

DON'T SUPERSIZE ME!
INDIVIDUAL CHAPTER 11 – MORE THAN A REALLY BIG CHAPTER
13

Ten Questions about Individual Chapter 11 Debtor Cases¹

NCBJ 84th Annual Meeting - New Orleans

October 14, 2010

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1. Are involuntary chapter 11 cases for individual debtors unconstitutional?

Maybe, maybe not. The Thirteenth Amendment provides that “[n]either slavery nor involuntary servitude, except as a punishment for a crime whereof the party shall have been duly convicted, shall exist within the United States, or any place subject to their jurisdiction.” The BAPCPA amendments to the Code raise a Thirteenth Amendment issue is because: (i) individuals are eligible for chapter 11; (ii) involuntary petitions are permitted in chapter 11; (iii) section 1115 adds postpetition earnings income to property of an individual chapter 11 debtor’s estate; (iv) section 1123(a)(8) permits and sometimes requires postpetition earnings to be used to fund an individual chapter 11 debtor’s plan; (v) section 1129(a)(15) may require the commitment of earnings for at least five years to distribution under the plan; (vi) an involuntary chapter 11 debtor cannot convert his/her case to another chapter; (vii) a creditor can propose a chapter 11 plan under certain circumstances; and (viii) an involuntary chapter 11 debtor does not have an absolute right to dismiss his/her case.

Both Congress and the Supreme Court (as well as other courts and some commentators) have indicated that being forced involuntarily to commit postpetition earnings to payment of creditors could violate the Thirteenth Amendment. For example, the Report of the House Judiciary Committee with respect to the 1978 Bankruptcy Code stated:

¹ Adapted from materials originally prepared by the Honorable Bruce A. Markell (U.S.B.J., D. Nev.) for the Federal Judicial Center’s Bankruptcy Judges Educational Program in Chicago, Illinois, July 9, 2009, and updated based in part on Sally Neely’s paper entitled “How BAPCPA Changes Chapter 11 Cases for Individuals – or – No, This is Not Your Mother’s Chapter 11!! (Mar, 15, 2010 revision) and on Peter M. Lively and Hillary Coleman’s paper entitled “Loan Modification and Individual Chapter 11 Debtor Cases.”

As under current law, chapter 13 is completely voluntary. The Committee firmly rejected the idea of mandatory or involuntary chapter XIII in the 90th Congress. The [T]hirteenth [A]mendment prohibits involuntary servitude. Though it has not been tested in a wage earner plan context, it has been suggested that a mandatory chapter 13, by forcing an individual to work for creditors, would violate this provision.

H.R. Rep. No. 95-595, at 120 (footnotes omitted), as reprinted in 1978 U.S.C.C.A.N. 5963, 6080-81. In *Toibb v. Radloff*, 501 U.S. 157 (1991), the Supreme Court determined that individuals are eligible for chapter 11, despite the fact that chapter 11 cases, unlike chapter 13 cases, can be commenced involuntarily. The Court said:

[T]he argument overlooks Congress' primary concern about a debtor's being forced into bankruptcy under Chapter 13: that such a debtor, whose future wages are not exempt from the bankruptcy estate, would be compelled to toil for the benefit of creditors in violation of the Thirteenth Amendment's involuntary servitude prohibition. Because there is no comparable provision in Chapter 11 requiring a debtor to pay future wages to a creditor, Congress' concern about imposing involuntary servitude on a Chapter 13 debtor is not relevant to a Chapter 11 reorganization.

Id. at 165-66 (citations omitted).

The only reported opinion dealing with this constitutional issue under the BAPCPA amendments, *In re Clemente*, 409 B.R. 288 (Bankr. D.N.J. 2009), handled the situation before it so as to avoid infirmity under the Thirteenth Amendment. There, the debtor wasn't able to confirm his chapter 11 plan, wasn't eligible for chapter 13, and couldn't convert his case to chapter 7 because a trustee had been appointed. The court noted that "Chapter 11 is his only option, and if unable to convert to a liquidating proceeding under Chapter 7, he could be forced to work for his creditors in breach of his freedoms guaranteed by the Thirteenth Amendment." *Id.* at 293. To avoid this result, the court, *sua sponte*, deemed the debtor's motion to convert to chapter 7 as a request, first, to terminate the trustee for the limited purpose of converting the case to chapter 7 and, then, to convert the case. The court then granted that motion. This result was in the best

interest of the estate and the creditors because “this matter will not be further delayed insofar as the constitutional question is no longer at issue.” *Id.* at 296.

Professor Margaret Howard, in a particularly nuanced and helpful analysis of the Thirteenth Amendment in her article, *Bankruptcy Bondage*, 2009 U. Ill. L. Rev. 191 (2009), points out that the lynchpin of the Thirteenth Amendment as interpreted by the Supreme Court is imprisonment or physical compulsion to work for another; hard choices with bad outcomes are not proscribed. Professor Howard concludes as follows:

Bankruptcy courts can confirm plans in individual, involuntary cases that provide for payments to be made from a debtor’s future earnings. But the courts cannot enforce these confirmation orders against uncooperative debtors by issuing coercive orders. This, the Thirteenth Amendment prohibits. The only remedies constitutionally available to a bankruptcy court facing a recalcitrant debtor in such a case are the old standbys – dismissal and conversion.

Id. at 234-45.

None of the panelists is a constitutional scholar. Therefore, we do not endorse Professor Howard’s conclusion. It does, however, underscore the need for careful and conscientious research and analysis before concluding that involuntary chapter 11 cases for individuals are unconstitutional.

2. Must an individual chapter 11 debtor file and follow a budget preconfirmation?

Because Section 1115 brings into the estate all of an individual chapter 11 debtor’s after-acquired property and personal service income, during the pendency of the case, the debtor will have no property or earnings that are not property of the estate. Therefore, the debtor and his or her dependents will have to consume property of the estate for living expenses and to pay domestic support obligations, among other things. Chapter 11 provides no real guidance on pre-confirmation, personal spending by an individual debtor.

