

Special Challenges of Individual Chapter 11s: They're Not Just Chapter 13's Older Sibling! What Every Chapter 13 Debtor's Lawyer Needs to Know

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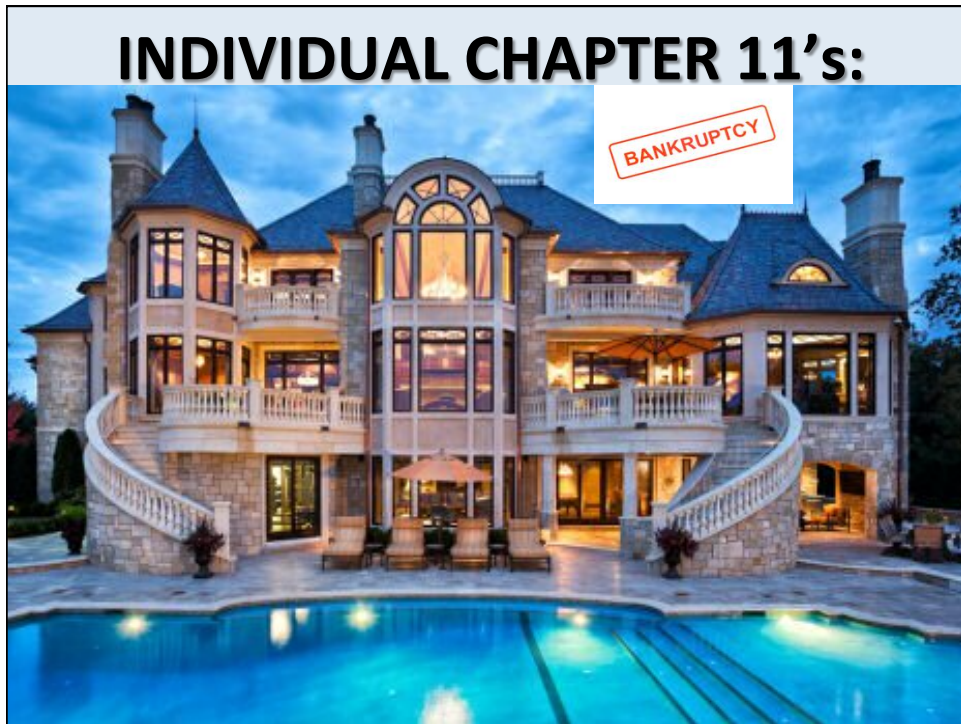
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Alternatives

- Chapter 7
 - No ability to stretch out secured debt
 - Loss of non-exempt assets
 - Relatively quick and low cost
- Chapter 13
 - Many advantages to those eligible, including super-discharge and ability to stretch out secured debt
- Chapter 11
 - Relatively complex and expensive
 - Advantages- easier eligibility; possible early discharge



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Eligibility

- Chapter 7
 - Any individual - § 109(b)
 - Possible dismissal issue under 707(a) and (b)
- Chapter 13
 - Individual; regular income; liquidated, noncontingent, unsecured debt less than \$383,175; secured less than \$1,149,525; § 109(e)
- Chapter 11
 - Any person eligible under Chapter 7; § 109(d)



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Who is Your Client in an Individual Chapter 11?

- If you represent a Chapter 11 debtor-in-possession, your client is the estate — ***not*** the debtor personally.



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Duties

- Chapter 7
 - § 521; file schedules, statement of financial affairs, cooperate with the trustee
- Chapter 13
 - Same duties as a Chapter 7 debtor; some trustee power under § 1303 and 1304; same duties § 704(a)(8)
- Chapter 11
 - Debtor-in-possession; rights, power and duties of a trustee § 1107(a); § 1106(a)



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Who is Your Client in an Individual Chapter 11?

- There is a metaphysical challenge of realizing that the human who hired you to file his/her chapter 11 petition is **not** your client in the bankruptcy case.



Who is Your Client in an Individual Chapter 11?

- Your client = the **Bankruptcy Estate** of an individual.



Who is Your Client in an Individual Chapter 11?

- Your client \neq the individual himself/herself.



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Who is Your Client in an Individual Chapter 11?

- Failure to understand this relationship results in serious liability exposure.



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Ethical Considerations in individual Chapter 11 cases:

1. The individual debtor's fiduciary duty to creditors; and
2. The estate counsel duties to the client in an individual Chapter 11.



The individual debtor's fiduciary duty to creditors:

- When an individual Chapter 11 debtor files the petition, they owe a fiduciary duty to the creditors to act in the best interests of the bankruptcy estate.



The individual debtor's fiduciary duty to creditors:

- This means that the individual Chapter 11 debtor must generally put the interests of his/her creditors ahead of the his/her own interests and must actively work to benefit the bankruptcy estate even if that would disadvantage the individual himself/herself.



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The individual debtor's fiduciary duty to creditors:

Creditors
come first



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The estate counsel duties to the client in an individual Chapter 11:



The estate counsel duties to the client in an individual Chapter 11:



- Attorneys must be careful to advise potential Chapter 11 debtors of the full ramifications of a Chapter 11 filing.
 - They must do so while being unable to give the individual (not in his role as the debtor-in-possession) advice as to how he or she could improve their financial condition at the expense of the estate.

Property of the Estate:

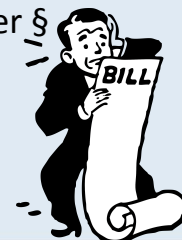
- Bankruptcy Code § 1115, added by the 2005 Amendments, radically changed the definition of what constitutes property of the estate in an individual Chapter 11 case.
- Significantly, § 1115 provides that the estate property includes an individual Chapter 11 debtor's "earnings from services performed . . . after commencement of the case but before the case closed."



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Property of the Estate:

- Payment of Living Expenses:
 - Can an individual debtor's living expenses be paid from estate property as ordinary course of business expenses under §§ 363(c)(1) and 1108 or is notice and a hearing required first under § 363(b)(1)?
 - Courts are split



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Property of the Estate:



- Payment of Living Expenses:
 - What expenses court will consider to be “ordinary?”
 - Courts are split



Property of the Estate:

**You Need
A Budget.**

- Payment of Living Expenses:
 - **Practice Tip:** Given § 1115, as well as a Chapter 11 debtor’s fiduciary duty to creditors, an individual Chapter 11 debtor should consider requesting bankruptcy court approval of a living expense budget in order to avoid challenges to the spending later.
 - Some jurisdictions have adopted a local rule.

Property of the Estate:

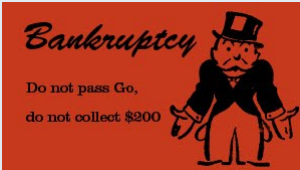
- Payment of Debtor’s Counsel for Personal Services:



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Property of the Estate:

- Payment of Debtor’s Counsel for Personal Services
 - A clear oversight within BAPCPA was the failure to amend § 330(a)(4)(B) to authorize the payment of debtor’s counsel for personal services in Chapter 11 cases.



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Property of the Estate:

- Payment of Debtor's Counsel for Personal Services
 - Consequently, individuals in Chapter 11 cases are unable to hire counsel for personal services (*e.g.*, criminal, divorce, exemption, discharge, or tax matters) if there is no benefit to the estate.



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Bankruptcy Code vs. the Internal Revenue Code



- A difficult issue arising is how post-petition earnings will be treated for tax purposes under the Internal Revenue Code.
 - How are post-petition earnings paid to individual debtor's estates and reported?
 - How are the post-petition earnings transferred from the estate to the individual (for use in personal expenses) treated for tax purposes?



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Bankruptcy Code vs. the Internal Revenue Code

- Will there be double taxation at the estate level and the individual level for amounts of post-petition earnings which are paid or used by debtors or individuals?



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Bankruptcy Code vs. the Internal Revenue Code

- While there is no definitive answer to these issues, a detailed reading of *Tax Consequences of Post-Petition Income as Property of the Estate in an Individual Debtor Chapter 11 Case and Tax Disclosure in Chapter 11* is highly recommended for a more complete understanding of these problems.



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Confirmation of Individual Chapter 11's:

- § 1115: property of the estate includes all property the debtor acquires after the commencement of the case and all earnings from post-petition services performed by the debtor.



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Confirmation of Individual Chapter 11's:

- § 1129(a)(15) permits confirmation of a plan notwithstanding the objection of an allowed unsecured claim so long as the individual debtor pays either property valued as of the effective date of the plan in an amount equal to the creditor's allowed unsecured claim or the debtor distributes an amount equal to or greater than the projected disposable income of the debtor for whichever is longer, a five-year period or during the period the plan provides payments.



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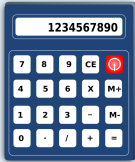
Confirmation of Individual Chapter 11's:

- § 1129(a)(15): a debtor may still confirm a plan without satisfying § 1129(a)(15) if no creditor objects to the plan.
- It is the only provision that requires a written objection for that provision to be considered by the court.



Calculation of “Projected Disposable Income”

- Pursuant to § 1129(a)(15), the “*projected disposable income*” test is imposed for the purposes of a Chapter 11 case in which the debtor is an individual when a “holder of an allowed unsecured claim objects to the confirmation of the plan.”



Confirmation of Individual Chapter 11's:

- § 1129(b)(2)(B)(ii): an exception to the **absolute priority rule** for individuals.
 - Narrow view: limits the exception to post-petition property and earnings from services.
 - Broad view: includes all property of the estate under both § 541 and post-petition earnings under § 1115.



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Confirmation of Individual Chapter 11's:

- § 1123(a)(8): allows a plan to provide for the payment of creditors through post-petition earnings from personal services performed by the debtor.



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Confirmation of Individual Chapter 11's:

- § 1141(d)(5): delays the granting of a ***discharge*** for an individual until the completion of all payments under the debtor's plan, provided after notice and a hearing, the court may grant a discharge to a debtor who has not completed its proposed plan payments as long as a modification under § 1127 is not practicable and the value of the payments that have been provided under the plan to allowed unsecured claims is equal to or exceeds the amount that such claims would have been paid if the debtor had been liquidated under Chapter 7.



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Confirmation of Individual Chapter 11's:

- § 1127(e): permits an individual debtor to ***modify*** his/her plan at any time after confirmation of the plan but before the completion of payments under the plan. Notwithstanding the fact that the plan has been substantially consummated.



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Funding & Operating Individual Chapter 11 Plans

Sonia E. Colón, Esq.

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Introduction

- ▶ BAPCPA made many changes to the Bankruptcy Code, particularly in Chapter 11
 - ▶ Expanded the individual chapter 11 debtor's estate
 - ▶ Created new benefits for individual chapter 12 and 13 debtors without affording individual chapter 11 debtors the same benefits
- ▶ Those changes may affect the administration of an individual chapter 11 debtor's plan

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Fiduciary Obligations

- ▶ Individual debtors can act as DIPs, just like corporate Chapter 11 debtors.
- ▶ Debtors-in-possession, like trustees, are fiduciaries to the creditors.
- ▶ Thus, individual DIPs must put the interests of their creditors before their personal interests and must work to benefit the estate even at a disadvantage to the individual debtor.
 - ▶ For e.g., if an individual debtor's estate can adequately pay creditors in full, but further litigating a claim the debtor has would lead to potential gain for the debtor, a court will likely not allow such delay because the "creditors' interests has a higher priority than the Debtor's own[] and they must take precedence." In re Bowman, 181 B.R. 836, 844 (Bankr. D. Md. 1995).

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Post-Petition Income

- ▶ Pre-BAPCPA, debtors could pay expenses using post-petition income, which was not part of the estate.
- ▶ BAPCPA expanded the Chapter 11 estate:
 - ▶ Chapter 11 estates now include "property . . . the debtor acquires [and] earnings from services performed . . . after the commencement of the case but before the case is closed" 11 U.S.C. § 1115(a) (2012).
- ▶ Post-BAPCPA, debtors must now seek payment of personal expenses from estate property.
- ▶ Problem: personal expenses do not always fall neatly within the scope of "actual, necessary" expenses under § 503(b)(1) or "ordinary course" expenses under § 363.

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- ▶ “There is scant authority regarding how individual chapter 11 debtors may pay expenses post-BAPCPA. Prior to BAPCPA, individual chapter 11 debtors were generally permitted to pay expenses from their postpetition income, which was not property of the estate. See e.g., *In re Goldstein*, 383 B.R. 496, 498 (Bankr .C.D.Cal.2007); *Cusano v. Klein*, 264 F.3d 936, 945 (9th Cir.2001).”
- ▶ “With BAPCPA’s addition of § 1115, individual chapter 11 debtors no longer have the option to pay expenses with postpetition income because virtually all property, including postpetition income from personal services, is property of the estate.”
- ▶ “Individual chapter 11 debtors must now seek payment of personal expenses from estate property, which may create problems considering the resulting diminution in estate assets and the fact that personal expenses do not always neatly fall within the scope of ‘actual, necessary’ expenses under § 503(b)(1) or ordinary course of business expenses under § 363.” *In re Villalobos*, No. BAP NV-11-1061-HKWJU, 2011 WL 4485793, at *8 (B.A.P. 9th Cir. Aug. 19, 2011).”

