the stay would be a non-filing spouse, but there is no reported caselaw on the issue.

E. No Need for Votes/Accepting Impaired Class

Often the greatest challenge that a Chapter 11 debtor seeking to confirm a plan of reorganization, which is the only way that a debtor receives a Chapter 11 discharge, is identifying and obtaining the positive vote of an impaired class of creditors as defined by Section 1124. This may prove a greater challenge for an individual Chapter 11 debtor, with a smaller variety of secured claims and consumer creditors not used to the Chapter 11 process.

Chapter 13 plan confirmation does not require an impaired accepting class of claims, or any affirmative action by any claimholder.

F. Limited Fiduciary Duties/Reporting Requirements

There is no question that the duties imposed on a Chapter 11 debtor – assumption of the duties of a "trustee" as a Debtor-In-Possession under the Bankruptcy Code, post-petition monitoring by the United States Trustee and required monthly operating reports -- are far greater than those placed on a Chapter 13 debtor by the Bankruptcy Code. *See* Section 1106 for a list of duties, which includes some duties specific to an individual debtor such as notifications to domestic support obligation claimholders. Generally, the only post-petition requirements placed on a Chapter 13 debtor are satisfactory document production to the Chapter 13 trustee and in some cases post-confirmation income reporting.

The duties and reporting requirements placed on an individual Chapter 11 debtor are often overwhelming, and sometimes impossible, for an unsophisticated debtor to complete. A debtor practitioner that anticipates a situation where the debtor is incapable of completing the monthly operating reports and otherwise complying with the Chapter 11 duties should suggest that individual debtor's accountant be employed to assist with the process, if the cashflow allows it.

IV. Is Chapter 11 A Better Option Than Chapter 13?

A. Over Chapter 13 Debt Limits

The individual debtor may not have Chapter 13 as a choice if over the Section 109(e) debt limits, and a Chapter 7 case has been ruled out due to the likelihood of a Section 707(b) income-based motion to dismiss or a likely fire-sale auction of irreplaceable assets.

B. Flexibility/No Trustee

Like most Chapter 11 debtors, in the vast majority of cases the debtor will remain a debtor-in-possession. Their actions, and progress, in the bankruptcy case will only be monitored and not controlled by the United States Trustee. Therefore, major decisions such as the marketing and sale of assets will normally remain within the control of the individual – so long as the United State Trustee, any creditors committee, and the bankruptcy court are satisfied that progress is being made and that the individual debtor is fulling their fiduciary duties.

Although Chapter 13 trustees tend to be much less active than Chapter 7 trustees in compelling individual debtors to liquidate assets not retained by the debtor under a confirmed Chapter 13 plan, they will expect faster progress than the relatively long deadlines of a Chapter 11 proceeding. Chapter 13 trustees also have standing to pursue voidance actions, with or without the individual debtor's consent. *In re Rodriguez*, 402 B.R. 299 (Bankr.N.D.Ind. 2009). The loss of an individual debtor's power over financial affairs is lower in a Chapter 13 case than in a Chapter 7 case, but there is no doubt that being a Chapter 11 debtor in possession provides the most control.

C. Delay in Filing a Plan/Commencing Payments

In most Chapter 13 case, the trustee and the bankruptcy court expect a Chapter 13 plan to be filed with the petition or shortly thereafter. *See* Fed.R.Bankr.P. 3015(b). Further, the first payment under the plan is required to commence within 30 days of the filing of the plan or the petition date, whichever is earlier. Section 1326(a)(1).

This contrasts with the sometime glacial pace of an individual Chapter 11 case. Payments by the individual debtor are not generally due until after a Chapter 11 plan is confirmed, and creative payment arrangements are permissible since the individual debtor has broad latitude in drafting a plan (often without a creditors committee interference or input if the case is too small for a committee to be formed).