In *In re Goldstein*, 383 B.R. 496, 499 (Bankr. C.D. Cal. 2007), the court hypothesized that section 363(c), which permits a debtor who is authorized to operate his/her business to “use property of the estate in the ordinary course of business without notice or a hearing,” may authorize an individual chapter 11 debtor “to buy bread and probably to purchase a ticket to travel to a court hearing.”

If the debtor's expenses are "actual, necessary costs and expenses of preserving the estate," such as maintenance payments on a principal asset, then they should qualify as administrative expenses² and may be paid, presumably in the ordinary course. What might these be? One argument, not tested in the case law, is that since personal service income is now property of the estate, the expenses necessary to produce that income are "necessary." These would include the cost of housing and feeding the debtor – but not in a mansion or with caviar. The division between what's necessary and what's luxury may seem intractable, until you realize that bankruptcy judges have been making this distinction for years under chapter 13, albeit with statutory guidance that permissible expenses are those "amounts reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor"³ But the language "actual, necessary costs and expenses of preserving the estate" is not so unusual or restrictive that it could not be adapted by a court as a common sense reading of what is necessary: a debtor needs to live, and is legally required to support dependents.

But what about expenses that may not be necessary to preserve the estate, but which were part of the debtor's prepetition expenses? Many personal expenses of everyday folk are not "necessary" to preserve the "estate." Examples might include payments on a country club membership, a vacation, or even something as prosaic as a daily hit at Starbucks.⁴ There appears to be no statutory provision authorizing these types of payments. Indeed, if such expenses do not qualify as administrative expenses payable in full on confirmation, it appears that there may be no authorization for them, which means, at the extreme, that they could be recovered under section 549.⁵

² 11 U.S.C. § 503(b)(1)(A). Taxes also will qualify as administrative expenses that may be paid in the ordinary course. *Id.* § 503(b)(1)(B).

³ 11 U.S.C. § 1325(b)(2)(A)(i). Although section 1129(b)(15) cross-references section 1325(b)(2), section 1129(a)(15) expressly applies only to plan confirmation, and thus only expressly to the value of property to be distributed under a confirmable plan. In addition, section 1129(b)(15) will not apply if no unsecured creditor objects to confirmation of the plan.

⁴ Even more troubling are expenses incurred for others that are not legally required, such as support for an elderly parent. These are not strictly necessary for the bodily sustenance of the debtor or legal dependents – but few outside of bankruptcy would quibble that a debtor should make such payments, and that the debtor should keep making them after filing.

⁵ This might have a perverse effect on the "best interests" test and on preplan disclosure as some courts require the disclosure statement to outline the effect of avoiding power recoveries from insiders. *See, e.g., In re Sierra-Cal*, 210 B.R. 168, 176-77 (Bankr. E.D. Cal. 1997) ("In order for the disclosure statement to contain adequate information about the liquidation analysis, the plan proponent would have to identify all potential § 502(d) disabilities known to it," including those of insiders and affiliates).

3. May an individual chapter 11 debtor's attorney be paid for defending nondischargeability complaints? For divorce representation?

Maybe, although it's not really clear what the statutory basis is. Payment of the debtor's professionals presents a concern because of the changes made by section 1115. It is quite likely that the debtor's lawyer will have significant post-filing bills, and will need to know how (and will deserve) to be paid. This is not a problem in chapter 13, as there is explicit recognition of the ability of a professional for a chapter 13 debtor to receive reasonable compensation "for representing the interests of the debtor"⁶

However, no such provision exists for lawyers representing individual chapter 11 debtors, who would presumably be covered by *Lamie v. U.S. Trustee*, 540 U.S. 526 (2004), and could not receive compensation from the estate property for work done for a debtor's personal interests.⁷ The zone of non-compensation could cover advice and representation regarding discharge or nondischargeability, exemptions, or plan structuring and preparation if the plan allocates some of the estate to the revested debtor postconfirmation. Further, efforts to obtain sufficient funds prepetition through a retainer to cover anticipated services may be unavailing because the unused portion of the retainer is treated as property of the estate,⁸ or results in causes of action under the avoiding actions, thus raising questions of disinterestedness.⁹ Thus, it is not clear how counsel in an individual chapter 11 case can be paid for work performed personally for the debtor, as opposed to the debtor in possession.

⁶ 11 U.S.C. § 330(a)(4)(B). This provision also applies to counsel for chapter 12 debtors.

⁷ The issue in *Lamie* was whether counsel for a corporate chapter 11 debtor could be compensated from the estate for work performed after the chapter 11 case was converted to chapter 7. The Supreme Court held that compensation from property of the estate in a chapter 7 case under section 330 is permitted only when counsel is retained under section 327 (*i.e.*, by the trustee) or 1103 (*i.e.*, by an official committee). By analogy, counsel for an individual chapter 11 debtor/debtor in possession may not be eligible for compensation from the estate under section 330 for work relating to the debtor's personal interests.

⁸ The Fourth Circuit in *Lamie* held that the unearned portion of debtor's counsel's retainer was property of the estate and could not be used to pay for post-conversion work. See *In re Equipment Services, Inc.*, 290 F.3d 739 (4th Cir. 2002); accord *Redmond v. Lentz & Clark P.A. (In re Wagers)*, 514 F.3d 1021, 1024-29 (10th Cir. 2007); *Morse v. Ropes & Gray, LLP (In re CK Liquidation Corp.)*, 343 B.R. 376 (D. Mass. 2006), *rev'g In re CK Liquidation Corp.*, 321 B.R. 10 (Bankr. D. Mass. 2005). This appears to be the majority rule. However, at least one court has held that post-conversion fees can be paid out of a prepetition retainer, albeit without explanation. See *In re Channel Master Holdings, Inc.*, 309 B.R. 855, 864-65 (Bankr. D. Del. 2004).

⁹ See 3 COLLIER ON BANKRUPTCY ¶ 327.04[2][b] (15th rev. ed. 2006).