William L. Norton III, *Post-Petition Operations For Individual Chapter 11 Debtors*, Bradley Arant Boult Cummings LLP: Post BAPCPA Issues (2015), [http://www.ca6.uscourts.gov/internet/judicial_conference/2015/presmaterials/ smallbk/ 3.pdf](http://www.ca6.uscourts.gov/internet/judicial_conference/2015/presmaterials/smallbk/3.pdf)

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Issues Concerning the Use of Post-Petition Income

- ▶ What personal expenses can a chapter 11 debtor pay using estate property?
- ▶ Can individual chapter 11 debtors pay attorneys using estate funds?
- ▶ Will judges take into account a debtor’s standard of living to determine reasonableness, or expect lower standards of living during the case?
- ▶ Can individual chapter 11 debtors pay reasonable living expenses for family members?
- ▶ Should individual chapter 11 debtor to request bankruptcy court approval of a living expense budget to avoid challenges to such expenses later?

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What are “ordinary course” and “necessary” expenses?

- ▶ Some courts view living expenses as “ordinary course” because, without paying them, the debtor cannot remain gainfully employed for the benefit of the estate.
- ▶ Still, what will a court deem to be “ordinary”?
 - ▶ Monthly rent and utilities?
 - ▶ A partner’s car payment?
 - ▶ A grandchild’s college tuition?
 - ▶ The mortgage on a vacation home?
 - ▶ Charitable donations?
 - ▶ Incurring new debt?

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Ordinary course, necessary, and reasonable expenses

are

- ▶ Bills and rent.
 - ▶ *In re McCann*, 537 B.R. 172 (Bankr. S.D.N.Y. 2015) (“An example of using property of the estate ‘in the ordinary course’ is paying for ordinary and necessary living expenses, such as bills and rent.”)
- ▶ A dependent’s car and medical expenses.
 - ▶ *In re Gray*, No. 06-927, 2009 WL 2475017 (Bankr. N.D.W. Va. Aug. 11, 2009) (finding that because the debtor’s partner of over 20 years had supported the debtor when the debtor had not been working, and because they lived as a family unit, the partner was a dependent of the debtor and that the debtor could pay for partner’s reasonable expenses)

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Ordinary course, necessary, and reasonable expenses are not . .

- ▶ Two internet and television services.
 - ▶ *In re Gray*, 2009 WL 2475017 (refusing to allow debtor to pay from the estate two internet and television services; one was enough).
- ▶ Moral responsibilities.
 - ▶ *Id.* (refusing to allow debtor to pay \$750 per month on 15 dogs because the debtor “cares for these dogs only out of a feeling of moral responsibility” and the dogs “provide no service to the debtor).
- ▶ Expensive individual cell phone plan.
 - ▶ *Id.* (finding excessive a \$250 per month cell phone plan but that \$100 per month would be reasonable).

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Maybe?

- ▶ Pool service, dry cleaning, college tuition for grandchildren, vacation home mortgage.
 - ▶ *In re Villalobos*, No. BAP NV-11-1061-HKWJU, 2011 WL 4485793 (B.A.P. 9th Cir. Aug. 19, 2011).
 - ▶ The 9th Circuit BAP reviewed the bankruptcy court’s approval of all of the above expenses to be paid out of the estate as “ordinary course” expenses.
 - ▶ The court noted the case law did not provide a clear answer as to the determination when an expense is reasonable. The debtor urged that reasonable expenses related to support and maintenance obligations should be considered. A creditor argued that the expenses proposed were unreasonable.
 - ▶ Without disapproving of any of the expenses, the case was remanded to the bankruptcy court for the adoption of a clear standard and findings of fact and conclusions of law.

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Other Important Considerations

- ▶ The debtor's ability to pay the expenses "has no bearing on whether certain expenses are ordinary course expenses." *In re Villalobos*, 2011 WL 4485793, at *9.
- ▶ The determination whether an expenses will be considered "ordinary" will depend on the specific facts of each case.

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Can individual chapter 11 debtors pay attorneys from the estate?

- ▶ BAPCPA amended § 330(a)(4)(B) to allow payment of individual Chapter 12 and 13 debtors' counsel without any requirement that the legal services benefit the estate.
- ▶ No such provision was made for individual Chapter 11 debtors.
- ▶ Thus, individual chapter 11 debtors cannot pay counsel from the estate if the only benefit that accrues is to the individual debtor and not to the estate.

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When do counsel benefit the individual's chapter 11 estate?

- ▶ May “employ an attorney to assist in carrying out the duties of a trustee” or in connection with the bankruptcy case. *In re Miell*, 2009 WL 2253256, at *1, *3 (Bankr. N.D. Iowa July 27, 2009).
- ▶ Generally, cannot use the estate to fund a criminal defense. *In re Stoecker*, 114 B.R. 965, 970 (Bankr. N.D. Ill. 1990).
- ▶ Nor can chapter 11 debtors use estate assets to fund tax litigation or family law matters.
 - ▶ *In re Miell*, 2009 WL 2253256 (Bankr. N.D. Iowa 2009) (refusing to award tax attorneys' fees from the estate where the legal services benefitted only the debtor and not the estate).
 - ▶ *In re Polishuk*, 258 B.R. 238, 251 (Bankr. N.D. Okla. 2001) (refusing to award divorce attorney fees from the estate, but awarding fees priority under § 503(b)(1)).

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Other Important Considerations

- ▶ Court approval to employ an attorney under § 327 does not mean that the attorney can be paid from the estate.

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Case Review

Case Citation	Facts and Holding	Important Rules & Considerations
In re Bowman, 181 B.R. 836 (Bankr. D. Md. 1995)	Chapter 7 debtor objected to trustee's proposed acceptance of settlement offer with respect to debtor's prepetition breach of contract and tortious interference claims and moved to convert Chapter 7 case to one under Chapter 11, which would have led to a potential increase in recovery for the individual debtor. The Bankruptcy Court held although the debtor had a right to convert the case, a conflict of interest existed requiring the debtor's removal from administration of converted case; and (3) proposed settlement would be approved as being in best interest of estate.	Chapter 11 debtors-in-possession are fiduciaries and owe the same duties as do trustees, which extend to all parties interested in the bankruptcy estate. Id. at 843. Debtors-in-possession must act in the best interest of the creditors, not in its own interest. His or her job is to make sure that creditors get paid. Id.

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Case Review

Case Citation	Facts and Holding	Important Rules & Considerations
In re Miell, 2009 WL 2253256 (Bankr. N.D. Iowa 2009)	Chapter 11 debtor moved to employ counsel for criminal defense, tax litigation, and related civil matters. Court denied payment to all of the attorneys, reasoning that their services benefited only the debtor and not the bankruptcy estate. The court also held that any retainers the attorneys had received are property of the estate.	Court approval to employ an attorney under § 327 does not mean that the attorney can be paid from the estate. Id. at *1. Attorneys fees will not be awarded without a benefit to the estate. Id. at *2. Debtors have no right to use estate assets to fund a criminal defense. Id.

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Case Review

Case Citation	Facts and Holding	Important Rules & Considerations
In re Seely, 492 B.R. 284 (Bankr. C.D. Cal. 2013)	In case that was converted from Chapter 11 to Chapter 7, Chapter 7 trustee moved for turnover of \$113,802.13 from debtors, representing nonexempt cash that was on hand as of petition date plus additional nonexempt cash that debtors received during pendency of case, based on contention that the funds were improperly expended without court order (funds were used to pay living expenses while the proceeding was a Chapter 11 case), and, because the funds in question were no longer in debtors' possession, trustee sought to surcharge certain settlement proceeds claimed as exempt by debtors. Debtors filed motion seeking release of the settlement proceeds. The Bankruptcy Court held that debtors did not engage in any wrongdoing when they expended estate assets to pay their "ordinary course" personal living expenses while they were in Chapter 11 without first obtaining permission from the court to do so, and so there were no "wrongful disbursements" that could be charged against the exempt settlement proceeds.	Section 363 allows Chapter 11 debtors in possession to use property of the estate in the ordinary course of business without prior court approval. Id. at 288-89. Pre-BAPCPA, post-petition wages of individual chapter 11 debtors did not make up part of the bk estate, so individual debtors could use those wages to pay post-petition living expenses. Id. at 289. But, post-BAPCPA, such wages become part of the estate, "and most debtors were left with no alternative but to use estate property to pay their post-petition living expenses." Id. Court held that it is "reasonable to conclude that Congress intended for post-petition wages in individual chapter 11 cases to receive treatment similar to post-petition wages in chapter 13 cases" Id. at 289-90.

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Case Review

Case Citation	Facts and Holding	Important Rules & Considerations
In re Harp, 166 B.R. 740, 746 (Bankr. N.D. Ala. 1993) (11 th Circuit Case, pre-BAPCPA)		Individual "Chapter 11 debtors-in-possession . . . have fiduciary responsibilities to unsecured creditors and other parties in interest requiring them to act in the capacity of a bankruptcy trustee." Id. at 746. These fiduciary responsibilities "imply a special burden on debtors such as the Harps to ensure that the resources that flow through the debtor-in-possession's hands are used to benefit the unsecured creditors and other parties in interest." Id. at 746-47.

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Case Review

Case Citation	Facts and Holding	Important Rules & Considerations
In re McCann, 537 B.R. 172 (Bankr. S.D.N.Y. 2015)	Facts not relevant to individual chapter 11 issues, but the court accepts the proposition that necessary living expenses, like bills and rent, constitute "ordinary course" expenses.	"An example of using property of the estate "in the ordinary course" is paying for ordinary and necessary living expenses, such as bills and rent." Id. at 172.

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Case Review

Case Citation	Facts and Holding	Important Rules & Considerations
In re Villalobos, No. BAP NV-11-1061-HKWJU, 2011 WL 4485793 (B.A.P. 9th Cir. Aug. 19, 2011)	<p>Individual chapter 11 debtor moved for approval of a monthly payment of ordinary course business expenses. These expenses totaled over \$128,000 and included payments for 3 mortgages, IRS payments, pool service, dry cleaning, medication, and over \$100,000 over the year in tuition for the debtor's grandchildren.</p> <p>The bankruptcy court did not make any findings of fact or explicit conclusions of law; it simply approved the expenses. With regard to the tuition payments for the grandkids, the bankruptcy court accepted them as "ordinary course" stating "I'm not going to throw the kids out of college. . . . I'm going to hold that they are ordinary expenses of this debtor and they have been traditionally and they're going to continue."</p> <p>At the bankruptcy court's hearing, the debtor argued that the addition of 1115 requires that he be allowed to pay personal expenses as ordinary course expenses from the estate. He argued that section 1129(a)(15) incorporates the disposable income test used in Chapter 13, which takes into account a debtor's reasonable expenses related to certain support and maintenance obligations. The IRS, in opposing the motion to authorize the expenses, argued that the expenses were not reasonable.</p> <p>The bankruptcy court, in its ruling, did not adopt any specific standard, and therefore the 9th Circuit BAP did not reach a decision concerning the proper standard to apply. Instead, the BAP reversed and remanded the case to the bankruptcy court to allow it to adopt a test, make findings of fact and conclusions of law. The BAP also held that a bankruptcy court's finding that a debtor had "historically paid certain expenses in insufficient" to allow the BAP to review the bankruptcy court's decision.</p>	<p>This court noted that it is unclear "whether the bankruptcy court must determine that the claim created by the loan itself meets the requirements for administrative expense priority under § 503(b)(1), or whether a debtor must show that all the expenses he intends to pay from the proceeds of the loan meet the requirements."</p> <p>Compare In re Kmart Corp., 359 F.3d 866, 872 (7th Cir.2004) (§ 364(b) only addresses a debtor's ability to incur debt or obtain credit and not the way the proceeds of the credit will be expended) with 3 Collier on Bankruptcy ¶ 364.02 (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.2009) (better view may be that the requirements of each provision, § 364(a) and § 503(b)(1), must be met to approve a financing motion).</p> <p>The court held that "[w]hether the Debtor has sufficient funds to pay administrative and priority creditors has no bearing on whether certain expenses are ordinary course expenses or whether they are allowable under § 363(b) or § 363(c)."</p>