D. Longer Plan Length/Drafting Flexibility

Chapter 13 plans are limited to a maximum of five years, and the courts have no equitable powers to extend the length. Section 1322(d). *See In re Grant*, 428 B.R. 504 (Bankr.N.D.Ill. 2010). Chapter 11 plans have no such set limitation, and the length of a Chapter 11 plan – and the proposed length of a re-amortized specific secured loan through the plan – will be reviewed for "fair and equitable" treatment under Section 1129(b). Further, there is no uniform plan in Chapter 11, unlike Chapter 13 (Official Form 113 -- with its opt-out differences by district), which a debtor is required to follow. Therefore, in addition to plan length an individual Chapter 11 debtor will generally be able to draft a plan to fit the specific needs and goals of the case (such as possible third-party releases) that would likely be rejected in a Chapter 13 case.

There are some other differences (positive and negative) for each chapter in plan drafting/permissible provisions:

Chapter 11 Plan Advantages	Chapter 13 Plan Advantages
No Section 1325 "hanging paragraph"; therefore vehicles secured by debt incurred within 910 days (and other PMSI personal property loans incurred within one year) **can** be bifurcated into a secured claim based on value.	Separate classification and treatment of co-debtor unsecured claims is permissible. Section 1322(b)(1). If the underlying debts were incurred as consumer debts, the Chapter 13 co-debtor stay protects the co-obligor during the plan period. Section 1301.
More time to file and confirm a plan (limited if the case is a "small business debtor").	No Disclosure Statement required, no competing plan possibility, simpler confirmation process/requirements.
Amortization of non-consumer secured claims over a much longer period.	Amortization of any secured claim limited to the five year plan maximum.
Payment of priority tax claims may be spread out over five years (and sometimes longer in negotiation with the taxing agencies) with interest required. Section 1129(a)(9). However, other priority claims must be paid at confirmation.	Required full payment of priority claims may be spread out over a five year plan, without interest but the interest usually remains non-dischargeable at conclusion of the plan.
No modification of home mortgage obligations permissible, other than strip-off of wholly unsecured subordinate mortgages. Only retention option of unmatured home first mortgage is cure of pre-petition default through plan permissible, with debtor maintaining post-petition payments. *In re LaPorta*, 578 B.R. 792 (Bankr.N.D.Ill. 2017).	Payment of balance on matured (or maturing) home mortgage loan through the plan (within the maximum five years) permitted, in addition to the cure and maintain option. Section 1322(c)(2).

E. Final Decrees/End to Trustee Fees

Quarterly United States Trustee fees in an individual Chapter 11 case end upon the entry of a final decree, generally upon motion shortly after confirmation of a plan. Fed.R.Bankr.P. 3022. In the alternative, the individual Chapter 11 debtor may have liquidated all of the estate assets and in the process paid all of the claims and seek a simple or structured dismissal of the case. The individual debtor may then move forward with life, regardless of the length of the plan, without the monthly operating report requirement and any trustee commissions on expenditures.

In a Chapter 13 case the Debtor also operates/lives with the confirmed plan, but Chapter 13 trustee commissions continue to accrue on payments made by the Chapter 13 trustee to claimholders. In some cases, and likely in most cases in which a Chapter 11 was considered due

to the debtor having above median income, the plan will normally last for five years. If the Chapter 13 trustee is acting as a conduit for post-petition mortgage payments, or a large balance claim is being paid through the plan, this could be a significant cost difference.

Representation Issues

Any attorney for a debtor-in-possession needs to understand who the client is. In a corporate Chapter 11, the bankruptcy estate is the client -- not the principals of the corporation personally. The attorney for a Chapter 11 corporate debtor often has to remind the debtor's officers that debtor management has a fiduciary duty to put the interests of creditors and other bankruptcy stakeholders ahead of their own personal interests. If the persons involved with a corporation have a potential interest in the bankruptcy estate -- whether they are equity holders, guarantors, holders of shareholder loan notes, or transfer voidance targets – they are best advised to hire their own separate personal counsel early in the corporate Chapter 11 case as their personal interests quickly diverge.

