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Individual Chapter 11 Cases Under BAPCPA
A Highly Challenging Proposition

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Joe Baldi's Top 10 (or more) Trouble Spots for Individual Chapter 11 Cases

1. Your client just flunked the means test and is not eligible for chapter 13 – welcome to chapter 11
2. Your client's post petition income just became property of the estate.
3. You now have to get your client to file monthly UST reports
4. Your client may have to give up the country club while the case is pending – what expenses are ordinary?
5. Your fees may not be allowed for advising on individual debtor issues – will you get “*Lamie'd*” – allowance of fees to chapter 11 individual debtor's counsel
6. You have to report on all of your client's business interests – Rule 2015.3 and the controlled entity
7. You still can't modify a mortgage secured by the debtor's house – anti-modification provisions in chapter 11 for residential mortgages
8. You have to get Citicorp to vote on your plan and not object to the plan

9. You have to figure out what “disposable income” is in chapter 11 – and how much needs to be paid under the plan. – does the means test apply in chapter 11 under 1129(a)(15). Compare to “projected disposable income” under *Turner*
10. You have to figure out what the Best Interest Test is in chapter 11 and how to value the estate on liquidation – is post petition income included or not?
11. You have to figure out how the Absolute Priority Rule works for individual chapter 11 debtors – what property can the debtor retain?
12. Your client makes more money, creditors can ask for bigger payments – modification after confirmation
13. Your client has to wait for his discharge till all payments are made under the plan – and pay UST fees while doing it.

Some Indicators for Considering and Individual Chapter 11 Case

1. Your client has non-dischargeable debt, significant income and assets and is facing judgment remedies.
2. Your client needs bankruptcy relief but exceeds the debt limits for chapter 13
3. Your client holds in her own name multiple non-residential real estate assets and seeks to modify the terms of the mortgage liens.

**INDIVIDUAL CHAPTER 11 CASES UNDER BAPCPA
COMPARISON AND CONTRAST TO CHAPTER 13 UNDER BAPCPA**

by
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Introduction

All bankruptcy petitioners know that the centerpiece of BAPCPA was to require debtors who could afford to make payments to creditors to do so. The mechanism of this congressional intent is initially found in Section 109 of the Bankruptcy Code, 11 USC § 109, setting forth eligibility requirements to be a debtor. We know that individuals may bring cases under Chapters 7, 11, 12 or 13. We also know that Chapter 12 is limited to family farmers, a topic of specialized importance which we do not propose to discuss today.

Code Section 109 (e) in turn informs us that:

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than \$307,675 and noncontingent liquidated secured debts of less than \$922,975 or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than \$307,675 and noncontingent liquidated secured debts of less than \$922,975 may be a debtor under Chapter 13 of this title.¹

Even if a debtor is eligible to seek relief under Chapter 7, however, that debtor's filing is subject to dismissal if the debtor has the means to make payments under a plan. We assume that you are very familiar with the means test and its interpretation and implementation. It is important

¹ These amounts increased in 2007 and will increase again in 2010

to note, however, that a Chapter 7 case may now be converted to a case under Chapter 11 or Chapter 13 on a finding of abuse under the means test, with the debtors consent. This is a highly significant departure from former practice and raises many interesting questions.

Comparison and contrast between Chapter 13 and Chapter 11 under BAPCPA

As an overview of the significant differences in Chapter 13 and Chapter 11, consider the following two tables. The first sets forth comparisons and contrasts between Chapter 11 and Chapter 13 under BAPCPA. The second sets forth differences between Chapter 11 under BAPCPA compared to former practice. It is important to note that these tables are not exhaustive.