In *Goldstein, supra*, a case involving a husband and wife who filed a joint chapter 11 petition, the court allowed each debtor to hire his/her own divorce counsel after finding that the services were “for the benefit of their two bankruptcy estates.” 383 B.R. at 498. The court noted that, because postpetition earnings were not property of the estate, “pre-BAPCPA case law took a restrictive view on the extent to which estate funds could be used to compensate divorce counsel,” permitting “only professional services relating to the disposition of estate property” to be reimbursed from the bankruptcy estate, while “services relating to the marital dissolution” were not. *Id.* In *Goldstein*, the court made no such distinction, finding that the bankruptcy estates would be benefited because “[e]mploying special divorce counsel will assist the debtors in resolving their differences in their marital dissolution and in disentangling their domestic lives during the bankruptcy proceeding.” *Id.* at 502.

4. How does § 1111(b)(2) impact loan modification in an individual chapter 11 case? How should “inconsequential value” under § 1111(b)(1)(B)(i) be determined when a debtor seeks to modify a partially secured non-residential real property loan?

For at least one of your panelists, any value is of consequence.

To put the section 1111(b)(2) election in context, a partially secured creditor holds an allowed claim¹⁰ (“ACt”) which, subject to valuation of the collateral pursuant to section 506(a)(1), is subject to bifurcation of the allowed claim (“ACt”) into (i) a secured claim equal to the value of the claim holders’ collateral (“ACs”) and (ii) a general unsecured claim for the remaining portion of the allowed claim (“ACu”). The allowed general unsecured claim (“ACu”) then participates in a class of general unsecured claims that is typically offered only a fractional payment, often paid over time.

If the partially secured creditor elects section 1111(b)(2) treatment, however, it defeats the application of section 506(a), and the plan’s treatment of the allowed claim as a whole (“ACt”) is governed by sections 1129(a)(7)(B) and 1129(b)(2)(A)(i)(II). These sections provide that, where a creditor elects section 1111(b)(2) treatment, the plan is fair and equitable provided that the total payments equal the total allowed claim (“ACt”) and the

¹⁰ For simplicity, we consider a single partially secured creditor, although the applicable sections speak in terms of classes. The same logic applies if there are multiple allowed-secured-claim holders properly classified in a single class that satisfies the applicable voting requirements for class decision-making.

discounted (for time value of money) value of the payments at confirmation equals the value of the collateral (“ACs”). Because the creditor can be crammed down if the proposed cash stream meets section 1129(b)(A)(i)(II)’s requirements, at least one of the panelists believes that the debtor can confirm a plan, over the objection of such a creditor, where the electing creditor receives a small stream payments together with a large balloon payment at maturity totaling at least “ACt,” but with a present value of only “ACs.”¹¹

A partially secured is barred from electing section 1111(b)(2) treatment if “the interest on account of such claims of the holders of such claims in such property is of inconsequential value. . . .”¹² If a creditor’s collateral is determined to have no value, then it is clearly “inconsequential” under section 1111(b)(1)(B)(I), and no section 1111(b)(2) can be made. However, at least one panelist believes that, if the section 506(a) valuation leaves at least \$1 in value, that value is never “inconsequential” for purposes of section 1111(b)(1)(B)(i). This is because, if the resulting unsecured claim would not dominate a general unsecured class whose vote is essential for confirmation, the debtor could thwart the partially secured creditor’s effort to benefit from the appreciation of the collateral, and capture that benefit for himself or herself.

Accordingly, at least one panelist believes that, whenever the 506(a) valuation leaves even \$1 of collateral securing a claim and the partially secured creditor wishes to make a section 1111(b) election, that creditor’s interest in the collateral is not of “inconsequential value.” Making the election transforms the creditor’s interest in the collateral from \$1 to

¹¹ The appropriate discount rate to determine present value is computed using the “risk free” rate (typically government bonds), plus an inflation factor (typically the consumer price index) and a “risk factor” where appropriate. At least one panelist believes that the “risk factor,” if any, should be based only on the anticipated fluctuation in the value of the collateral, not on the debtor’s ability to sustain the payment stream, as the collateral’s value continues to secure the section 506(a) secured portion of the claim and is available to the creditor for liquidation upon default. Therefore, the proper discount rate to use to determine present value arguably should not include a “risk” factor where a section 1111(b)(2) election has been made, because the election itself is evidence of the creditor’s belief that the value of the collateral is likely to appreciate, not depreciate, post-confirmation. Otherwise, the creditor would have accepted a secured claim equal to the current value of the collateral and an unsecured claim for the remainder of the debt.

If no “risk factor” premium is added to the base “risk free” rate, the total payment stream to satisfy “ACt” will be substantially less. An extreme example is a stream of \$1 payments with a balloon payment in 15 years:.

A. Using 10% time-value-of money. PV = \$224,521.00

B. Using 4% time-value-of money. PV = \$549,359.50

¹² 11 U.S.C. § 1111(b)(1)(B)(i).

something more (\$1 plus the possibility of benefitting from collateral appreciation) and indicates that the creditor, at least, believes that possibility has real value.

5. If the holder of an allowed unsecured claim objects to an individual chapter 11 debtor=s plan, how should the required amount of projected disposable income@ be calculated? How is PDI applied?

BAPCPA added section 1129(a)(15) as a confirmation requirement in certain circumstances, for individual debtors. New section 1129(a)(15) provides:

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

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

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

Although based on chapter 13 practice, the section 1129(a)(15) confirmation requirement differs from its chapter 13 counterpart in several respects.¹³ First, it differs as to time. Under chapter 13, a debtor=s plan must extend for three years (in some cases, five years) unless the plan provides for payment in full of all unsecured claims sooner.¹⁴ Section 1129(a)(15) does not specify a minimum period of time, but does specify that the value of the property to be distributed under the plan must be Anot less than the projected disposable income of the debtor . . . to be received during the 5-year period@ commencing

¹³ BAPCPA also added Section 1123(a)(8), which requires the individual chapter 11 debtor=s plan to provide Aall or such portion of earnings from personal services . . . or other future income . . . as is necessary for the execution of the plan.@ This provision apparently ensures that an individual debtor can devote his or her personal service income to the plan. The requirement to devote future income to fund the confirmed plan is, of course, a confirmed plan implementation matter.