An attorney for an individual Chapter 11 debtor does not have the option of suggesting separate personal counsel – they are it. Individual debtors in possession have the same fiduciary duties to creditors and the bankruptcy estate, even though these duties may be in complete opposition to their personal interests. Individual debtors also have personal interests to protect, such as exemption of assets and defense of objections to discharge and dischargeability, which are often completely counter to the interests of the bankruptcy estate.

Combine these often-conflicting fiduciary duties to the bankruptcy estate with the simultaneous representation of the debtor's personal interests and you have the "metaphysical challenge" that is individual Chapter 11 debtor representation. *See* C.R. Bowles Jr., *Ghosts of Individual Chapter 11 Debtors*, 25 **Am.Bankr.Inst.J.** 46 (2007).

I. Compensation

Unlike most Chapter 13 cases in which a "no look" debtor attorney fee is approved by text order, or a Chapter 7 case where the debtor's attorney is compensated prior to the filing and Form B2030 is filed usually without further action, retention of counsel for an individual Chapter 11 debtor requires the full professional employment procedure contained in Section 327 – with an employment application that cannot be approved on an expedited basis and an employment affidavit regarding potential conflicting interests. Further, compensation in an individual Chapter 11 case can only take place after an application pursuant to Section 327 with each court and United States Trustee having its own requirements. *See In re Harry Viner, Inc.*, 520 B.R. 268 (Bankr.W.D.Wis. 2014). This is a further reminder that an individual Chapter 11 is not simply a "jumbo" Chapter 13.

Section 330(a)(4)(B) recognizes the availability of bankruptcy estate funds to compensate counsel for Chapter 12 and Chapter 13 debtors "for representing the interest of the debtor in connection with the bankruptcy case . . .". Unfortunately, the 2005 BAPCPA amendments did

not add counsel for Chapter 11 debtors to this section -- despite removing any likely source for payment of this necessary representation through greatly expanding the assets of the Chapter 11 estate to include post-petition earnings. Each court and United States Trustee region will differ, but generally an attorney for a Chapter 11 individual debtor may not be compensated from the bankruptcy estate on matters that solely benefit the individual such as exemption of asset disputes, discharge litigation or criminal defense matters.

Therefore, an attorney for an individual Chapter 11 debtor should ideally keep separate time records for such "personal" matters and separate them in any fee application. The source of payment for these services, since bankruptcy estate funds are not available, presents a major challenge.

II. Retainers

Pre-filing planning to secure payment for representation in these personal interest matters should be done consistent with the rules of ethics, ideally through designation of as much as possible (if not all) of the pre-petition retainer identified as an "advance payment retainer" fully earned and transferred to the attorney at the time of payment. *See In re Pawlak*, 483 B.R. 169 (Bankr.W.D.Wis. 2012). Normally, pre-petition "security retainers" received by the attorney for debtor will be considered bankruptcy estate property and therefore may possibly be off limits for services that only benefit the individual debtor personally. *See Dowling v. Chicago Options Assoc.*, 226 Ill.2d 277, 875 N.E. 2d 1012 (2007) for a discussion on the different forms of retainer.

Counsel for a Chapter 11 debtor should therefore hold as much of the pre-petition retainer (which has ideally been set up as an advance payment retainer) for personal debtor representation matters that may arise later, and apply for payment from bankruptcy estate funds for traditional debtor in possession bankruptcy estate services to the extent the court will allow. Counsel for an individual Chapter 11 debtor should also be aware of the bright line rule in *Lamie v. United States Trustee*, 540 U.S. 526, 124 S.Ct. 1023, 157 L.Ed. 1024 (2004) that prohibits use of bankruptcy estate funds for compensation of Chapter 7 debtor's counsel in a converted case. The conversion/failure rate of individual Chapter 11 cases is generally much higher than that of Chapter 13 cases. This is further reminder that an attorney that takes on an individual Chapter 11 case without a sufficient (and properly classified) retainer faces serious risk of non-payment of fees, and also that any available advance payment retainer funds should be held back (if possible) as they may be needed at the end of a failed case.