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Case Review

Case Citation	Facts and Holding	Important Rules & Considerations
<i>In re Gray</i> , No. 06-927, 2009 WL 2475017, at *3 (Bankr. N.D.W. Va. Aug. 11, 2009)	<p>Debtor filed a voluntary Chapter 11. Proposed to pay \$4500 per month on the plan. A creditor objected to the plan, arguing that several of the expenses listed by debtor were unreasonable and unnecessary such that the plan payments could be increased. The creditor argued that the debtor's partner should not be considered a dependent under the Code and therefore the debtor should not be allowed to pay for the partner's expenses. The court noted a split as to how "dependent" is defined by the court, but ultimately concluded that "[b]ased on their extensive history together [over 20 years], including the continued support they provide for one another, . . . the Debtor and [her partner] form a "family unit," such that [the partner] is a "dependent" of the Debtor."</p> <p>Additionally, the court found that where the debtor's current monthly income was over \$18,000, "[t]he expenses that the Debtor incurs to support [her partner] in the form of medical bills (\$375.00 monthly), household expenses (jointly totaling \$900.00 monthly), and fuel (jointly totaling \$350.00 monthly) for [her partner's] car are reasonable and necessary."</p> <p>The creditor also objected to certain other expenses. The court found it "unreasonable and unnecessary for the Debtor to maintain two television services. The Court will disallow the \$149.00 per month spent on Direct TV service" and \$30 on AOL where the debtor also had Comcast service, which provided TV, internet, and phone service.</p> <p>Moreover, the court found unreasonable an expense of \$250 per month for a cell phone; a more reasonable amount would be \$100 per month.</p> <p>Finally, the court disallowed a \$750 per month expenditure on 15 dogs, concluding that "the Debtor cares for these dogs only out of a feeling of moral responsibility" and that the dogs "provide no necessary service to the Debtor."</p>	<p>This court noted a split of authority on the determination whether someone is a "dependent" under the Code. It ultimately adopted a broader view of that word and held that a partner with whom the debtor had been living for over 20 years and that had provided for the debtor when the debtor was not working constituted a dependent such that the debtor could now pay for the partner's expenses out of the estate.</p> <p>This court found it unreasonable to pay for monthly expenses for 15 dogs.</p>

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Conclusion

- ▶ The law in each district and circuit is still developing in individual chapter 11 issues.
- ▶ It is important to be aware of developments in your district and circuit, as well as other districts and circuits.
- ▶ Until then, it is best to advise individual chapter 11 debtors to err on the side of caution and ask the court for permission before expending any estate funds.
- ▶ In some judicial districts, local rules or standing orders require an individual Chapter 11 debtor to do this. Seeking early judicial approval minimizes the risk that creditors later might challenge as impermissible or unreasonable.

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Special Challenges of Individual Chapter 11s:

Not Just Chapter 13's Older Sibling! What Every Chapter 13 Debtor's Lawyer Should Know

FACT PATTERNS

1. Fact Pattern #1 – Donald Smith:

It's Friday and your first client in the afternoon is Donald Smith. He proceeds to tell you that this is not his first time seeing a bankruptcy lawyer. It seems he went through a dissolution of marriage in late 2009, and as a consequence of his marital breakup, his wife (and business partner) liquidated their business leaving unsatisfied trade debt subject to a personal guaranty. As a consequence, he filed a Chapter 7 bankruptcy case, and received a discharge. Since then he started a new business (operated as an S-corp.) and was successful for several years, until health problems interfered with his ability to run the business. He has regular income of about \$2,000 per month from disability, which is used almost totally to pay for expenses for his 10-year-old child from his previous marriage. He has about \$70,000 in credit card debt used for the business, \$350,000 in personal guaranty obligations evenly spread over ten trade creditors associated with the business, as well as a personal guaranty of a secured line of credit to the extent of \$1,000,000. The collateral in the business is worth only about \$400,000 if sold at retail over time, and about \$200,000 if liquidated expeditiously. Because of his health issues, he really wants to close the business down and work for someone else if possible. In addition, the business paid \$50,000 to his new wife to install a pool which is used to ameliorate his chronic health problems.

Questions:

Should Mr. Smith consider filing a Chapter 11 or Chapter 13?

What fiduciary duties would arise in his individual case should he file under Chapter 11?

What reporting and operating issues would Donald face in Chapter 11?

What would a Chapter 11 plan look like for Donald?

How would confirmation of a Chapter 11 plan differ from a Chapter 13 plan?

If Donald is unable to get the vote of the unsecured class, what options does he have? How would that compare to where he would be in a Chapter 13 (assuming he was eligible)?

2. Fact Pattern #2 – John and Sally:

Husband and wife, John and Sally, are your clients in their joint individual Chapter 11 case, which has been jointly administered with two related corporate cases. It seems that John and Sally attempted to structure their restaurant business so that all of the assets and operations would be within their corporate entities, but alas, John and Sally did not get the benefit of competent legal advice and instead most of the business assets are titled in their individual names, thus necessitating the multiple filings including their joint individual case.

The good news is that you've managed to work through a very complex set of issues and reached settlements with multiple secured creditors, and have the vote of the unsecured class in a case that involves John and Sally both agreeing to manage and operate the restaurants for at least 5 years under the plan.

The bad news is that, about a month before confirmation, John and Sally set up a conference call with you and the divorce lawyers that they have each hired (unbeknownst to you) to talk about the dissolution of marriage action that they intend to file before confirmation. They want your advice about litigating the dispute between them as to the value of the business, and how that value should be split up between the disgruntled spouses. Oh, by the way, the disclosure statement reflects that the value of the equity in the business is zero.

Questions:

Can John and Sally hire professionals to represent them in their dissolution of marriage action during their individual Chapter 11 case? Would it be different if they were in Chapter 13?

Do you explain to John and Sally what fiduciary duties they have to their creditors, the estate, and the court in the context of their recent marital problems?

What fiduciary duties do you have as counsel for John and Sally, and their bankruptcy estate, in the context of their Chapter 11?

John and Sally inform you that while they both had salaries approved at the inception of their individual case, John has not been working in the business for the past 6 months (although he has been drawing a salary). Does this complicate matters in their Chapter 11 case? Would the situation be different if they were in a Chapter 13 case?

INDIVIDUAL CHAPTER 11S

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I. Who is Your Client in an Individual Chapter 11?

Judge Alan Jaroslovsky (ND Calif) warned in his *Notice to Bar Regarding Individual Chapter 11 Cases*, (posted on his website) the following:

A Chapter 11 is not just a big Chapter 13. If you represent a Chapter 11 debtor in possession, your client is the *estate*, not the debtor personally. Failure to understand this results in serious liability exposure.

As debtors' attorneys know, or should know, the vast majority of courts have held that counsel for Chapter 11 debtors represent the bankruptcy estate¹ and not the principals of the debtor.² While representing your actual client in a corporate Chapter 11 case is difficult, representing a debtor's bankruptcy estate in an individual Chapter 11 is almost an out of body experience. As noted by one of the leading scholars in Bankruptcy ethics, Prof. Nancy Rapoport:

Representing a corporation can present numerous problems for Estate Counsel, but representing individual Debtors in chapter 11 is even trickier: "The complex fiduciary duties of a chapter 11 debtor-in-possession and its counsel can become even more confused when the debtor(s)-in-possession are individuals." Obviously, there is the metaphysical challenge of realizing that the human who hired you to file his chapter 11 petition is not your client in the bankruptcy case. Even though it's fairly easy, at least in theory, to understand that the president of a corporation or the managing partner of a partnership is not your client when you are representing the business entity itself, it stretches the bounds of legal fiction to comprehend the difference between the Bankruptcy Estate of an individual (your client) and the individual himself (not your client).

Rapoport and Bowles at 70-71.

Two issues are critical to addressing the challenging ethical problems in individual Chapter 11 cases: (1) the individual debtor's fiduciary duty to creditors and (2) the estate counsel duties to the client in an individual Chapter 11.³

One of the most difficult concepts Chapter 11 debtors have to grasp, when they file their bankruptcy is that they owe a fiduciary duty to their creditors⁴ to act in the best interests of their

¹See *In re Dixon*, 2010 WL 3767604 (Bankr. N.D. Cal. 2010)(debtor's counsel had conflict of interest by representing debtor in Chapter 11 and defending against creditor objection to \$1 million exemption in retirement funds); see generally, *Everett v. Perez*, 30 F.3d 1209 (9th Cir. 1994); *In re Cenargo International PLC*, 294 B.R. 571 (Bankr. S.D. N.Y. 2003); *In re ICM Notes, Ltd.*, 278 B.R. 117 (S.D. Tx. 2002); *In re Harp*, 166 B.R. 740 (Bankr. N.D. Ala. 1993); *In re Rusty Jones, Inc.*, 134 B.R. 321 (Bankr. N.D. Ill. 1991); *In re Grabill, Corp.*, 113 B.R. 966 (Bankr. N.D. Ill. 1990); *In re Storms*, 101 B.R. 645 (Bankr. S.D. Cal. 1989). See also, Rapoport and Bowles, Has the DIP's Attorney Become the Ultimate Creditor's Lawyer in Bankruptcy Reorganization Cases?, 5 Am. Bkr. Inst. L. Rev. 47 (Spring 1997) (hereinafter "Rapoport & Bowles").

²However at least two cases, *Hansen Jones & Lela P.C. v. Segal*, 220 B.R. 434 (D. Utah 1998) and *In re Sidco, Inc.*, 173 B.R. 194 (E.D. Col. 1994) have held that counsel owe duties to the Debtors-in-possession, not the estate.

³There are numerous other problems with individual Chapter 11 debtors, including attorney-client privilege issues, which are beyond the scope of this article. See generally *In re Bame*, 251 B.R. 367 (Bankr. D. Minn. 2000).

bankruptcy estate.⁵ Courts have universally held that individual chapter 11 debtors owe these duties just like other debtors-in-possession.⁶

This means the individual Chapter 11 debtor must generally put the interests of his creditors ahead of his or her own interests and must actively work to benefit a bankruptcy estate even when that would disadvantage the individual himself. Two cases demonstrate the issues found in this standard.

In the case of *In re Bowman*,⁷ a Chapter 7 debtor objected to the Chapter of Trustee's settlement of a lawsuit for an amount which would pay the debtor's creditors in full, but not produce any distribution to the debtor.⁸ The debtor exercised her right⁹ to convert her case to a Chapter 11 case. The Court granted the debtors' motion, but immediately reconverted the case to a Chapter 7 case finding the debtor's insistence on further litigation of her claim was a violation of her fiduciary duty as a Chapter 11 debtor in possession. The *Bowman* court held:

Likewise, in this case when Debtor must weigh whether to accept a prompt settlement that would substantially pay her creditors or to wait and gamble on a potential to receive a greater recovery, her creditors' interests have a higher priority than the Debtor's own; and they must take precedence. Debtor's own statement that she "intends to proceed with litigation, through trial," indicates her unwillingness to examine other interests above hers. But there is more to the conflict than mere unwillingness, it is an inherent conflict of interest between her duty as a fiduciary to the estate and her desire to maximize the amount of money she may recover for herself.¹⁰

In a similar fashion, the Court in *In re Tel-Net Hawaii, Inc.*¹¹ removed the debtor in possession who was the corporation's controlling shareholder due to its failure to pursue preference actions which would have increased its exposure on guaranteed debts.¹² The Court found that in light of

⁴*Id.* at 53-55. See also, *Commodity Futures Trading Commission v. Wentraub*, 471 U.S. 343, 355 (1985).

⁵See Rapoport & Bowles at 53-58 for a full discussion of the exact nature of these duties.

⁶See generally *In re Hardy*, 319 B.R. 5 (Bankr. N.D. Fla. 2004) (Full disclosure of assets and of business transactions required); *In re Robino*, 243 B.R. 472 (Bankr. N.D. Ala. 1999) (compliance with Court orders); *In re Tornheim*, 181 B.R. 161 (Bankr. S.D. N.Y. 1995) (duty to pay fees and file required reports); *In re Bowman*, 181 B.R. 836 (Bankr. D. Md. 1995) (duty to put creditor interests first in settlement of a lawsuit); *In re Harp*, 166 B.R. 740 (Bankr. N.D. Ala. 1993) (duty to properly account for estate property and to properly use estate funds).

⁷181 B.R. at 836.

⁸*Id.* at 841.

⁹*Id.* citing *In re Finney*, 992 F.2d 43, 45 (4th Cir. 1993).

¹⁰*Id.* at 845. However, courts do not automatically require trustees to settle claim where an offer is made to pay creditors' claims in full. See generally, *In re Central Ice Cream Co.*, 836 F.2d 1068 (7th Cir. 1987) (discussing settlement which included payments to equity owners and insiders).

¹¹105 B.R. 594 (Bankr. D. Haw. 1989).

¹²*Id.* at 595.

the conflicting interests of its controlling shareholder, an independent trustee had to be appointed.