¹⁴ See 11 U.S.C. ' 1325(b)(4).

with the start of plan payments, Aor during the period for which the plan provides payments, whichever is longer.¹⁵ Thus, if property from any other source is used to make payments to unsecured creditors, the plan may be shorter than five years.¹⁶ Second, chapter 13 limits the maximum plan length to five years,¹⁷ while section 1129(a)(15) does not specify a maximum term.¹⁸ Finally, chapter 13 requires payments to begin within 30 days of the commencement of the case, regardless of whether the plan is confirmed,¹⁹ and then measures the plan period from the first scheduled payment to unsecured creditors.²⁰ Under section 1129(a)(15)(B), however, the minimum five year period commences on the Adate that the first payment is due under the plan,²¹ which will be after confirmation.²²

¹⁵ 11 U.S.C. ' 1129(a)(15)(B). As noted, *supra*, this requirement arises only if a holder of an allowed unsecured claim objects to confirmation.

¹⁶ This view is supported by section 1123(a)(8), which permits, but does not require, an individual debtor=s plan to include all postpetition earnings from services as a means of plan implementation.

¹⁷ See 11 U.S.C. ' ' 1322(d), 1325(b)(4)(A)(i)B(ii).

¹⁸ If any creditor with an allowed unsecured claim objects to the plan, the statute conditions confirmation on the distribution of property under the plan with a value equal to projected disposable income over a five-year period or Athe period for which the plan provides payments, whichever is longer.@ 11 U.S.C. ' 1129(a)(15)(B). Chapter 11 does not contain provisions like sections 1322(b)(5) and 1329(b) that accommodate long-term obligations, such as home mortgage debt. Thus, the court in *In re Johnson*, 402 B.R. 851, 855 (Bankr. N.D. Ind. 2009), surmised that
a Chapter 11 plan [for an individual debtor] could last for decades.
All it would take for that to happen is for a debtor to have a 20 to
30 year home mortgage . . . and for the confirmed plan to
provide that the mortgage debt will be paid according to its terms.

¹⁹ See 11 U.S.C. ' 1326(a)(1). The plan must be filed within 15 days of the commencement of the case. Fed. R. Bankr. P. 3015(b).

²⁰ See 11 U.S.C. ' 1325(b)(1)(B).

²¹ 11 U.S.C. ' 1129(a)(15)(B).

²² To summarize ' 1129(a)(15) requirements for the mathematically inclined, call ' 1129(a)(15)=s required minimum value of total disbursements under the plan: X

$$X = Y * PDI$$

$$PDI = DI \text{ (possibly revised } a \text{ la Lanning)}$$

$$DI = CMI - B - SP - B - ARN$$

ARN determined under ' 1325(b)(2), if CMI < median-income
for household size (or if court does
not apply ' 1325(b)(3) to ' 1129(a)(15))

An understanding of the calculation of “projected disposable income (“PDI”) and its role in chapter 13 is necessary to fully grasp the application of section 1129(a)(15). In chapter 13 pre-BAPCPA, the instructions for confirmation under 1325(b)(1) were clearly understood to require three years of projected disposable income (APDI@) to fund the plan. Disposable income was determined under 1325(b)(2) with the court relying on debtor=s Schedule AI@ for income and Schedule AJ@ for expenses; the court had discretion to determine what expenses were reasonably necessary for each Debtor. PDI was the plan payment in all cases.

BAPCPA modified the language of 1325(b)(1) as follows:

(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan

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

(B) the plan provides that all of the debtor=s projected disposable income to be received in the ~~three year~~ applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

BAPCA appears to provide a mechanical calculation based on objective criteria for purposes of determining PDI. Under both sub-sections 1325(b)(2) and 1325(b)(3), Schedule AI@ income has been replaced by Acurrent monthly income@ (ACMI@), which is essentially the debtor=s average income or receipts from any source (including income that

ARN determined under ' 1325(b)(3) if CMI > median-income for household size (but only if court applies ' 1325(b)(3) to ' 1129(a)(15))

Y = greater of (i) five years or (ii) period of time plan provides payments

PDI = AProjected Disposable Income@ As defined in ' 1325(b)(2)@.

DI = ADisposable Income@ under ' 1325(b)(2).

SP = support payments deducted under ' 1325(b)(2)(i.e., child support, foster care or disability payments for a dependent child).

ARN = AAmounts Reasonably Necessary@ determined under ' 1325(b)(2)&(3).

CMI = Current Monthly Income defined in ' 101(10A).

would not be taxed) for the last six full months preceding the commencement of the case.²³ Following the Supreme Court decision in *Hamilton v. Lanning* (*In re Lanning*), 2010 WL 2243704 (U.S., 2010), the income and expense sides of projected disposable income may be adjusted by the bankruptcy court for changes that are known or virtually certain at the time of plan confirmation.²⁴

The calculation and meaning of PDI is complicated by BAPCPA's redefining "disposable income" differently for below-median-income debtors under 1325(b)(2) and above-median-income debtors under 1325(b)(3) and assigning 3 year and 5 year commitment periods, respectively. The resulting PDIs under 1325(b)(2) and 1325(b)(3) are apples and oranges. While the term "disposable income" is used interchangeably under 1325(b)(2) and 1325(b)(3), those two sections implement distinctly different mathematical formulas and therefore do not calculate comparable measures of value; the former calculates a value to be applied to make the full monthly payments under the plan, while the latter calculates a value to be applied for payments only to general unsecured creditors.

The 1325(b)(2) definition of disposable income more closely resembles pre-BAPCPA disposable income as a measure of CMI²⁵ less expenses (without reductions of CMI for administrative expenses, secured claim arrears and priority claims); it appears to be a measure of all of Debtor's disposable income (a chapter 13 plan payment), not an amount directed only to unsecured creditors. Expenses to be deducted in determining disposable income under 1325(b)(2) differ depending on whether the debtor is in business. If the debtor is not in business, expenses are those "amounts reasonably necessary to be expended . . . for the maintenance or support of the debtor or a dependent of the debtor" or for any postpetition domestic support obligation, that first becomes payable after the date the

²³ 11 U.S.C. § 101(10A). Alternatively, if the debtor does not file the schedule of current income required by section 521(a)(1)(B)(i) (i.e., Schedule I to Official Form 6), current monthly income is to be derived from the 6-month period ending on . . . the date on which current income is determined by the court. 11 U.S.C. § 101(10A)(A)(ii).