III. Attorney-Client Privilege

The issue of what happens to the attorney-client privilege between the attorney for debtor and management when a corporate Chapter 11 case converts to Chapter 7 has been long been resolved -- it transfers to the Chapter 7 trustee. *Commodity Futures Trading Commission v. Weintraub*, 471 U.S. 343, 105 S.Ct. 1986, 85 L.Ed.2d 372 (1985). Not surprisingly, the issue of which party controls the attorney-client privilege upon conversion of an individual Chapter 11 case to Chapter 7 (the individual debtor or the Chapter 7 trustee) has created a patchwork of decisions and no simple answer.

The majority view is probably best represented by the opinion *In re Baine*, 251 B.R. 367 (Bankr.Minn. 2000) which presents a multi-part test to determine control of the privilege on an issue by issue basis, determined by whether the communications related to debtor in possession duties (not subject to the privilege) or to the individual debtor's own personal interests (subject to the privilege). Of course, individual debtors and their counsel may not at the time of the communication be considering this distinction or make the same determination as a subsequent court. Therefore, the safe practice is to assume – and inform – an individual Chapter 11 debtor not to expect to retain the privilege if the case is converted.

IV. Representation Agreement/Engagement Letter

In representation of an individual Chapter 11 debtor, a specific representation agreement (or at least a detailed engagement letter) is crucial due to the seemingly conflicting duties of both counsel and client in the case. The representation agreement should cover the following issues:

1. Recognition by the client of the fiduciary duties and transparency of being a debtor-in-possession, and allowing withdrawal of the attorney if the duties are not followed;

2. Recognition of the dual representation on personal, non-bankruptcy estate matters and the fact that representation on these matters cannot be paid from bankruptcy estate property (and will be paid if possible from the pre-petition advance payment retainer);

3. Recognition of the uncertain scope of the attorney/client privilege discussed previously;

4. Recognition that some post-petition matters may occur, such as representing in adversary proceedings and conversion of the case to Chapter 7, that may require a separate and new post-petition representation agreement. *See In re Bethea*, 352 F.3d 1125 (7th Cir. 2003).

Conclusion

Despite the complexities and representation difficulties presented by the current individual Chapter 11 process, it can be a useful tool for a debtor under a limited set of circumstances: 1) personally owned, specialized assets that would either not fare well in a Chapter 7 auction or are irreplaceable to the debtor such as ownership in a closely held corporation; 2) a high income individual with unusually large consumer debt, such as a family law property settlement obligation, that is not eligible for Chapter 13; or 3) an unusually large debt sole proprietor operation. Even if not actually used, the credible threat of an individual Chapter 11 case can sometimes cause a lender to come to the table for a workout or forbearance agreement that allows counsel to achieve a good outcome for the client.

However, in the opinion of the author there are too many individual Chapter 11 cases filed where the debtor is either: 1) pro se or under-represented in terms of having counsel unprepared to handle a Chapter 11 proceeding; 2) counsel is under-retained and the risk of non-payment or withdrawal from the case is high; or 3) the costs of the proceeding do not justify the potential benefit to the debtor, often without the client's full understanding of what can and cannot be accomplished. These contribute to the relatively high failure rate of individual Chapter 11 cases, and erode confidence of all parties in interest in the bankruptcy process as a positive means to solve the debtor's financial problems. Statutory reform to make individual Chapter 11 cases fit the unique realities of a person and the bankruptcy estate being combined would be the ideal solution, but for now bankruptcy practitioners must make the best of the current conflicting fiduciary duties and the mismatched Chapter 13 and Chapter 11 provisions currently in place.