CHAPTER 13 BAPCPA	CHAPTER 11 BAPCPA
Monetary limitations for eligibility. 11 USC §109	No monetary limitations for eligibility
Enhanced dischargeability. 11 USC §1328	No discharge at confirmation. No enhanced dischargeability. New §1141(d)(5)(A) provides that an individual Chapter 11 debtor generally cannot obtain a discharge until all plan payments have been made except under very limited circumstances.
Commitment period determined by the means test. 11 USC §707 and 11 USC §1322(d) (three or five years)	Five year commitment period if creditors object to other treatment in order to confirm plan over objection. 11 USC §1129(a)(15). “Projected disposable income” uses definition in 11 USC §1325(b)(2)
Post petition income is property of the estate. 11 USC §1306(a)	Post petition income is property of the estate. 11 USC §1115((a)
Post petition income submitted to the control of trustee as necessary for execution of plan. 11 USC §1322	Post petition income must be devoted to the plan to the extent necessary for its execution. 11 USC §1123(8).
Supervision by Chapter 13 trustee	Supervision by United States Trustee
No creditors committee	Possibility of a creditors committee
No special small business requirements	Special small business requirements. 11 USC §1116
No voting	Voting by creditors; plan confirmation over objection by creditors as provided by 11 USC § 1129 and particularly 11 USC § 1129(a)(15)
No disclosure statement required	Plan and disclosure statement required. 11 USC §1121
All disposable income must be contributed to plan	No similar provision in 11 USC §1123 - however plan must provide for such income

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	to be contributed to plan as “necessary for the execution of the plan”
Unsecured creditor or Chapter 13 trustee may seek to modify plan at anytime before completion of plan payments. 11 USC § 1329	Unsecured creditor or UST may seek to modify confirmed plan any time before completion of plan payments. 11 USC §1127
Filing fee under \$300	Filing fee over \$1,000
Possible automatic stay for co-debtor 11 USC §1301	No automatic stay for co-debtor – however, it might be possible to provide for this in a plan under section 105
Statutory classification of debts for which Debtor is liable with a co-debtor 11 USC §1322(b)(1)	No such statutory authorization; possible under a plan
Retail valuation 11 USC §506(a)(2)	Retail valuation does not apply in Chapter 11
11 USC §1325(a) limits cramdowns	No analogous provision in Chapter 11
Financial management course required 11 USC §1328(g)	No financial management course required except in limited circumstances. ²

Chapter 11 Pre-BAPCPA	Chapter 11 Post-BAPCPA
Post petition earnings were not property of the estate	Post-petition earnings are property of the estate. 11 USC §1115
Plan could be confirmed on consent of	Code requires post-petition earnings to be

² Individual chapter 11 debtors are s required to have the post-petition debtor education course in order to obtain a discharge in limited circumstances. Under Section 1141(d)(3) if an individual debtor is liquidating all or substantially all of his or her assets, is not continuing in the operation of a business, and would be denied a discharge under Section 727(a), then the Chapter 11 debtor would not be entitled to discharge. Section 727(a)(11) provides that the failure to complete debtor education after the filing of the petition is grounds for denial of a discharge. Therefore, in situations where the individual debtor is liquidating all or substantially of his or her assets, not operating a business, then the individual debtor will need to meet the post-petition debtor education.

creditors or under section 1129 cram-down provisions – new value from some outside source.	devoted to the plan 11 USC §1123(a)(8); 1129(a)(15)
No particular parameters for payment of claims	Claims must be paid in full or “projected disposable income” as defined in 11 USC §1325(b)(2) must be paid for up to 5 years following the date of the first payment under the plan.
No prior provision	Domestic support obligations must be current as of date of confirmation. 11 USC §1129(a)(14)
No prior provision	All tax information requested must have been provided prior to confirmation. BAPCPA §1228(b) (not codified in Bankruptcy Code).
No prior provision	Disclosure statement must provide a meaningful explanation of federal tax consequences of the plan. 11 USC §1125(a)(1)
Discharge occurred at substantial consummation of plan	Discharge delayed until plan has been fully executed. 11 USC §1141(d)(5)
Plan modification was limited	Plan modification is available on motion of debtor, creditor, trustee or UST, “whether or not the plan has been substantially consummated.” 11 USC §1127(e)

Practice Considerations

1. When to file an individual Chapter 11?

Historically, it wasn’t even clear that an individual could file a Chapter 11 case. Not until 1991 did the Supreme Court finally rule that individuals engaged in business could file a Chapter 11 case.³ According to statistics compiled by Judge Bruce A. Markell, between 680 and 2448

³ *Toibb v. Radloff*, 501 US 157 (1991)

individuals filed Chapter 11 cases in 2005 out of a total of 6800 Chapter 11 filings as opposed to only 80 public companies which filed in that year.⁴

Individuals tended to file Chapter 11 cases when their debts exceeded the limitations of Chapter 13. Celebrities such as Kim Basinger filed Chapter 11 cases when they sought to avoid burdensome executory contracts. Many Chapter 11 cases were filed in California to save debtors' equity in very expensive houses.