²⁴ The *Lanning* holding simply states: "when a bankruptcy court calculates a debtor's projected disposable income, the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation."

²⁵ Section 1325(b)(2) provides that income for purposes of that section, and derivatively for purposes of section 1129(a)(15), does not include any funds received by way of child support, foster care or disability payments for a dependent child.

petition is filed.²⁶ Such expenses also may include charitable contributions so long as the contributions do not exceed 15 percent of the debtor's gross income for the year in which such contributions are made.²⁷ If the debtor is in business, expenses also include those amounts reasonably necessary to be expended . . . for the payment of expenditures necessary for the continuation, preservation, and operation of such business.²⁸

In stark contrast to the definition of "disposable income" under 1325(b)(2), the definition of "disposable income" under 1325(b)(3) reduces CMI beyond the categories of reductions used under 1325(b)(2), suggesting that PDI is to be received by only general unsecured creditors under 1325(b)(1).²⁹ Disposable income under 1325(b)(3) reduces CMI by standardized expense categories (analogous to the reasonably necessary expenses of 1325(b)(2)), but goes further under the Means Test of 707(b)(2) to reduce CMI by categories of typical plan recipients (some administrative expenses, secured claim arrears, and priority claims). The resulting PDI is not comparable to the PDI under 1325(b)(2) and arguably is an amount that is being directed to only the general unsecured creditors. Under 1325(b)(4), the commitment period is 5 years when 1325(b)(3) is used.

As highlighted above, BAPCPA modified 1325(b)(1) by replacing the three year period with the applicable commitment period, and instructing that PDI be applied to make payments to unsecured creditors under the plan.³⁰ The addition and placement of the phrase to unsecured creditors leaves unclear whether PDI now measures only the amount of disposable income payable to unsecured creditors or whether PDI is a measure of the entire disposable income to be applied to the plan for all plan purposes (namely administrative expenses, secured claims, and priority claims). In other words, PDI post-BAPCPA is not necessarily the plan payment.

An argument has been made that the cross-reference in section 1129(a)(15) to section 1325(b)(2) also makes section 1325(b)(3) applicable in construing permissible expenses under section 1129(a)(15) for debtors whose annualized current monthly income

²⁶ 11 U.S.C. § 1325(b)(2)(A)(i).

²⁷ 11 U.S.C. § 1325(b)(2)(A)(ii).

²⁸ 11 U.S.C. § 1325(b)(2)(B).

²⁹ Under section 1325(b)(3), CMI is reduced by administrative, secured and priority unsecured claims, suggesting the phrase "to unsecured creditors" refers to general unsecured creditors receiving disposable income.

exceeds the median income for the state or region in which debtor resides.³⁰ On the one hand, the reference in section 1129(a)(15) is explicitly to, and only to, paragraph (2) of section 1325(b). Ostensibly, Congress had it within its power to draft the cross-reference more broadly, but did not.³¹ On the other hand, because section 1325(b)(3) specifies that A[a]mounts reasonably necessary to be expended under paragraph (2) shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2) . . . ,@ section 1325(b)(3) can be viewed as a Anested@ substest of section 1325(b)(2). This leads to an inconsistency.

The reference in 1129(a)(15) for calculating projected disposable income Aas defined in section 1325(b)(2)@ together with the possibility that 1325(b)(3) is applicable, necessitates an examination of how projected disposable income (APDI@) is calculated under both 1325(b)(2) and 1325(b)(3) and how PDI is applied under 1325(b)(1)(B) and 1129(a)(15)(B). Applying either measure of Adisposable income@ as Aprojected disposable income@ under 1129(a)(15)(B) to Abe distributed under the plan@ by both above- and below-median individual chapter 11 debtors is workable because both figures result in calculation of a payment that is directed to the plan, rather than to unsecured creditors, that is, a “plan base.”

For above-median chapter 13 debtors, the 1325(b)(3) measure of Adisposable income@ as Aprojected disposable income@ under 1325(b)(1)(B) to Abe applied to make payments *to unsecured creditors* under the plan@ works, because it measures a value of CMI reduced by living expenses, administrative, secured and priority claims.³² However, for below-median chapter 13 debtors required to use the 1325(b)(2) full monthly payments

³⁰ Under this construction the cross-reference to section 1325(b)(2) would implicitly incorporate paragraph (3) of section 1325(b) and treat that paragraph as a necessary rule of construction rather than a separate paragraph.

³¹ The conclusion that section 1325(b)(3) is not applicable in chapter 11 was adopted by the court in the only reported case dealing with the issue, *In re Roedemeier*, 374 B.R. 264, 272-73 (Bankr. D. Kan. 2007). It is also incorporated into Official Form 22B and supported by Collier. *See* 7 COLLIER ON BANKRUPTCY & 1129.03[15][a] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009).

³² Some courts, including the Ninth Circuit in *Manry v. Kagenveama (In re Kagenveama)*³², have held that, based on Athe plain meaning of the statute,@ Aprojected disposable income@ under section 1325(b)(1)(B) is determined simply by multiplying Adisposable income,@ determined under section 1325(b)(3), by the applicable commitment period. Where PDI under 1325(b)(3) is zero, there is no applicable commitment period. This is consistent with the interpretation that 1325(b)(3) calculates a PDI that is payable only to unsecured creditors and is not a plan payment. At least one of your panelists strongly agrees with this objective measurement of the debtor=s income.

under the plan measure of **disposable income** as **projected disposable income** under 1325(b)(1)(B) to be applied to make payments *to unsecured creditors* under the plan does not work.³³ The result is the direction of the entire amount determined to constitute that which debtor is able to pay (total PDI, not reduced by administrative, secured and priority claims) **to general unsecured creditors** until that class of claims is fully paid. This is an absurd result as it does not allow any PDI to be used for other plan purposes (such as paying Chapter 13 Trustee fees, reinstating a home loan, or paying priority taxes) until unsecured creditors are fully paid. The far more logical interpretation, which is being employed by the courts, is to ignore “to unsecured creditors” and treat PDI as a plan base.³⁴

As section 1129(a)(15) incorporates section 1325(b)(2), cases construing that section will be relevant in determining which expenses may be used to calculate disposable income under chapter 11. The reference in 1129(a)(15) that projected disposable income funds the plan is consistent with its instruction to calculate projected disposable income under 1325(b)(2) rather than the broader interpretation that it may also imply use of 1325(b)(3) for an above-median-income individual chapter 11 debtor.