Therefore, attorneys must be careful to advise potential Chapter 11 debtors of the full ramifications of a Chapter 11 filing. Further they must do this while being unable to give the individual (not in his role as debtor-in-possession) advice as to how he or she could improve their financial condition at the expense of the estate.¹³

II. Property of the Estate

Bankruptcy Code § 1115,¹⁴ added by the 2005 Amendments, radically changed the definition of what constitutes property of the estate in an individual Chapter 11 case. Most significantly, § 1115 provides that estate property includes an individual Chapter 11 debtor's "earnings from services performed . . . after the commencement of the case but before the case is closed."¹⁵

Prior to the enactment of § 1115, courts were bitterly divided as to what portion, if any, of an individual debtor's post-petition earnings constituted property of the estate under § 541. A majority of courts held that, under the "earnings exception" of § 541(a)(6),¹⁶ post-petition earnings of an individual Chapter 11 debtor were excluded from property of the estate.¹⁷

¹³See *In re Harp*, 166 B.R. 740, 747-48 (Bankr. N.D. Ala. 1993); It is not easy for a debtor-in-possession, corporate or individual, to serve two masters-juggling the personal needs and desires of the debtor itself, with its clear fiduciary responsibilities to unsecured creditors, other parties in interest and the court. Nor is the role any easier for the attorney who represents the debtor-in-possession.

¹⁴ Section 1115 provides:

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

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

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

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

11 U.S.C. § 1115.

¹⁵ 11 U.S.C. § 1115(a)(2).

¹⁶ Section 541(a)(6) provides that the bankruptcy estate includes "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, *except such as are earnings from services performed by an individual debtor after the commencement of the case.*" 11 U.S.C. § 541(a)(6) (emphasis added).

¹⁷ See, e.g., *In re Hake*, 2006 WL 2621116, at *7-8 (B.A.P. 6th Cir. Sept. 14, 2006); *Roland v. UNUM Life Ins. Co. of Am (In re Roland)*, 223 B.R. 499, 502 (W.D.N.Y. 1998); *In re Powell*, 187 B.R. 642, 644-45 (Bankr. D. Minn. 1995).

However, a sizeable minority of courts found that at least a portion of post-petition profits generated by professionals and sole proprietors were not earnings subject to the § 541(a)(6) exception and, therefore, were estate property.¹⁸ While § 1115 resolves this split of authority, it leaves unanswered several practical questions related to how an individual Chapter 11 debtor's post-petition income will be treated during the bankruptcy case.¹⁹

A. Payment of Living Expenses

One such issue is whether an individual debtor's living expenses can be paid from estate property as ordinary course of business expenses under §§ 363(c)(1)²⁰ and 1108,²¹ or whether notice and a hearing under § 363(b)(1)²² is required for living expenses to be paid. Prior to the enactment of § 1115, few cases addressed the issue of whether a debtor was required to obtain court approval for the payment of living expenses from estate property. Of those courts that considered the issue, some held that normal living expenses of an individual Chapter 11 debtor did not need court approval,²³ while others indicated that some form of court approval would be necessary, at least in cases of significant expenses.²⁴ Indeed, one early pre-BAPCPA decision, *In re Vincent*,²⁵ held that no authority permitted the payment of an individual Chapter 11 debtor's living expenses from estate property.²⁶

¹⁸ See, e.g., *In re Harp*, 166 B.R. 740, 748-55 (Bankr. N.D. Ala. 1993); *In re Herberman*, 122 B.R. 273, 278-80 (Bankr. W.D. Tex. 1990); *In re Cooley*, 87 B.R. 432, 438-41 (Bankr. S.D. Tex. 1984).

¹⁹ See Appendix of cases attached hereto.

²⁰ Section 363(c)(1) provides:

If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

11 U.S.C. § 363(c)(1).

²¹ Section 1108 provides: "Unless the court, on request of a party in interest and after notice and a hearing, orders otherwise, the trustee may operate the debtor's business." 11 U.S.C. § 1108

²² Section 363(b)(1) provides, in pertinent part, that: "The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b)(1).

²³ See *In re Murray*, 216 B.R. 712, 713 (Bankr. W.D. N.Y. 1998); *In re Keenan*, 195 B.R. 236, 243 (Bankr. W.D. N.Y. 1996); *In re Bradley*, 185 B.R. 7, 8 (Bankr. W.D. N.Y. 1995) ("[W]hen a Chapter 11 Debtor-in-Possession is a natural person, his personal expenses and his obligations for incidents of his personal life are every bit as much a part of the ordinary course of his business and financial affairs as are expenses incident to the operation of the various shopping malls, nursing homes, and office buildings that he owned.")

²⁴ See generally *In re Harp*, 166 B.R. 740, 741-46, 755-56 (Bankr. N.D. Ala. 1993) (discussing that the chapter 11 debtor violated his fiduciary duties by paying for rental of vacation homes, sponsoring a large pre-game Alabama-Auburn brunch and taking a vacation to an exclusive resort in the Netherland Antilles).

²⁵ 4 B.R. 21 (Bankr. M.D. Tenn. 1979).



Post-BAPCPA at least one bankruptcy court has held that § 363(c)(1) authorizes individual Chapter 11 debtors to use estate property to pay “ordinary” living expenses, without obtaining court approval.²⁷ The court reasoned:

Notwithstanding section 363(c)(1)'s reference to the ordinary course of a debtor's *business*, because the debtor cannot continue to generate post-petition wages without being able to pay for the personal expenses necessary to permit him to live his life and remain gainfully employed, section 363(c)(1) has generally been understood to authorize chapter 13 debtors to pay post-petition living expenses without notice and an opportunity for hearing or a prior court order, so long as such expenses are “ordinary course” rather than unusual or extraordinary. If a chapter 13 debtor's post-petition living expenses prove unreasonable or excessive, his chapter 13 case will be converted or dismissed, either because his plan was not proposed in good faith or because he is unwilling to devote all of his disposable income to the payment of creditors under his plan, and not because the debtor failed to obtain prior court approval for the payment of his ordinary course living expenses during the pendency of the case.

Rather than struggle to invent out of whole cloth a procedure and standard for approving requests by chapter 11 debtors for authority to spend property of the estate for the payment of post-petition living expenses, the court should give section 363(c)(1) the same interpretation in chapter 11 cases as it has always been understood to have in chapter 13 cases. That is, the court should recognize that section 363(c)(1) authorizes a debtor in possession to use property of the estate to pay post-petition living expenses without prior court approval, so long as the amounts to be disbursed qualify as “ordinary course” expenses. An individual chapter 11 debtor needs to pay his living expenses in order to continue generating revenues for the estate. Thus, the payment of ordinary course living expenses should be treated as being within the debtor's ordinary course of business for the purpose of interpreting section 363(c)(1).²⁸

²⁶ *Id.* at 23; *see also In re Walter*, 83 B.R. 14, 19-20 (B.A.P. 9th Cir. 1988) (“The bankruptcy court properly relied on case law whereby courts had held that personal living expenses for debtors and their families, as well as attorney's fees which benefitted the debtor as an individual, but not the bankruptcy estate, could not be paid out of monies or assets of the estate. The bankruptcy court has authority to deny the debtor use of estate property for living expenses for himself or his family.”)

²⁷ *In re Seely*, 492 B.R. 284, 289-91 (Bankr. C.D. Cal. 2013); *see also In re Goldstein*, 383 B.R. 496, 499 (Bankr. C.D. Cal. 2007) (suggesting that 365(c) permits a debtor-in-possession to use estate property to “buy bread and probably to purchase a ticket to travel to a court hearing” but it did not authorize the debtors to hire divorce counsel); *In re Villalobos*, 2011 WL 4485793, at *8-9 (B.A.P. 9th Cir. Aug. 19, 2011) (suggesting that Section 365(c) may permit an individual chapter 11 debtor to pay living expenses as ordinary course expenses but remanding to the bankruptcy court to articulate the legal rule relied on by the court in approving certain expenses for payment).

²⁸ *In re Seely*, 492 B.R. 284, 290 (Bankr. C.D. Cal. 2013)..

While it remains to be seen whether other courts will agree that “ordinary course” living expenses can be paid without prior court approval, the more difficult question is likely what expenses courts will consider to be “ordinary” living expenses for purposes of § 363. For instance, will judges take into account the debtor’s standard of living in determining what expenses constitute reasonable living expenses?²⁹ Should Courts adopt a disposable income test similar to § 1325(b) or § 1129(a)(15),³⁰ or will they impose the “minimal” standard of living tests imposed on parties seeking to discharge student loans?³¹ While none of these questions have clear answers, some courts will expect lower standards of living from individual debtors during the pendency of their Chapter 11 cases.³²

Also, there is the question of whether individual Chapter 11 debtors can pay reasonable living expenses for members of their families. Consider whether a bankruptcy court would permit a corporate Chapter 11 debtor to pay the living expenses of a president’s son, brother-in-law or other relative, if they provided no value to the debtor’s estate. While spouses, former spouses, children of the debtor and other designated parties are entitled to first priority payments for their domestic support obligations,³³ and Chapter 13 debtors are expressly authorized to pay for the support of their dependents³⁴ in their cases, there appears to be no similar expense authorization in Chapter 11 that would permit an individual Chapter 11 debtor to pay for his or her family’s support from estate funds.³⁵ Indeed, in a pre-section 1115 individual chapter 11 case, *U.S. v. Sutton*, the Fifth Circuit overruled a lower court decision which allowed living expenses of the

²⁹ While isolated cases have approved, indirectly, expenditures of an affluent nature, see *In re Bradley*, 185 B.R. at 11 (refusing to impose a budget on an individual chapter 11 debtor) and *In re Rodriguez*, 41 B.R. 774, 775 (Bankr. S.D. Fla. 1984) (approving personal expenses of \$7,000 per month), most Courts have refused to consider status or lifestyle in determining what constitutes reasonable living expenses. See generally *In re Cardillo*, 170 B.R. 490, 491 (Bankr. D.N.H. 1994) (Chapter 13 case); *In re Jones*, 55 B.R. 462, 466-67 (Bankr. D. Minn. 1985) (Chapter 13 case); *In re Gray*, 2009 WL 2475017, at *1-4 (Bankr. N.D. W. Va. Aug. 11, 2009) (court found expenses for care of 15 dogs and duplication of internet and cable providers to be unreasonable and held, as a result, that individual’s chapter 11 plan did not meet the disposable income requirement of Section 1129(a)(15)); see also *In re Villalobos*, 2011 WL 4485793, at *8-9 (B.A.P. 9th Cir. Aug. 19, 2011) (bankruptcy court’s finding that individual chapter 11 debtor had historically paid certain expenses was insufficient grounds for approving debtor’s post-petition payment of luxury vehicles, expensive homes, and college tuition of grandchildren from estate property).

³⁰ See generally *In re Watson*, 403 F.3d 1, 7-8 (1st Cir. 2005) (Chapter 13 debtor’s childrens’ private school tuition was not a reasonably necessary expense); *In re Gleason*, 267 B.R. 630, 633-35 (Bankr. N.D. Iowa 2001) (Chapter 13 debtor’s recreation and gift expenses not reasonably necessary); *In re Dick*, 222 B.R. 189, 190-91 (Bankr. D. Mass. 1998) (Chapter 13 debtor’s payment on non-income producing vacation home not a reasonably necessary expense).

³¹ See generally *In re Cox*, 338 F.3d 1238, 1241-1242 (11th Cir. 2003); *In re Hornsby*, 144 F.3d 433, 437 (6th Cir. 1998).

³² See generally *In re Wood*, 68 B.R. 613, 617 (Bankr. D. Haw. 1986) (large expenditures on pet care demonstrated mismanagement of individual chapter 11 debtor’s business affairs); *In re Gray*, 2009 WL 2475017 at *1-4 (Bankr. N.D. W. Va. Aug. 11, 2009).

³³ See 11 U.S.C. §§ 101(14A), 507(a)(1), and 1112(b)(4)(P).

³⁴ See 11 U.S.C. § 1325(b)(2)(A)(i).

³⁵ See *U.S. v. Sutton*, 786 F.2d 1305, 1306-1308 (5th Cir. 1986) (holding that an incarcerated individual Chapter 11 debtor was not permitted to have his estate pay living expenses of his wife and minor children).

individual Chapter 11 debtor's spouse and minor children to be paid from estate funds.³⁶ While Courts should be able to distinguish *Sutton* on its unique facts, it does illustrate the problems with new § 1115.