Today, individuals need to consider carefully when and why they should file a Chapter 11 case. Chapter 7 for an individual engaged in business often is a reasonable option now. The means test only applies to individuals whose debts are "primarily consumer debts" under 11 USC §707(b). The question of what constitutes a "consumer debt" is quite interesting and complex but beyond the scope of this presentation. Judge Pepper of the Eastern District of Wisconsin has written an interesting opinion on this point holding that a debtor who does not have primarily consumer debts need not file a form 22 with the court.⁵

Chapter 11 now requires a debtor to commit post-petition income to a plan for up to five years. 11 USC §1129(a). In addition, the Code has substantially changed the treatment of executory contracts in Chapter 11. Further, the Code has dramatically changed treatment of income tax obligations, so that the interest rate to be paid now can no longer be reduced as a result of a confirmed plan. Rather, the interest rate in effect as of the time of confirmation will apply. 11 USC §1129(a)(9). Moreover, just as in Chapter 13, domestic support obligations must be current at confirmation of the plan and at all times thereafter. 11 USC §1129(a)(14).

⁴ Markell, Bruce A., *The Sub Rosa Subchapter: Individual Debtors in Chapter 11 After BAPCPA*, University of Illinois Law Review, Vol 2007 67, 68

⁵ *In re Kinne*, 06-21356 (Bankr. E.D. WI. May, 2006)

Because of this and many other onerous provisions of Chapter 11, attorneys for individuals engaged in business should consider whether it is in their best interests to file a Chapter 7 case. Your liquidation analysis should consider whether the value of the debtor's estate in liquidation compares favorably or not to the debtor's projected income over the next five years.

Individual Chapter 11 cases would seem to be indicated when:

- Debtors are facing immediate enforcement of judgments. Chapter 11 might be a reasonable substitute to the posting of an appeal bond through the invocation of the automatic stay.
- Debtors need time to resolve payment on non-dischargeable debt such as taxes, domestic support obligations or otherwise non-dischargeable debt.
- Debtors might face serious economic, personal or tax consequences as a result of the liquidation of property in order to satisfy debt.

Considerations which might have militated in favor of Chapter 11, particularly in case of executory personal service contracts are no longer favorable. Debtors under Chapter 11 would now be required to pay rejection damages in full as a part of the confirmed plan under Chapter 11 thus seriously attenuating the benefit sought to be derived from the filing.

2. Constitutional Considerations

One of the more interesting aspects of Chapter 11 under BAPCPA is that Section 707 of the Code now affords a creditor or the United States Trustee the opportunity to move to convert to Chapter 11 but only in the case of a debtor whose debts are "primarily consumer debts?" Why is it that a debtor whose debts are not "primarily consumer debts" may seek relief under Chapter 7 without regard to his projected disposable income whereas a debtor whose debts are "primarily consumer debts" can be forced into a Chapter 11? In addition, can the debtor actually be required

to work? Would this constitute involuntary servitude in violation of the 13th Amendment to the United States Constitution? What about an involuntary Chapter 11? Scholars have raised this question⁶ but the courts have not yet considered it under BAPCPA.⁷

⁶ Keach, Robert J., *Dead Man Filing Redux: Is the New Individual Chapter 11 Unconstitutional?* 13 Am Bankr. Inst. L. Rev. 483 (Winter, 2005).

⁷ *In re Noonan* 17 BR. 793 (Bankr. S.D. NY 1982) considered this question in context of prior law.

3. Pre-Confirmation Issues – Administrative Expenses

Debtor's personal expenses

While the Code does reasonably inform us that projected disposable income is to be determined by reference to “current monthly income” as set out in form B22B, the Code does not address at all how to deal with payment of necessary and ordinary expenses of the debtor prior to confirmation as does 11 USC §1325. We suggest that the debtors in individual Chapter 11 cases ought to establish a budget for their “operations” during Chapter 11, including their personal expenses with a request that normal expenses of the debtor be deemed to be “in the ordinary course of business” and incurred on a monthly basis without further order of court. Presumably the debtor’s monthly “operating reports” will reflect income and expense. And any creditor or other party in interest who objects could bring the matter to the Court’s attention. Ultimately, we suggest that these matters will be handled more or less consensually in the same manner as are cash collateral orders.