³³ PDI cannot have two definitions nor can it have two uses at the same time. It cannot be a measure of total disposable income paid into a plan over a commitment period and at the same time be a measure of a portion of disposable income payable to only the unsecured creditors. The majority of courts interpret PDI as a measure of total disposable income. For this interpretation to work under 1325(b)(1)(B), one must ignore the fact that BAPCPA added the phrase *to unsecured creditors* between *will be applied to make payments* and *under the plan*. By interpreting PDI as a measure of total disposable income, the calculation of PDI under 1325(b)(3) becomes a useless exercise that is ultimately abandoned for use of disposable income measured by Schedule **AI** less Schedule **AJ**; a result ultimately reached under 1329 modification notwithstanding confirmation at a lesser amount. As a practical matter, practitioners and Chapter 13 Trustees typically agree that the Plan payment will be Schedule **AI-AJ**.

³⁴ A number of Circuit Courts of Appeal B and many bankruptcy courts B have held that **projected disposable income** under section 1325(b)(1) is different from **disposable income**, as defined in section 1325(b)(2) and (3). These courts generally hold that **disposable income** provides a rebuttable starting point for calculating **projected disposal income** but that changed circumstances may also be taken into account. See *In re Turner*, 574 F.3d 349, 356 (7th Cir. 2009); *Nowlin v. Peake (In re Nowlin)*, 576 F.3d 258, 260 (5th Cir. 2009); *Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269, 1270, 1274-82 (10th Cir. 2008), cert. granted in part, 130 S. Ct. 487 (2009); *Coop v. Frederickson (In re Frederickson)*, 545 F.3d. 652, 658-60 (8th Cir. 2008), cert. denied, 2009 WL 210498 (U.S. Mar. 23, 2009). These courts, and possibly the Supreme Court in *Lanning*,³⁴ interpret PDI as an amount calculated to be received into the plan and not directed only to the unsecured creditors; more consistent with the concept of PDI pre-BAPCPA and post-BAPCPA 1325(b)(2) as explained herein.

In summary, where an unsecured creditor objects to confirmation in an individual chapter 11 case, it is not yet clear which measure of PDI will be used for purposes of plan payment calculation, although it seems apparent that interpreting section 1325(b)(2) to provide a plan base is the more sensible approach.

To what extent must an individual chapter 11 debtor comply with the absolute priority rule as to a dissenting class of unsecured creditors?

Unclear, although nearly all of the reported cases to date hold that the absolute priority rule no longer applies to individual chapter 11 debtors.³⁵

BAPCPA amended section 1129(b)(2)(B)(ii) by adding language shown in italics below:

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, *except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.*³⁶

The added language permits individual chapter 11 debtors to retain “property included in the estate under section 1115” even if a dissenting class of unsecured creditors could otherwise contend that such retention violates the absolute priority rule.

The scope of this exception turns on the meaning of the phrase “included in the estate under section 1115.” Section 1115, also added by BAPCPA, specifies that property of the estate for individual chapter 11 debtors is different than property of the estate for all other chapter 11 debtors. Specifically, 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—

³⁵ *But see In re Gbadebo*, 210 WL 158609 (Bankr.N.D.Cal April 16, 2010)(Tchaikovsky, B.J.) (BAPCA did not do away with absolute priority rule in chapter 11 cases for individuals).

³⁶ 11 U.S.C. § 1129(b)(2)(B)(ii).

(1) all property of the kind specified in section 541 that the debtor acquires after the commencement of the case . . . and

(2) earnings from services performed by the debtor after the commencement of the case

If the language “included in the estate under section 1115” in section 1129(b)(2)(B)(ii) means only property that is added by section 1115, then it has a very narrow meaning: it refers only to postpetition income from services and property acquired after the commencement of the case that is not specified in section 541.³⁷ If, however, section 1115 supplants section 541 so that that property of the estate in an individual’s chapter 11 case is defined by section 1115, then it has a very broad meaning, essentially exempting individuals from the absolute priority rule as to unsecured creditors.

Initial interpretations favor the broad meaning.³⁸ These courts interpreted section 1115’s use of the phrase “in addition to the property specified in section 541” to mean that section 1115 absorbs and then supersedes section 541 for individual chapter 11 cases. This construction, in turn, leads to the conclusion that section 1129(b)(2)(B)(ii)’s exception extends to *all* property of the estate, including such things as prepetition ownership interest of nonexempt property.

Although relatively straightforward, this reading is not without problems. It essentially reads the absolute priority rule out of individual chapter 11 cases, and does so in a convoluted manner – arguably evidence that Congress did not fully appreciate the effect of the language it chose. This is especially true given that the addition of section 1123(a)(8) regarding use of future earnings to fund plans³⁹ effectively overruled *Norwest Bank*

³⁷ Section 1115(a)(1) brings into the estate such things as gifts to the debtor.

³⁸ See *In re Shat*, 2010 WL 702443, at *5-10 (Bankr. D. Nev. Feb. 22, 2010); *In re Roedemeier*, 374 B.R. 264 (Bankr. D. Kan. 2007); *In re Tegeder*, 369 B.R. 477 (Bankr. D. Neb. 2007); see also *In re Johnson*, 402 B.R. 851, 852-53 (Bankr. N.D. Ind. 2009) (stating in dicta that “An individual debtor’s plan does not need to satisfy the absolute priority rule, 11 U.S.C. 1129(b)(2)(B), and, even though unsecured creditors will not be paid in full, can be confirmed over their objection so long as the plan satisfies the disposable income test of § 1325(b)(2).”).