Ultimately, given BAPCPA's addition of § 1115, as well as a Chapter 11 debtor's fiduciary duty to creditors,³⁷ an individual Chapter 11 debtor should consider requesting bankruptcy court approval of a living expense budget in order to avoid challenges to the spending later in the case.³⁸ As one bankruptcy court recently noted,

A chapter 11 debtor in possession or his counsel might well conclude that it would be in the debtor's best interest to seek such approval, whether or not it is required, in order to put parties in interest on notice as to the amounts the debtor intends to spend on living expenses each month, rather than wait until estate assets have been dissipated and another party in interest claims that the debtor's disbursements were unreasonable or excessive (and therefore constitute grounds to warrant the appointment of a chapter 11 trustee or conversion of the case) or did not qualify as ordinary course expenditures.³⁹

Notably, some jurisdictions have adopted either a local rule or practice providing for the submission and approval of a living expense budget by individual Chapter 11 debtors.⁴⁰

³⁶ *Id.*

³⁷ One of the most difficult concepts that Chapter 11 debtors have to grasp when they file for bankruptcy protection is that debtors-in-possession owe fiduciary duties to their creditors to act in the best interests of their bankruptcy estates. See C.R. Bowles, Jr., & Nancy B. Rapoport, *Has the DIP's Attorney Become the Ultimate Creditors' Lawyer in Bankruptcy Reorganization Cases?*, 5 AM. BANKR. INST. L. REV. 47, 53-58 (Spring 1997). Courts have universally held that individual Chapter 11 debtors owe these duties just like other debtors-in-possession. See generally *In re Hardy*, 319 B.R. 5, 6-8 (Bankr. M.D. Fla. 2004) (full disclosure of assets and of business transactions required); *In re Robino*, 243 B.R. 472, 486-87 (Bankr. N.D. Ala. 1999) (compliance with court orders required); *In re Tornheim*, 181 B.R. 161, 164 (Bankr. S.D.N.Y. 1995) (timely and accurate financial disclosures required); *In re Bowman*, 181 B.R. 836, 843-45 (Bankr. D. Md. 1995) (fiduciary duties include a duty of care to protect assets, a duty of loyalty, and a duty of impartiality); *In re Harp*, 166 B.R. 740, 746-47, 755-56 (Bankr. N.D. Ala. 1993) (duty to properly account for all property received, to furnish information requested by a party in interest, and to ensure that estate resources are used to benefit unsecured creditors and other parties in interest).

³⁸ See *In re Harp*, 166 B.R. 740, 755-56 (Bankr. N.D. Ala. 1993); see also *In re Roland*, 223 B.R. 499, 506-507 (W.D.N.Y. 1998); *In re Weber*, 209 B.R. 793, 799-800 (Bankr. D. Mass. 1997) (discussing expenditures of non-estate property in connection with determination of debtors' good faith).

³⁹ *In re Seely*, 492 B.R. 284, 289 n.5 (Bankr. C.D. Cal. 2013).

⁴⁰ See Laury Macau Ley, *The Individual Chapter 11 Case: Still Problematic After All These Years*, 22 NEV. LAW. 17, 18 (March 2014); see also Bankr. C.D. Cal. Local Form 2081-1.2.Motion.Budget, *Notice of Motion and Motion in Individual Chapter 11 Case for Order Setting Budget for Interim Use of Estate Property as Defined in 11 U.S.C. § 1115*, available at http://www.cacb.uscourts.gov/forms/local_bankruptcy_rules_forms.

B. Payment of Debtor’s Counsel for Personal Services

A clear oversight within BAPCPA was the failure to amend § 330(a)(4)(B) to authorize the payment of debtor’s counsel for personal services in Chapter 11 cases. This provision states as follows:

(B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor’s attorney for representing the interest of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.⁴¹

BAPCPA did not make this section applicable to Chapter 11 despite the amendments to Chapter 11 that made the treatment of individuals in Chapter 11 similar to Chapters 12 and 13. Consequently, individuals in Chapter 11 cases are unable to hire counsel for personal services, such as criminal, divorce, exemption, discharge, or tax matters, if there is no benefit to the estate.⁴²

C. Case Annotations Regarding Post-Petition Use of Property of Estate

Post-BAPCPA Cases

***In re Seely*, 492 B.R. 284 (Bankr. C.D. Cal. 2013).**

In *Seely* individual Chapter 11 debtors had used prepetition and post-petition funds to pay for their personal living expenses during their Chapter 11 case. The debtors’ case was subsequently converted to a Chapter 7, and the trustee sought to surcharge a personal injury settlement claimed as exempt by the debtors in order to recover the debtors’ expenditures for living expenses during the Chapter 11 case. The court found that to surcharge an exemption, the trustee had to show that the debtors’ conduct was wrongful and warranted the extraordinary remedy of surcharging exempt assets. The trustee asserted that, because the individual Chapter 11 debtors were not

⁴¹ 11 U.S.C. § 330(a)(4)(B).

⁴² See *In re Meill*, 2009 WL 2253256 at *1-4 (Bankr. N.D. Iowa July 27, 2009) (“Only attorneys employed by Trustee under § 327 with Court approval are entitled to compensation under § 330(a), and then only to the extent that the legal services benefit the bankruptcy estate The Court may not alter the Bankruptcy Code compensation scheme through the use of § 105(a). Retainers received by Debtor’s attorneys, whether in connection with the case or not, constitute property of the estate to the extent the funds have not yet been applied to pay for prepetition services as of the petition date Trustee is entitled to an accounting of retainers held in Debtor’s attorney’s trust accounts. She is also entitled to turnover of such funds. If funds remain unadministered at the closing of the case, or if funds revert in Debtor after confirmation of a plan, which are not otherwise obligated under the Plan, the Bankruptcy Code does not restrict Debtor from paying his attorneys with those funds.”); *In re Weaver*, 336 B.R. 115, 118-26 (Bankr. W.D. Tex. 2005). *Accord In re Polishuk*, 258 B.R. 238, 250-51 (Bankr. N.D. Okla. 2001) (attorney representing debtor in state court divorce action was entitled to be compensated from estate for time spent in trial of divorce action and in obtaining equitable distribution of marital property, but not for litigating child support and custody issues, given lack of any real “benefit” from such services to estate); *In re Goldstein*, 383 B.R. at 502 (retention of divorce counsel for each chapter 11 co-debtor benefited estate).

operating a business, § 363(c)(1) did not allow their payment of personal living expenses without express authorization from the court.

The court framed the issue as whether an individual Chapter 11 debtor is required to seek court approval before paying for personal living expenses. The court explained that, after BAPCPA, post-petition earnings became property of the estate under § 1115(a). The court reasoned that because BAPCPA did not provide a standard for courts to determine if individual Chapter 11 debtors can use estate funds to pay personal living expenses, Congress must not have intended such debtors to seek court authorization. The court went on to find that, because BAPCPA was intended to make individual Chapter 11 cases more like Chapter 13 cases, Congress intended post-petition wages to be used for ordinary personal living expenses under both bankruptcy chapters.

Ultimately, the court concluded that § 363(c)(1) should be given the same interpretation in individual Chapter 11 cases as it is given in Chapter 13 cases, holding “the payment of ordinary course living expenses should be treated as being within the debtor’s ordinary course of business for the purpose of interpreting § 363(c)(1).” The court noted, however, that “[w]hether or not a given expense is an ordinary course expense is a question of fact that may require consideration of both a vertical and a horizontal test of ordinariness.” Because the trustee in *Seely* did not argue that any of the debtors’ expenditures were non-ordinary course expenditures, the court found no wrongdoing on the debtors’ part and denied the motion to surcharge exempt funds from the personal injury settlement.

***In re Villalobos*, 2011 WL 4485793 (B.A.P. 9th Cir. Aug. 19, 2011).**

The individual Chapter 11 debtor in *Villalobos* owned 23 parcels of land and five luxury vehicles. He also owned and operated several businesses and claimed certain lawsuits against the California Public Employees Retirement System and the California Attorney General as assets on his schedules (the “California Litigation”). The debtor sought approval of ordinary course expenses (the “Budget”) under §§ 363(c)(1) and 1115. The Budget included monthly expenses of \$55,419.00 for mortgages on the real property and monthly expenses of \$72,633.00 for personal expenses: federal taxes, insurance, pool service, dry cleaning, medications, dental and medical, utilities, food, the five luxury automobiles, and tuition for grandchildren. The IRS objected to the Budget arguing that the debtor’s personal expenses were not necessary to preserve the estate. The debtor responded by stating he “could not survive” without paying his personal living expenses.

At a hearing before the bankruptcy court, the debtor testified that he was in the process of selling several properties and three of the luxury cars. He also testified that he had committed to paying for the education of six grandchildren and had previously paid such tuition. In approving the Budget, the bankruptcy court did not make any finding as to the reasonableness of the Budget, but stated that the court was “not going to throw the [grandchildren] out of college” and “such expenses are ordinary expenses of this debtor.”

On appeal, the Ninth Circuit Bankruptcy Appellate Panel found “scant authority regarding how individual Chapter 11 debtors may pay expenses post-BAPCPA.” The debtor asserted that the

addition of § 1115, making post-petition earnings property of the estate, forced him to either be allowed use estate property for personal living expenses or be forced out of Chapter 11. The debtor further argued that § 1129(a)(15) provides the standard for approving personal expenses, which takes into account a debtor's reasonable expenses in calculating disposable income. Because the Bankruptcy Code allowed for payment of personal expenses post-confirmation, the debtor argued that he should also be allowed to pay personal expenses pre-confirmation.

The IRS relied on *In re Walter*, 83 B.R. 14, 19 (B.A.P. 9th Cir. 1988), in arguing that personal expenses, "which benefit a debtor individually but not the estate, cannot be paid out of monies or assets of the estate." The Ninth Circuit BAP distinguished *In re Walter* because that case used the business justification test to approve non-ordinary course expense under § 363(b), while the debtor in this case sought approval of the Budget as ordinary course expenses under § 363(c).

The IRS further argued that even if the business justification test was not appropriate, ordinary course expenses must still be reasonable. Specifically, the IRS argued that maintenance of luxury vehicles and homes and tuition for grandchildren are not reasonable. The Ninth Circuit BAP did not decide the standard to be applied in determining whether personal living expenses may be paid with estate funds in an individual Chapter 11 because the bankruptcy court did not articulate any standard in approving such expenses. The court did specifically hold that "a finding that the Debtor may have historically paid certain expenses is insufficient, without more, to support an appellate review regarding whether the bankruptcy court abused its discretion in approving the [Budget]." Thus, the court reversed and remanded the case "for the bankruptcy court to articulate the legal rule being applied and the explicit findings of fact that support the legal rule."

***In re Miell*, 2009 WL 2253256 (Bankr. N.D. Iowa July 27, 2009).**

In *Miell* an individual Chapter 11 debtor sought approval of various attorneys' fees, asking the court to use § 105(a) to allow compensation under § 330(a)(4)(B), which applies to Chapter 12 and 13 cases only. The debtor sought compensation for his criminal defense attorneys, tax litigation attorneys, and bankruptcy attorney. The U.S. Trustee and certain creditors objected. A Chapter 11 trustee had been appointed in the case.

The court found that, in the Eighth Circuit, attorneys' fees will be denied to the extent that the services benefited the debtor as opposed to the estate. *In re Kohl*, 95 F.3d 713, 714 (8th Cir. 1996). The court also relied on the general rule that criminal defense counsel for a debtor may not be compensated from estate funds. The court held that § 105(a) could not be used to bypass the express provisions of the Bankruptcy Code. Lastly, the court found that a debtor has an interest in unearned portions of prepetition retainers and such property belongs to the estate.

The court denied all requests for compensation for the debtor's attorneys. It stated that only counsel employed by the trustee under § 327, with court approval, was entitled to compensation, and the court would limit such compensation to services that benefited the estate. The court refused to use § 105(a) to alter the compensation scheme of the Bankruptcy Code. It also ordered an accounting of the retainers for unearned portions as of the petition date, with such



unearned portions to be turned over to the trustee. To the extent funds re-vested in debtor following confirmation of his plan, the debtor could compensate his attorneys with such funds.

***In re Gray*, 2009 WL 2475017 (Bankr. N.D. W. Va. Aug. 11, 2009).**

In *Gray* a creditor objected to an individual Chapter 11 debtor's plan on the grounds that she did not commit all of her disposable income to her plan. The debtor's plan provided for monthly plan payments of \$4,500.00. The objecting creditor claimed that certain monthly expenses in the debtor's budget were unreasonable and unnecessary. Particularly, the objecting creditor opposed expenses to pay for the debtor's partner of twenty years, the care of fifteen dogs, and television and telecommunication expenses. The debtor's partner, who traditionally contributed to the household income, was temporarily out of work due to surgeries and arthritis during the debtor's bankruptcy case. Thus, the debtor was supporting her partner as well. The debtor also had two television services, two internet providers, and a \$250.00 per month cell phone expense.

The court found § 1129(a)(15) required the plan payments to be "not less than the projected disposable income of the debtor." The court looked to § 101(10A) and 1325(b)(2) for the calculation of disposable income. Section 1325(b)(2) specifically allows for a reduction in disposable income for "amounts reasonably necessary . . . for maintenance or support of the debtor or a dependent of the debtor."

The court first addressed whether the debtor's partner was a dependent or whether expenses for her partner's care could be excluded from the debtor's monthly expenses. Finding a wide spectrum of what other courts consider to be a dependent, the court agreed with *In re Gonzales*, 297 B.R. 143, 150-52 (Bankr. D.N.M. 2003), that the purpose of the term dependent is "to recognize and protect a genuine family unit, which may be broader than the traditional nuclear family." Because of the lengthy history of the debtor and her partner and the mutual financial support they provided each other over the years, the court held that the debtor's partner was a dependent. The court also held that the medical bills, household expenses, and fuel expenses for the debtor's partner were both "reasonable and necessary" because they did "not appear to be extravagant and [were] consistent with the long term living arrangement" between the partners.