Attorneys Fees

This is potentially a trouble spot. As Judge Markell points out,⁸ Chapter 13 does provide for payment of attorneys fees for post-filing matters from property of the estate. Chapter 11 does not (at least for attorneys for the Debtor, as opposed to attorneys for the Debtor in Possession). The implication is that the Chapter 11 attorney for an individual needs a substantial retainer.⁹

⁸ Markell, Bruce A., *The Sub Rosa Subchapter: Individual Debtors in Chapter 11 After BAPCPA*, University of Illinois Law Review, Vol 2007 67, 83

⁹ *Lamie v. United States Trustee*, 540 US 526 (2004)

Cash Collateral

Many chapter 11 debtors will have granted security interests in cash collateral to one or more secured creditors. This might especially be in the form of an assignment of rents in the case of real estate investors. Such debtors must be especially careful to comply with Bankruptcy Code section 363 or risk running afoul with both the creditor and the court.

Borrowing

Many chapter 11 debtors will have the need to borrow during the course of their chapter 11 cases, even if only to purchase a replacement vehicle. All debtors must be especially careful to comply with Bankruptcy Code section 363 or risk running afoul with the court.

Taxes and Domestic Support Obligations

Congress clearly intended that the Bankruptcy Code be a vehicle for the enforcement of tax and domestic support obligations. As a consequence, failure to have these matters current at the time of filing is grounds for dismissal and failure to keep these matters current is grounds for denial of confirmation.¹⁰

4. Plan Issues

A Chapter 11 plan for an individual must meet all of the requirements formerly in place for any Chapter 11 case together with the additional requirements now imposed by 11 USC §1123(a)(8). This provides that debtors are to utilize “all or a portion of” their post-petition earnings for the execution of their plan. How much? Section 1129(a)(15) requires “disposable income” to be utilized for the plan unless unsecured creditors are to be paid in full. How much of the disposable income?

¹⁰ 11 USC §1129(a)(9)(A) and 11 USC §1129(a)(14) respectively

If the debtor is earning money at a fast pace, must the plan be paid in full on an accelerated basis?
Or may the debtor pay over a five year period?

5. Confirmation Issues

Projected Disposable Income

As discussed earlier, projected disposable income applies for Chapter 11 purposes. This suggests that income and expense as permitted in form B22B is to be utilized to determine the amount of monthly payments under a plan. To confirm a plan, claims must be paid in full or the value of property to be distributed under the plan must be not less than the projected disposable income of the debtor over a five year period.

Can a debtor exempt a portion of the debtor's income under a State exemption? Most income related exemptions are time period based. If a debtor can claim an income exemption, for what time period(s) can it be claimed?

What happens if the debtor has been underemployed or did not have a great deal of "current monthly income," but has a lot of property? Could the debtor satisfy the requirements of the Code by liquidating enough of his property to pay a value equal to five years worth of projected disposable income even if he would have property left over? Or would such a plan fail to meet the "best interests of creditors test" resulting in conversion to Chapter 7.

Even more strangely, in the event of conversion from Chapter 11 to Chapter 7, Section 1115(a)(2) would no longer apply and all post-petition income would revert to the Debtor, no longer being property of the Estate.

Feasibility

Feasibility becomes a serious question under Chapter 11 for individuals, particularly for those who have substantial non-dischargeable debts. Although debtor is not entitled to his plan discharge until full performance of Chapter 11 plan obligations in an individual case, the deadlines for filing complaints under Code Sections 523 or 727 are still 60 days after the Section 341 meeting unless extended.¹¹ Accordingly, it is anticipated that creditors will have to act quickly or else seek protracted extensions of these deadlines.