³⁹ Section 1123(a)(8) requires an individual chapter 11 debtor to include in the plan all postpetition earnings from services as is necessary to fund the plan. Section 1129(a)(15) then requires, as a condition of confirmation, the provision of value equal to at least five years’ worth of projected disposable income if the holder of an allowed unsecured claim objects to the plan.

Worthington v. Ahlers, 485 U.S. 197 (1988),⁴⁰ without any mention of that case in the legislative history.

But the arguments in favor of the broad reading are powerful. Absolute priority is not sacrosanct. Chapter 13 has no absolute priority rule,⁴¹ and most of the changes effected by BAPCPA to chapter 11 cases for individual debtors adapted various chapter 13 provisions to chapter 11.⁴² The broad view also saves section 1129(b)(2)(B)(ii) from an almost trivial reading; if the narrow view is taken, the section arguably protects only the value of aggregate postpetition earnings payable after the fifth anniversary of plan confirmation.⁴³ The broad view also avoids very difficult tracing and allocation issues.⁴⁴

Given the relatively straightforward reading of the statute supporting the broader reading and the general rehabilitative aim of chapter 11, it is the broader reading that has to date been adopted.⁴⁵

⁴⁰ *Ahlers* held that, if the new value exception to the absolute priority rule survived the enactment of the Bankruptcy Code in 1978, new value could not be satisfied by promised contributions of labor.

⁴¹ Chapter 13 has no “fair and equitable” requirement for confirmation. See 11 U.S.C. § 1325(b)(1). The same is true for chapter 12. See *id.* §1225(b)(1).

⁴² In *Rodemeier*, *supra* at 276, the court made this point, saying:

Significantly, Chapter 13 does not impose the absolute priority rule on debtors. Taken together, these changes [which make chapter 11 for individual debtors much like chapter 13] indicate Congress intended to extend the exemption from the absolute priority rule to individual Chapter 11 debtors as well. If a class of unsecured creditors who are not to be paid in full under an individual Chapter 11 debtor’s plan can bar the debtor from keeping any prepetition property (which will nearly always include the debtor’s interest in whatever business the debtor engages in) by rejecting the plan and invoking the absolute priority rule – that is, if the new exception in § 1129(b)(2)(B)(ii) is read narrowly – then it is difficult to see what purpose these other, related amendments can serve.

⁴³ See *In re Shat*, *supra* at *6; Bruce A. Markell, *The Sub Rosa Subchapter: Individual Debtors in Chapter 11 after BAPCPA*, 2007 U. ILL. L. REV. 67, 90.

⁴⁴ Challenging issues would arise in sorting out the extent to which property of the estate at confirmation has been acquired with postpetition earnings or is otherwise “proceeds, product, offspring, rents, or profits of or from” property acquired postpetition by the debtor (rather than the estate). There may be a premium on asset segregation and good record keeping. Should expenses that “preserve” or otherwise relate to the property specified as property of the estate in section 541 (“section 541 property”) be allocated to section 541 property, while other “personal” expenses of the debtor be allocated to section 1115 property?

⁴⁵ In any event the exception has an exception; it may not be used to undermine the confirmation requirement that the debtor be current on all postpetition domestic support obligations as required for confirmation by section 1129(a)(14). “Domestic support obligations” are defined in section 101(14A), and

Regardless of whether the exception is read narrowly or broadly, there remains ambiguity over how exempt property is treated under section 1129(b)(2)(B)(ii). To the extent that an individual chapter 11 debtor exempts property from property of the estate, that property leaves the estate. If such property is no longer property of the estate, the question arises as to whether it is still “property” the retention of which will not be permitted unless creditors are paid in full. Put another way, is section 1129(b)(2)(B)(ii) restricted to property of the estate, or was the use of the unqualified term “property” in section 1129(b)(2)(B)(ii) intended by Congress to include exempt property of the debtor as well?

The courts that have addressed this issue are divided,⁴⁶ although those cases that hold that exempt property is property governed by section 1129(b)(2)(B)(ii) have to address numerous inconsistencies. For example, since the value of exempt property will not be counted in the “best interests” test of section 1129(a)(7),⁴⁷ why should creditors be able to complain about its retention by the debtor under the absolute priority rule of section 1129(b)(2)(B)(ii)? Similarly, inclusion of exempt property in “property” referred to in section 1129(b)(2)(B)(ii) would seem to undermine the fresh start policy. Also, to the extent that courts believe that canons of statutory interpretation support their view,⁴⁸ they fail adequately to address (a) the failure in the various paragraphs of section 522(c) to cross-reference such exempt property as being available to creditors in the case of a chapter 11

are in the nature of support payments to dependents and former spouses. Section 1129(a)(14) requires all such obligations that first become due after the commencement of the case to be paid in full as a condition of confirmation.

⁴⁶ A number of courts have held that section 1129(b)(2)(B)(ii) is restricted to property of the estate. *See, e.g., In re Bullard*, 358 B.R. 541, 545 (Bankr. D. Conn. 2007); *In re Henderson*, 321 B.R. 550, 558-561 (Bankr. M.D. Fla. 2005), *aff'd*, *Van Buren Indus. Invs. v. Henderson (In re Henderson)*, 341 B.R. 783 (M.D. Fla. 2006); *In re Egan*, 142 B.R. 730, 733 (Bankr. E.D. Pa. 1992). Other cases, often from Florida – which has a very generous homestead exemption -- have held that section 1129(b)(2)(B)(ii) is not satisfied even if the debtor retains only exempt property. *See, e.g., In re Gosman*, 282 B.R. 45, 49-52 (Bankr. S.D. Fla. 2002); *In re Ysparro*, 100 B.R. 91, 95 (Bankr. M.D. Fla. 1989); *MJPB, Inc. v. Fross (In re Fross)*, 1999 WL 26886 at *6-11 (B.A.P. 10th Cir. Jan. 15, 1999)(unpublished).