As to the creditor's other objections to expenses, the court held that \$750.00 per month to care for fifteen dogs was unnecessary because the dogs did not "provide a necessary service to the Debtor." The court found that the debtor's "feeling of moral responsibility" to care for the dogs was insufficient to allow such an expense. The court also found two television services and internet providers were unreasonable and unnecessary. Additionally, the debtor's monthly cell phone expense of \$250.00 was found to be unreasonable. The court limited the debtor's television and internet services to one and reduced the monthly cell phone expense to \$100.00.

The court concluded that the debtor's monthly disposable income should be \$4,867.30, as opposed to \$4,500.00. Because the debtor did not meet § 1129(a)(15)'s disposable income requirement, the court sustained the creditor's objection to the debtor's plan.

***In re Goldstein*, 383 B.R. 496 (Bankr. C.D. Cal. 2007).**

In *Goldstein* a husband and wife filed a joint petition for relief under chapter 11 and, on the same day, filed motions under § 327(e) for each to retain special counsel for their divorce proceedings. Each debtor had retained divorce counsel prior to filing for bankruptcy.

The court began by analyzing the effect of § 1115(a), explaining that, pursuant to § 1115, individual Chapter 11 debtors “are no longer permitted to use their post-petition income to pay [personal expenses such as] divorce counsel unless such an expense is authorized for property of the bankruptcy estate.” The court reasoned that § 363(c) likely allows an individual Chapter 11 debtor to pay expenses in the ordinary course of business, such as expenses for food and transportation, from estate property. However, the court noted that payment of divorce counsel is not typical and not in the ordinary course of business.

The court next analyzed whether the joint bankruptcy petition created one estate or two estates. Finding support in the Bankruptcy Code for both views, the court reasoned that where the interests of joint debtors are at odds, “the estates should be treated as separate for each spouse.”

In treating the debtors’ estates separately, the court found that the employment of special counsel for each debtor was in the best interest of the estates, explaining that the marital dissolution directly impacted the resolution of the bankruptcy.

B. Pre-BAPCPA Cases

***In re Polishuk*, 258 B.R. 238 (Bankr. N.D. Okla. 2001).**

In *Polishuk* an individual Chapter 11 debtor filed for bankruptcy protection on the eve of the trial in his divorce case. The debtor’s bankruptcy case was subsequently converted to a Chapter 13 case and then to a Chapter 7. During the pendency of the chapter 11 case, the debtor’s reported net income was too low to service his debts. The debtor’s Chapter 13 plans were facially unconfirmable because, among other things, they provided for increasing monthly payments from unspecified sources. After the case was converted to a Chapter 7 case, the debtor’s bankruptcy counsel sought compensation for services rendered during the Chapter 11 and Chapter 13 cases, and the debtor’s divorce counsel sought compensation for services provided in the divorce case.

The court initially found that the debtor never had “a sincere desire to reorganize” and that his actions in his bankruptcy case indicated his intent was to simply postpone and later overturn the state court’s divorce decree. The Chapter 7 trustee and the debtor’s ex-wife objected to the compensation of the debtor’s attorneys on the basis that the debtor’s attorneys provided no benefit to the bankruptcy estate.

The court held that the debtor’s bankruptcy counsel did not provide a benefit to the estate because the financial reports in the Chapter 11 case, and the debtor’s failure to make plan payments in the Chapter 13 case, indicated that counsel was aware that a the debtor’s plans were

not confirmable. The court did award compensation to divorce counsel to the extent that his efforts resulted in a division of the marital property, impacting the composition of the bankruptcy estate. However, the court denied compensation for services provided by divorce counsel relating to an appeal of the divorce decree and issues on child custody.

***In re Murray*, 216 B.R. 712 (Bankr. W.D.N.Y. 1998).**

In *Murray* an individual Chapter 11 debtor sought approval to employ counsel for a family law matter. The issue before the court was whether the debtor was permitted to use property of the estate to pay for this personal expense.

Relying on *In re Keenan*, 195 B.R. 236 (Bankr. W.D.N.Y. 1996), and *In re Bradley*, 185 B.R. 7 (W.D.N.Y. 1995) (both summarized below), the court held that the debtor was “as free to spend estate monies on his matrimonial problems as he is free to spend them on his ordinary business expenses and on normal living expenses.” The court stated that it was unnecessary to seek court approval, but the debtor risked creditors moving to convert his case or to appoint a trustee based on such expenditures.

The court refused to approve the debtor’s family law counsel under § 327 because it would give administrative status to such attorneys’ fees.

***Roland v. UNUM Life Ins. Co. of Am.*, 223 B.R. 499 (E.D. Va. 1998).**

Individual Chapter 11 debtors sought approval from the bankruptcy court to use advances of post-petition earnings to pay for criminal defense counsel in an FBI investigation. The bankruptcy court denied the debtors’ application because “the post-petition earnings were the sole source of funding for the joint plan.” Additionally, the bankruptcy court found that because there was only an investigation and no indictment, “[a]ny benefit to the estate was purely theoretical.”

The debtors appealed the bankruptcy court’s decision, and the district court identified the primary issue as whether a bankruptcy court could prevent an individual Chapter 11 debtor from using non-estate funds to pay for criminal defense counsel. The district court agreed with the bankruptcy court that the debtors’ post-petition wages were not property of the estate under § 546(a)(6). Thus, the advances that the debtors sought to use were also not property of the estate.

The district court relied on *In re Andrews* in finding that bankruptcy courts have no jurisdiction over non-estate funds. 80 F.3d 906, 909 (4th Cir. 1996). Additionally, the court found that the possibility of criminal proceedings was “simply too attenuated to the bankruptcy proceeding to create jurisdiction over the matter for the bankruptcy court.” As to the factor that post-petition earnings were the only source of funding for the debtors’ plan, the court found that the Bankruptcy Code did not require an individual Chapter 11 debtor to pay creditors with future earnings. *Toibb v. Radloff*, 501 U.S. 157, 166 (1991). The court reasoned that because a bankruptcy court could not compel an individual Chapter 11 debtor to use non-estate funds to pay creditors (pre-BAPCPA), it also could not prevent the use of those funds for other purposes.

The district court then addressed whether the debtors' fiduciary duties to creditors provided the bankruptcy court with jurisdiction. The court reasoned that because the post-petition earnings were not property of the estate, they were analogous to an appointed trustee's personal property, for which the trustee does not have to seek approval from the bankruptcy court to use. Essentially, "the scope of the debtor-in-possession's fiduciary obligation is determined by the property constituting the estate. Irrefutably, the debtor-in-possession owes no obligation to the estate for non-estate property." *In re Molina Y Vedia*, 150 B.R. 393, 400 (Bankr. S.D. Tex. 1992).

The district court concluded that the debtors did not need bankruptcy court approval to use their post-petition funds to pay criminal defense counsel. Notwithstanding this holding, the court noted that creditors could still seek to have their debts declared non-dischargeable, a trustee appointed, or the case converted or dismissed. Use of non-estate funds could affect good faith determinations under the Bankruptcy Code. The district court reversed and remanded the case to the bankruptcy court.

***In re Weber*, 209 B.R. 793 (Bankr. D. Mass. 1997).**

The U.S. Trustee (UST) objected to an individual Chapter 11 debtor's plan because it was not proposed in good faith pursuant to § 1129(a)(3). The debtor, a physician, proposed to pay unsecured creditors, who were owed approximately \$2.5 million, only \$125,000, about five percent of their claims. The debtor's projected monthly expenses totaled more than \$11,000, including more than \$1,000 for family expenses, entertainment, and recreation. The debtor had no dependents other than his wife. The court detailed the debtor's seven vacations taken during the approximately 18 months of the chapter 11 case, totaling more than \$15,000 in expenses. The debtor also proposed to maintain his country club membership and to continue paying the mortgages on his home in a wealthy suburb of Boston and his vacation home in Cape Cod. Notably, all of the unsecured creditors accepted the debtor's plan.

In determining whether an individual Chapter 11 debtor's use of future income to pay creditors is a factor in determining good faith, the court found that all decisions addressing good faith considered "a debtor's ability to pay" as a factor. The debtor argued that he did not owe a duty to creditors with regard to future income because it was not property of the estate under § 541(a)(6). The court found that even if the debtor's post-petition earnings were not property of the estate, he still had to make a good faith effort to pay creditors for his plan to be considered proposed in good faith. Thus, the court considered the debtor's future earnings in determining the good faith issue and concluded that Chapter 13's disposable income test provided a "guideline" as to whether the debtor "committed sufficient available resources to a plan."

The court found that the debtor could "more than double the . . . proposed payments to creditors" by, among other things, selling one of his homes and traveling less. In other words, the debtor could not use Chapter 11 to continue his "extravagant lifestyle" while only paying creditors five percent of their claims. The court held that the debtor's plan did not meet § 1129(a)(3)'s good faith requirement. Nonetheless, the court found that the dismissing or converting the case would not be in the best interest of the creditors. Thus, the court allowed the debtor to amend his plan in accordance with the court's opinion.

***In re Keenan*, 195 B.R. 236 (Bankr. W.D.N.Y. 1996).**

In *Keenan* an unsecured creditor asked the court to limit the individual chapter 11 debtors' use of insurance proceeds. The debtors-in-possession were about to receive \$100,000.00 in insurance proceeds for a pre-petition car accident. The parties agreed to certain amounts of the first \$25,000.00 being allocated to the debtors' business expenses and personal expenses. The court was asked to decide the allocation for the remainder of the insurance proceeds.

Though the court recognized that other courts across the country recognized a variety of treatments for an individual Chapter 11 debtor's post-petition income, the court did not understand why such decisions had to be made at all. The court reasoned that Congress had set parameters in the Bankruptcy Code for debtors and interested parties to negotiate allocation of such funds. The court reasoned that bankruptcy courts are better at answering "'yes' or 'no' questions" within those parameters, such as whether a trustee should be appointed or a case converted, as opposed to "micromanaging the estate."

The court concluded that it was not required to, and would refuse to, answer the creditor's question as to how the insurance proceeds should be allocated. The court stated that the moving creditor or other parties could negotiate an acceptable allocation of the proceeds with the debtors or such parties could act in accordance with the Bankruptcy Code, by seeking the appointment of a trustee, moving to convert or dismiss the case, or moving for stay relief. The court did put a 20-day hold on the use of the insurance proceeds to allow for negotiations or motions from interested parties. Otherwise, the debtors were free to use the insurance proceeds in the ordinary course of their affairs.

***In re Bradley*, 185 B.R. 7 (Bankr. W.D.N.Y. 1995).**

In *Bradley* an individual Chapter 11 debtor's wife sought a divorce and asked the bankruptcy court for an administrative expense of \$1 million, the estimated support payment to be ordered in the divorce.

The court first relied on its prior order denying certain creditors' motion to have the court limit the debtor's allowance for personal expenses. In that order the court stated that the debtor's "personal expenses and his obligations for incidents of his personal life are every bit as much a part of the ordinary course of his business and financial affairs as are expenses incident to the operation of the various shopping malls, nursing homes, and office buildings that he owned." However, the court explained that its prior ruling, holding that the debtor could use estate property for personal expenses, "did not mean that every person to whom he became obligated had a right to look to property of the estate for payment," particularly payment as an administrative expense.

The court concluded that the debtor's wife should not have any advantages or disadvantages that she would not have had the debtor not filed for bankruptcy. Thus, the court held that her claim was not entitled to an administrative expense status ahead of her husband's other unsecured creditors.

***In re Warner*, 141 B.R. 762 (Bankr. M.D. Fla. 1992).**

The United States appealed a bankruptcy court's order allowing attorneys' fees for an individual Chapter 11 debtor's criminal defense counsel and criminal defense local counsel. The debtor was convicted of crimes involving securities fraud and ordered to pay restitution of \$22 million plus costs of prosecution. The bankruptcy court approved the debtor's retention of criminal defense counsel and local counsel to appeal the conviction. The bankruptcy court later approved the requests for compensation, except for approximately \$5,000 that the court found to be overhead costs of the criminal defense counsel.

The district court noted that the standard of review for an award of attorneys' fees in bankruptcy was an abuse of discretion standard. The district court then addressed "whether the bankruptcy court abused its discretion in awarding any attorneys' fees for the criminal appeal from the bankruptcy estate." The United States argued that special counsel must benefit the estate, not simply the debtor, and that employing counsel to appeal a criminal conviction did not meet this requirement.

The district court concluded that special counsel could be appointed under § 327(a) and (e) if counsel "either assists the debtor in possession in carrying out his duties under [c]hapter 11 or is in the best interest of the estate." *Official Comm. of Disputed Litig. Creditors v. McDonald Inv., Inc.*, 42 B.R. 981 (N.D. Tex. 1984) (citing *In re Tashof*, 33 B.R. 225 (Bankr. D. Md. 1983)). The district court held that employing special counsel in this case was in the best interest of the estate because it sought to keep the debtor out of jail, which was necessary for him to manage the estate, and to overturn a multimillion-dollar judgment, which was a liability of the estate. Thus, the bankruptcy court did not abuse its discretion in awarding attorneys' fees for the debtor's criminal defense counsel.