Cramdown

Code seems to incorporate the Chapter 13 means test analysis by referring to 11 USC §1325 for purposes of determining projected disposable income, it is not crystal clear that Congress intended every reference from Section 1325 to be incorporated by reference for purposes of Chapter 11. Much litigation can be anticipated in this respect. In addition, what if the debtor actually earns more during the five year commitment period than projected? Might the debtor keep those assets even if the plan is not modified? And what if the debtor receives post-petition income not from services? Suppose the debtor wins the World Series of Poker or a jackpot at a slot-machine or in the lottery. Suppose the debtor wins the Nobel Prize. Suppose the debtor wins a big prize on Jeopardy. Is this “income from services?” Must all post-petition income be committed to a plan? Clearly, income from an inheritance would not, because only inheritances within 180 days after the date of filing are part of the estate.¹²

¹¹ BAPCPA 321(d), 119 Stat at 95-96; see 11 USC § 1141(d)(2),(5)

¹² 11 USC §541(a)(5)

6. Post-Confirmation Issues

Plan Modification

Chapter 13 practitioners know that a confirmed plan may be modified on the motion of the debtor, an unsecured creditor or the trustee. However, in practice, they know that the plan modification is most often instigated by the debtor and rarely by a creditor or a trustee. An analogous provision has now been enacted for Chapter 11 individual debtors.¹³ Oddly, the Chapter 11 debtor doesn't have the right to pay new health insurance premiums as might a Chapter 13 debtor under 11 USC §1329.

Creditor Practice

It is conceivable that a creditor might periodically seek to modify a plan during the course of the five year commitment period based upon the debtor's increased earnings during that time. As a result, it is likely that interested creditors will negotiate plan provisions requiring periodic proof concerning the debtor's post-petition income from services.

7. Tax Issues

It is unclear whether the debtor and the debtor's estate continue to be unitary for income tax purposes. Although it did issue Notice 2006-83, on October 2, 2006 I IRB 2006-40, which gives some guidance, the IRS has not yet issued rules, regulations or procedures for treatment of individuals who file Chapter 11 cases under BAPCPA.

¹³ 11 USC § 1127(c)

8. Small Business Cases

Debtors engaged in commercial or business activities with less than \$2 million in debt in a case where there is no creditors committee, or where the court has determined the committee is not sufficiently active¹⁴, are now subject to different rules as “small business debtors.” We anticipate that many individual Chapter 11 debtors will be “small business debtors.” While the small business case rules appear to be less rigorous for disclosure statements,¹⁵ they include additional reporting and filing requirements¹⁶, and provide for stricter deadlines for filing and confirmation of a plan.¹⁷ While a complete discussion of how the new small business case rules affect an individual Chapter 11 debtor is beyond the scope of this discussion, the practitioner must bear them in mind when counseling a potential or actual individual Chapter 11 debtor.

¹⁴ 11 USC §101(51D)

¹⁵ 11 USC §1125(f)

¹⁶ 11 USC §1116

¹⁷ 11 USC §1121(e) and 1129(e)

Conclusion

Individual Chapter 11 cases should not be considered to be a Jumbo Chapter 13. As in other aspects of BAPCPA, the new law not only changes the old law, but it is also an overlay with respect to existing unchanged old law. An individual Chapter 11 debtor not only must fulfill all requirements of Chapter 11 as it was, but also must also overcome many obstacles presented by the Code as it has become. The practitioner should be acutely aware and alert to all nuances of Chapter 11 for individuals under BAPCPA before undertaking representation in such a case. Cited below is a compendium of resource materials which we believe practitioners will find helpful in analyzing their individual chapter 11 cases.¹⁸

¹⁸ See also *Individual Chapter 11 Cases after BAPCPA*, *ABI Caribbean Insolvency Symposium, 2006*, <http://www.abiworld.org/committees/newsletters/consumer/vol4num2/CISchapter11article.pdf>; Landry, R.J. , *Individual Chapter 11 Reorganizations, Big Problems with the New "Big Chapter 13"*, *University of Arkansas at Little Rock Law Review*, Vol. 29, February 2007, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=922516# The latter work is highly recommended for its scholarly approach to the issues raised in individual chapter 11 cases. *Individual Chapter 11 Cases, Desert Sanctuary or Prickly Pear Trap for Debtors (and Counsel)*, NCBJ 82nd Annual Meeting, Scottsdale, Arizona, September 24-27, 2008, Hon. Mike K. Nakagawa, James E. Bailey, III, and Sally Neely, Panelists, Hon. Paul W. Bonapfel, Moderator [http://www.law.mercer.edu/academics/handouts/NCBJ%20\(08\)%20Materials%20\(Final\).pdf](http://www.law.mercer.edu/academics/handouts/NCBJ%20(08)%20Materials%20(Final).pdf), citing materials from other sources