***In re Wood*, 68 B.R. 613 (Bankr. D. Haw. 1986).**

The United States moved to convert or dismiss the case of individual Chapter 11 debtors because, among other things, the debtors did not obtain court approval before using post-petition income to pay attorneys' fees, pet expenses, and travel expenses. Additionally, the debtors had repeatedly failed to follow court orders and to properly report the financial information of the estate. The debtors also sought to extend the time to file a plan on multiple occasions, and when they finally filed a plan, they did not file a disclosure statement. Notably, the proposed plan provided for certain payments to creditors to come from unspecified sources at unspecified times in the future, depending on the debtor's pending litigation against certain creditors. The motion to convert or dismiss was filed more than three years following the petition date.

Considering the foregoing, the court concluded that the debtors' delay was "unreasonable and prejudicial to creditors." The court also held that the unapproved expenditures for attorneys, pets, and travel were for the debtors' benefit, not the estate's benefit. The court further stated that the "Debtors live an affluent life while the creditors wait, wait, and wait." Such expenditures without paying creditors "signify gross mismanagement of debtor's affairs." The court granted the motion to convert the case to a Chapter 7.

***In re Rodriguez*, 41 B.R. 774 (Bankr. S.D. Fla. 1984).**

In *Rodriguez* an individual Chapter 11 debtor was in the country on a visa that did not permit him to obtain employment. The court approved the debtor's retention of criminal defense counsel to be paid from the estate. The court found that the debtor had averaged \$6,728 per month on "direct living expenses" for alimony and child support, management of his businesses, and care for his son. During his Chapter 11 case, the debtor had also spent \$46,442 on "indirect business expenses," which the court found reasonable and within the ordinary course of the debtor's business.

A creditor sought an accounting and injunctive relief to prevent the debtor from using his capital assets, and investment income from those assets, to pay personal living expenses. The court and the parties agreed that the Bankruptcy Code and case law did not provide instruction on the issue. The court first recognized that § 1107(a) provided the debtor with the same powers as a trustee and that § 363(c)(1) allowed the debtor to use property of the estate within the ordinary course of the debtor's business.

Second, the court reasoned that because the debtor could not seek employment under his visa, and a criminal investigation would likely prevent meaningful employment even if the debtor sought it, the court's only options were to allow the debtor to use his capital assets and income from those assets for personal expenses or dismiss the debtor's chapter 11 case. No party had sought dismissal of the case, and the movant had actually agreed that it was best for all interested parties for the Chapter 11 case to continue in order to liquidate the debtor's assets.

Limiting its holding to these particular facts, the court held that the debtor could use his capital assets and income from those assets for personal living expenses. The court allowed the debtor \$7,000 per month for such living expenses, finding that such figure was in accord with the debtor's current spending on living expenses, which was not unreasonable.

***In re Vincent*, 4 B.R. 21 (Bankr. M.D. Tenn. 1979).**

In *Vincent* an individual Chapter 11 debtor moved the court to pay personal living expenses from the estate. Similarly, the debtor's ex-wife moved for payment of alimony and child support from the estate. Evidence presented to the court showed that the debtor's personal living expenses included expenses for a child to be born within the year, \$316 per month on rent, \$180 per month on health insurance, \$30 per month on water, \$95 per month on electricity, \$400 per month on telephone expenses, and various other monthly bills for gasoline, credit cards, and disability insurance. The debtor suffered a heart attack during the pendency of his Chapter 11 case and was not employed. A trustee had been appointed to operate the debtor's business. Prior to the Chapter 11 case, a state court appointed a receiver for the debtor's business and provided for a monthly allowance to the debtor, which was subsequently rescinded due to the debtor's failure to follow court orders and cooperate with the receiver.

The court found that the debtor's property as of the petition date was property of the estate under § 541. The court explained that the debtor's earnings and property acquired after the petition

date, assuming such earnings and property did not derive from property of the estate, belonged to the debtor and were not subject to the bankruptcy court's control.

After considering the foregoing, the court held that “no authority vests in this court to provide for the necessary expenses of the debtor” from the estate. The debtor must pay for living expenses from employment obtained post-petition, whether from the trustee or elsewhere. The court then compared the case to a Chapter 7 case, explaining that “[c]ertainly in the event of a straight bankruptcy . . . the estate has no obligation to pay necessary living expenses.” Though the debtor's heart attack complicated this case, that fact did not provide an exception to the rule.

Likewise, the court held that the debtor's estate had no duty to pay the debtor's ex-wife for future support, as those payments were under the jurisdiction of the state court. Thus, the court denied the debtor's motion and the motion of his ex-wife because there was “no provision in the Code for such payments from the debtor's [c]hapter 11 estate.”

III. Bankruptcy Code vs. the Internal Revenue Code

One of the more difficult issues arising under the BAPCPA is how post-petition earnings will be treated for tax purposes under the Internal Revenue Code. In the leading article on this topic, “*Tax Consequences of Post-Petition Income as Property of the Estate in an Individual Debtor Chapter 11 Case and Tax Disclosure in Chapter 11*”⁴³ (“Tax Consequences”) by Jack Williams and Jacob L. Todres, the authors note several tax issues arising from § 1115.

- How are post-petition earnings paid to individual debtor's estates and reported?
- How are the post-petition earnings transferred from the estate to the individual (for use in personal expenses) treated for tax purposes?
- Will there be double taxation at the estate level and the individual level for amounts of post-petition earnings which are paid or used by debtors as individuals?

While there is no definitive answer to these issues, a detailed reading of Tax Consequences is highly recommended for a more complete understanding of these problems.

Some issues were made clear by the IRS in Rev. Notice 2006-83 issued Sept. 18, 2006 (the “IRS Notice”), following the effective date of the 2005 Amendments.

First, Form W-2 for post-petition wages should be issued to the individual debtor and not the Chapter 11 estate. As to 1099s, however, individual debtors should provide the bankruptcy estate's tax identification number to any person or entity that might issue 1099s to the debtor. The distinction is that W-2s require withholdings, while 1099s do not. Similarly, individuals in Chapter 11 remain subject to self-employment taxes even though all of their income from services are property of the bankruptcy estate.

The IRS Notice also requires debtors and the estate to attach a schedule to their income tax returns allocating pre- and post-petition income. This is typically based on a simple percentage method, but can be done in any fashion as long as the debtor and the estate are in agreement. If

⁴³13 Am. Bankr. Inst. L. Rev. 701 (2005).

an agreement cannot be reached, the debtor and the trustee should seek a court determination under §505.

The IRS Notice did not address the double taxation issue and instead requested comments “regarding whether such post-petition compensation is subject to double taxation as gross income to the debtor under §61 and earnings under §1115(a)(2) of the Bankruptcy Code includable in the estate’s gross income under §1398(e)(1), without a corresponding deduction for the estate.” No further public dialog has occurred since the date of the IRS Notice.

IV. Confirmation of Individual Chapter 11s after BAPCPA.

The most dramatic changes to Chapter 11 by the BAPCPA were the amendments affecting Chapter 11 individuals. By amending six sections in Chapter 11, Congress expanded reorganization options for individuals and forced Chapter 11 attorneys to learn more about Chapter 13 “projected disposable income” than perhaps they ever cared to. The six amended sections are summarized as follows:

1. Section 1115 was added to provide that in addition to the property of the estate specified in § 541, property of the estate for individual debtors under Chapter 11 shall include all property that the debtor acquires after the commencement of the case and all earnings from post-petition services performed by the debtor.

2. Section 1129(a)(15) was added to permit confirmation of a plan notwithstanding the objection of an allowed unsecured claim so long as the individual debtor pays either property valued as of the effective date of the plan in an amount equal to the creditor’s allowed unsecured claim or the debtor distributes an amount equal to or greater than the projected disposable income of the debtor, as defined under § 1325(b)(2), during a five-year period beginning on the date the first payment is due under the plan or during the period for which the plan provides payments, whichever is longer.⁴⁴ The effect of this modification is to incorporate the Chapter 13 disposable income concept into Chapter 11 cases filed by individuals. This has been interpreted to allow the debtor to confirm a plan that is not limited by the commitment periods set forth in Chapter 13 cases. Section 1129(a)(15) refers to the projected disposable income of the debtor “during a five-year period,” and fails to establish a time period under which such money should be paid to creditors.

3. An exception to the absolute priority requirements imposed by Code § 1129(b)(2)(B)(ii) was added for individuals. The provision states that “except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.”

All of the Circuit Courts that have addressed this issue have concluded that the limitation on the absolute priority rule imposed by the 2005 Amendments applies only to the retention of

⁴⁴ See § 1129(a)(15).

postpetition property and earnings from services.⁴⁵ The courts adopting the “narrow” view assert that by the reference to Code § 1115 within Code § 1129(b)(2)(B)(ii), Congress intended to limit the exception to postpetition property and earning from services. The most compelling aspect of this argument is the convoluted statutory language that now exists after the 2005 Amendments. If Congress intended to eliminate the absolute priority rule altogether, it could have easily done so without any reference to § 1115. Furthermore, there is no legislative statement associated with the 2005 Amendments that expresses any intention of Congress to eliminate the absolute priority rule. As the Supreme Court stated in *Hamilton v. Lanning*⁴⁶, we “will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.” This narrow interpretation only allows the debtor to retain prepetition property if that property is exempt.⁴⁷

Courts adopting the “broad” view, have concluded that the reference to Code § 1115 within Code § 1129(b)(2)(B)(ii), includes all property of the estate under both § 541 and postpetition earnings under §1115.⁴⁸ The courts adopting this view typically avoid the legislative history argument by finding that a plain reading of the amendments permit the debtor to retain all property of the estate.⁴⁹ This view is consistent with how a plan is confirmed in Chapter 13 cases and makes more sense as it relates to the practical problems for individuals in satisfying the absolute priority rule in Chapter 11 cases.⁵⁰ Courts adopting this view also point out that the

⁴⁵ See *Zachary v. Calif. Bank & Trust*, 811 F.3d 1191 (9th Cir. 2016); *In re Ice House America, LLC*, 751 F.3d 734 (6th Cir. 2014); *In re Lively*, 717 F.3d 406 (5th Cir. 2013); *In re Stephens*, 704 F.3d 1279 (10th Cir. 2013); *In re Maharja*, 449 B.R. 484 (Bankr. E.D. Vir. 2011), *aff'd*, 681 F.3d 335 (4th Cir. 2012); *In re Woodward*, 537 B.R. 894 (8th Cir. BAP 2015); *In re Gbadebo*, 431 B.R. 222 (Bankr. N.D. Calif. 2010)(Plan not confirmed because bad faith, 1129(a)(15), and absolute priority rule. Court held that §1129(b)(2)(B)(ii) means that the debtor may retain only the property added to the estate by §1115 and not all property under §541. This court concluded that to rule otherwise would make the voting of unsecured creditors meaningless and is contrary to the general purpose of BAPCPA to increase payouts to creditors.). *Accord In re Andrews*, 2015 WL 4608091 (Bankr. M.D. Tenn. 2015); *In re Akinpelu*, 530 B.R. 822 (Bankr. N.D. Ga. 2015); *In re Lucarelli*, 2014 WL 4388250 (Bankr. D. Conn. 2014); *In re Mullins*, 435 B.R. 352 (Bankr. W.D. Vir. 2010); *In re Gelin*, 437 B.R. 435 (Bankr. M.D. Fla. 2010); *In re Steedley*, 2010 WL 3528599 (Bankr. S.D. Ga. 2010)(debtor may retain exempt property only); *In re Stephens*, 445 B.R. 816 (Bankr. S.D. Tex. 2011); *In re Walsh*, 447 B.R. 45 (Bankr. Mass 2011); *In re Draiman*, 450 B.R. 777 (Bankr. N.D. Ill. 2011); *In re Kamell*, 451 B.R. 505 (Bankr. C.D. Cal. 2011); *In re Lindsey*, 453 B.R. 886 (Bankr. E.D. Tenn 2011); *In re Borton*, 2011 WL 5439285 (Bankr. Idaho 2011); *In re Karlovich*, 456 B.R. 677 (Bankr. S.D. Cal. 2010); *In re Tucker*, 2011 WL 5926757 (Bankr. Or 2011); *In re Lively*, 2011 WL 6936363 (Bankr. S.D. Tx 2011); *In re Arnold*, 471 B.R. 578 (Bankr. C.D. Cal. May 17, 2012); *In re Ferguson*, 474 B.R. 466 (Bankr. D.S.C. 2012).

⁴⁶ 130 S. Ct. 2464, 2473 (2010).

⁴⁷*In re Steedley*, 2010 WL 3528599 (Bankr. S.D. Ga. 2010)(debtor may retain exempt property only).

⁴⁸ *In re Shat*, 424 B.R. 854 (Bankr. D. Nev. 2010)(holding that Congress intended to make individual Chapter 11 cases more like Chapter 13 and there is no “absolute priority rule in Chapter 13 cases). *Accord In re Friedman*, 466 B.R. 471 (9th Cir. BAP 2012)(*overruled by Zachary*); *In re Roedemeier*, 374 B.R. 264 (Bankr. D. Kan. 2007); *In re Tegeder*, 369 B.R. 477 (Bankr. D. Neb. 2007); *In re SPCP Group, LLC*, 465 B.R. 316 (M.D. Fla. 2011); *In re Johnson*, 402 B.R. 851 (Bankr. N.D. Ind. 2009); *In re Bullard*, 358 B.R. 541 (Bankr. D. Conn. 2007).

⁴⁹ Note, however, that courts adopting both the “narrow” and the “broad” view have found that their interpretation is supported by a clear reading of the statute. Furthermore, courts adopting the “broad” view have found that the statutory language is ambiguous. See *In re Stat*, 424 B.R. 854 (Bankr. D. Nev. 2010).

⁵⁰ As a matter of policy, the absolute priority rule does not make sense for individuals. The rule was imposed prior to the Bankruptcy Code when it applied only to corporations. It became applicable to individuals only by virtue of the consolidation of Chapters X, XI and XII into Chapter 11 under the Bankruptcy Code. As it relates to individuals, §§1129(a)(7) and (a)(15) insure that unsecured creditors get paid amounts in excess of the liquidation



“narrow” view causes the exception under § 1129(b)(2)(B)(ii) to have nominal effect because the debtor must pay creditors all of his projected disposable income for sixty months anyway, thus what § 1129(b)(2)(B)(ii) giveth, § 1129(a)(15) taketh away.

The split among the courts highlights the uncertainty that exists in applying seeming straight forward statutory maxims. Applicable maxims are: (i) when the language of the statute is clear, the court must enforce it in accordance with its terms notwithstanding prior practice, (ii) even when the language of the statute is clear, courts must consider the legislative history and issues of policy and previous practice to determine congressional intent, and (iii) the Court must not erode a past bankruptcy practice absent a clear indication in the legislative history that Congress intended such a departure. In application, however, many of these maxims overlap and create a conflict of opinions within the Supreme Court Justices on how to apply them.⁵¹

The 2005 Amendments also added a provision to Code § 1129(b)(2)(B)(ii) that the absolute priority exception created by the 2005 Amendments were "subject to the requirements of subsection (a)(14) of this section." The meaning of this limitation is not entirely clear. The reference to (a)(14) may have been an error, but the significance of this provision is nominal. Code § 1129(a)(14) requires the debtor to pay the postpetition domestic support obligations in order to confirm a Chapter 11 Plan. Since subsection (a)(14) is already a confirmation requirement, the placement of this requirement in the cram-down provisions of § 1129(b)(2) is superfluous. More than likely the cross-reference was misnumbered and Congress intended to refer to subsection (a)(15). It would make more sense to have the cramdown of unsecured claims to be subject to the disposable income requirements in (a)(15). Regardless, § 1129(a)(15) is a mandatory confirmation requirement, and thus the provision is a duplication of a requirement that already exists. Whether Congress intended the debtor to be required to pay domestic support obligations or to comply with the disposable income requirement of § (a)(15) makes very little difference, since the debtor must comply with both subsections (a)(14) and (a)(15) in order to confirm a plan.

- **Practice Tip:** Notwithstanding the general requirement that the provisions of § 1129(a) be satisfied, a debtor may still confirm a plan without satisfying § 1129(a)(15) if no creditor objects to the plan. Section 1129(a)(15) is the only provision within § 1129(a) that requires a written objection for that provision to be considered by the court. Thus, it may occur that even though the class of unsecured creditors did not vote to accept the plan, thus forcing the debtor to invoke the cramdown provisions under § 1129(b), the debtor may still be able to confirm the plan without having to satisfy § 1129(a)(15) if no holder of an unsecured claim files a written objection to the plan.⁵²

value of the estate and the projected disposable income of the debtor over sixty months. This is “fair and equitable” in Chapter 13 and should be “fair and equitable” in Chapter 11.

⁵¹ See Klee, Kenneth N., *Bankruptcy and the Supreme Court* (Am. College of Bankr. 2008).

⁵² See *In re Shat*, 424 B.R. 854, 63 Collier Bankr. Cas. 2d (MB) 748, Bankr. L. Rep. (CCH) P 81701 (Bankr. D. Nev. 2010).

It seems that the better statutory wording, if Congress intended to eliminate the absolute priority rule, would have been to add the new provisions of § 1129(a)(15) to the exception for individuals under § 1129(b)(2)(B)(ii). This would make it clear that the absolute priority rule would not exist for an individual as long as the plan provided for the payment of 60 months worth of projected disposable income. Such plans would be deemed to be “fair and equitable,” and thus should be confirmed even though the individual debtor retained nonexempt property of the estate. This would also eliminate the need for a creditor to object to the plan even though the creditor’s class has not accepted the plan.

In jurisdictions that follow the “narrow” interpretation, the debtor has three options in confirming a plan: (i) get the unsecured class to consent to the plan, thus avoiding cramdown and application of the absolute priority rule under § 1129(b)(2)(B)(ii), (ii) pay the present value of the unsecured claims in full over the feasible life of the plan, thus satisfying § 1129(b)(2)(B)(i) and avoiding application of the absolute priority rule, or (iii) convince the court to apply the “new value” corollary.

To apply the new value corollary, the debtor must meet three requirements: (a) the new value contribution must be necessary or essential to the success of the debtor, (b) the new value contribution must be in money or money's worth⁵³, and (c) the debtor's new value contribution must be “reasonably equivalent” to the value of the assets retained by the debtor⁵⁴. The obvious problem for debtors in satisfying these requirements is that in most cases, all of the debtor’s disposable income is already being paid to fund the plan and all the debtor has left is exempt assets to contribute as new value⁵⁵. Typically, this is not enough.⁵⁶

4. Section 1123(a)(8) was added to allow a plan to provide for the payment of creditors through post-petition earnings from personal services performed by the debtor. As it relates to individuals, this provision likely was added to make it clear that the Supreme Court decision in *In re Ahlers*,⁵⁷ which stated that the new value exception, if it exists at all, could not be satisfied by the contribution of post-confirmation personal services (“sweat equity”) that a farmer may contribute in growing crops, would not be applicable as long as the debtor satisfied the requirements of § 1129(a)(15).⁵⁸

5. Section 1141(d)(5) was added to delay the granting of a discharge for an individual until the completion of all payments under the debtor’s plan, provided after notice and a hearing, the court may grant a discharge to a debtor who has not completed its proposed plan payments as long as a modification under § 1127 is not practicable and the value of the payments that have been provided under the plan to allowed unsecured claims is equal to or exceeds the

⁵³ See *In re Ahlers*, 108 S.Ct. 963 (1988).

⁵⁴ See *In re Andrews*, 2015 WL 4608091 (Bankr. M.D. Tenn. 2015).

⁵⁵ See *In re Davis*, 262 B.R. 791, 798-99 (Bankr. D. Az. 2001), quoting *In re Rocha*, 179 B.R. 305 (Bankr. M.D. Fla. 1995)(new value must come from an “outside” source); *In re Cipparone*, 175 B.R. 643 (Bankr. E.D. Mich. 1994).

⁵⁶ See *In re Andrews*, 2015 WL 4608091 (Bankr. M.D. Tenn. 2015) (The value of the debtor’s exempt assets was insufficient in relation to the value of the assets retained by the debtor.).

⁵⁷ 108 S.Ct. 963 (1988).

⁵⁸ It is doubtful that this provision was intended to overrule *Ahlers* in the cramdown context, however. See *In re Andrews*, 2015 WL 4608091 (Bankr. M.D. Tenn. 2015) (The debtor’s projected disposable income to be paid into the plan under § 1129(a)(15) does not count as new value.).

amount that such claims would have been paid if the debtor had been liquidated under Chapter 7. See § 1141(d)(5). Courts permit the debtor to close the case after the confirmation of the plan and then reopen the case when the plan is complete in order to enter the discharge order.⁵⁹ This allows the debtor to operate during the plan without having to pay U.S. Trustee fees.

In *In re Sheridan*⁶⁰, the court applied the following factors in finding cause to grant a discharge on the effective date of the plan: (i) likelihood that the debtor will make all payments under the plan, (ii) assurance in the form of collateral that the creditors will be paid, and (iii) debtor's income is sufficiently reliable so to create a strong probability that the unsecured creditors will be paid with interest. Another court has held that the desire to stop the payment of U.S. Trustee fees is not sufficient cause to grant an early discharge.⁶¹ It has also been held that in order to obtain an early discharge under § 1141(d)(5)(A), the debtor must show cause at the time that the plan is confirmed.⁶²

6. Finally, § 1127(e) was added to permit an individual debtor to modify his/her plan at any time after confirmation of the plan but before the completion of payments under the plan, notwithstanding the fact that the plan has been substantially consummated. This can be accomplished upon the request of the debtor, the trustee, the U.S. Trustee, or the holder of an allowed unsecured claim to increase or reduce the amount of payments of claims to a particular class, extend or reduce the time period for payments under the plan, or alter the amount of the distribution to a creditor to the extent necessary to take account of any payment of such claim made outside of the plan. Otherwise, Code §§ 1121 through 1128 and the requirements of § 1129 apply to any such modification, including the requirement of appropriate disclosure under § 1125. See § 1127(f). This was made clear by the 2010 Bankruptcy Technical Corrections Act effective Dec. 22, 2010, which changed the reference from subsection (a) to subsection (e).

C. Calculation of "Projected Disposable Income"

Pursuant to § 1129(a)(15), the "projected disposable income" test is imposed for the purposes of a Chapter 11 case in which the debtor is an individual when a "holder of an allowed unsecured claim objects to the confirmation of the plan." "Projected disposable income" of the debtor is defined in § 1325(b)(2) to require the following:

⁵⁹ *In re Johnson*, 402 B.R. 851 (Bankr. N.D. Ind. 2009) (held that individual Chapter 11 case could be closed, upon theory that case was "fully administered" once order confirming debtor's five-year reorganization plan had become final, once all transfers contemplated by plan had been effected, once all outstanding adversary proceedings and contested matters had been resolved, and once debtor had begun to manage his affairs and debtor's payments to creditors had commenced).

⁶⁰ 391 B.R. 287 (Bankr. E.D. N.C. 2008). See also, *In re Brown*, 2008 WL 4817505 (Bankr. D.D.C. 2008) (The existence of a long term debt does not prevent the debtor from filing a motion to obtain a discharge.).

⁶¹ See *In re Belcher*, 410 B.R. 206 (Bankr. W.Va. 2009); *In re Ball*, 2008 WL 2223865, *4 (Bankr. N.D. W.Va. 2008). See also *In re Beyer*, 433 B.R. 884 (Bankr. M.D. Fla. 2009) (avoiding an increase in tax liability is not cause for early discharge.).

⁶² *In re Necaize*, 443 B.R. 483 (Bankr. S.D. Miss. 2010).

“Current monthly income” (defined in § 101(10A)) received by the debtor (other than child support payments, foster care payments, or disability payments for a dependent child);

less amounts reasonably necessary for:

- (a) maintenance or support of the debtor or dependent,
- (b) post-petition domestic support obligations;
- (c) charitable contributions (not to exceed 15% of gross income of the debtor for the year in which the contributions are made); and
- (d) if the debtor is engaged in business, the payment of expenditures necessary for the continuation, preservation, and operation of the business.

“Current monthly income” is to be calculated pursuant to Form 122B, which is designed for Chapter 11 debtors. Although the purpose of the calculation is to determine “projected disposable income,” note that the “current monthly income” is a six month average of the debtors prepetition income—thus it is not necessarily “current” or “monthly” and often will not be the “projected” income of the debtor during the term of the plan.

In Chapter 13 cases, the deductions to the “current monthly income” calculation depends on whether the debtor passes the “means test” under § 1325(b)(3). If the debtor passes the “means test,” the calculation is determined in accordance with the wording of paragraph 1 above as interpreted by case law. If the debtor is over the median income, the debtor must apply amounts specified under § 707(b)(2), which applies the IRS National Standards and Local Standards and the debtor’s actual monthly expenses for the Other Necessary Expense category. In summary, in Chapter 13 cases, the “reasonable necessary” calculation becomes a mathematical formula which deducts (without review for reasonableness or necessity) the amounts set forth in Form 122C-2. Since § 1129(a)(15) only refers to the calculation of “project disposable income” in §1325(b)(2), the more objective mathematical calculation under §1325(b)(3) presumably was not intended to apply in Chapter 11 cases. The Committee Note to Form 122B supports this interpretation, and thus Form 122B does not include the mathematical calculation under § 1325(b)(3). On the other hand, an argument can be made that the IRS standards should apply because §1325(b)(3) it is not separate from 1325(b)(2), but is an extension of that section.