⁴⁷ *See, e.g., In re Johnson*, 101 B.R. 307, 309 (Bankr. M.D. Fla. 1989).

⁴⁸ *See In re Gosman, supra* at 49-52 (arguing that, if Congress had intended to exclude exempt property from section 1129(b)(2)(B)(ii), it could have easily done so).

cramdown by an individual⁴⁹ or (b) the fact that the debtor retains the exempt property not under the plan, but under section 522(c).⁵⁰

6. Lien stripping in an individual chapter 11 case:

a. Is it possible to lien strip a junior residential real property loan?

No, if it's partially unsecured. Probably, depending on the jurisdiction, if it's wholly unsecured.

Prior to the 1978 enactment of Bankruptcy Code, liens were deemed to pass through bankruptcy. Whether this principle is embodied in the Code was not made clear in the legislative history, thereby creating a fertile area of bankruptcy litigation.

The Supreme Court considered this issue in *Dewsnup v. Timm*, 502 U.S. 410 (1992), where a first deed of trust was secured by the chapter 7 debtor's real property with a fair market value far less than the amount of the debt. The debtor filed an adversary proceeding to strip down the lien, based on the theory that once the value of the claim was reduced under section 506(a), section 506(d) permitted strip down. The Supreme Court refused to allow the strip down: "we hold that § 506(d) does not allow a debtor to 'strip down' respondent's lien, because respondent's claim is secured by a lien and has been fully allowed pursuant to § 502." *Id.* at 417. The Court concluded that the phrase "allowed secured claim" in section 502(d) did not have the meaning given in section 506(a)⁵¹, but rather should be read "term-by-term" to refer to any claim that is, first allowed, and second, secured." *Id.* at 416. Since the claim at issue had been fully allowed pursuant to section 502 and was secured by a lien on the underlying collateral, it did not come within the scope of section 506(d). The Court believed that it could not effect a major change in the pre-Code rule that liens pass through bankruptcy (at least "[a]part from reorganization proceedings") absent evidence in either the language or the legislative history of section 506 that Congress

⁴⁹ Section 522(c)(1)-(4) specifies the types of claims that are exempt from section 522(c)'s prohibition that property claimed as exempt "is not liable during or after the case for any [prepetition] debt."

⁵⁰ See *In re Bullard*, *supra* at 545 n.11.

⁵¹ "An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property. . . ." 11 U.S.C. § 506(a).

intended such a change. *Id.* at 419. The Court also cited concern over the potential windfall to the debtor should the underlying collateral increase in value.

The Court in *Dewsnup* was not unequivocally enthusiastic about its holding: “[w]ere we writing on a clean slate, we might be inclined to agree with petitioner that the words ‘allowed secured claim’ must take the same meaning in § 506(d) as in § 506(a).” *Id.* at 417. The Court expressly limited its decision to the facts before it. Justice Scalia strongly dissented, arguing the plain meaning of section 506(d)’s “allowed secured claim” must be the meaning ascribed to the phrase in section 506(a): “the portion of a creditor’s allowed claim that is secured after the calculations required by that provision have been performed.” *Id.* at 421.

In the reorganization context, sections 1123(b)(5) and 1322(b)(2) of the Code provide that chapter 11 and 13 plans, respectively, may “modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor’s principal residence” Shortly after *Dewsnup*, the Supreme Court interpreted section 1322(b)(2) in *Nobleman v. American Savings Bank*, 508 U.S. 324 (1993), to bar the strip-down of an undersecured residential loan. However, the Court’s reasoning in *Nobleman* arguably left the door open for the “strip-off” of an entirely unsecured residential loan⁵² because the Supreme Court relied on the secured portion of the bifurcated claim to deem the creditor a “holder of a secured claim” entitled to protection under section 1322(b)(2). A majority of courts, including the Second, Third, Sixth, Ninth and Eleventh Circuits, have walked through the door left ajar by *Nobleman* to strip off wholly unsecured residential loans under section 1322(b)(2).⁵³ The same reasoning should allow a strip-off of a wholly unsecured residential loan under section 1123(b)(5)’s identical provision.⁵⁴

⁵² The term “unsecured” is used to mean a claim secured by a lien where the value of the underlying security is zero (or less) in relation to such claim. Arguably, a claim that is secured by a lien cannot be “unsecured” until sections 506(a) and 506(d) are applied, and therefore, any claim that is secured by a lien is considered at least partially secured until otherwise determined.

⁵³ See *Zimmer v. PSB Lending Corp. (In re Zimmer)*, 313 F.3d 1220, 1221 (9th Cir. 2002); *Lane v. W. Interstate Bancorp (In re Lane)*, 280 F.3d 663, 667-69 (6th Cir. 2002); *Pond v. Farm Specialist Realty (In re Pond)*, 252 F.3d 122, 126 (2^d Cir. 2001); *McDonald v. Master Fin. Inc. (In re McDonald)*, 205 F.3d 606, 615 (3^d Cir. 2000); *Tanner v. FirstPlus Fin., Inc. (In re Tanner)*, 217 F.3d 1357 (11th Cir. 2000); *Domestic Bank v. Mann (In re Mann)*, 249 B.R. 831, 840 (B.A.P. 1st Cir. 2000).

⁵⁴ A recent bankruptcy court decision, *In re Lavelle*, 2009 WL 4043089 (Bankr. Nov. 19, E.D.N.Y. 2009) (Eisenberg, B.J.), relied on the cases allowing a strip-off under section 1322(b)(2) to strip off an entirely unsecured consensual junior lien in chapter 7 under section 506(d). At least one of the panelists agrees with the analysis of the court in *Lavelle*. However, *Lavelle* runs directly counter to *Laskin v. First Nat’l*

b. Chapter 18 or Chapter 20: Can lien stripping be permanent without a chapter 11 or chapter 13 discharge?

Maybe, depending on the jurisdiction.

A bankruptcy discharge in a chapter 7 case extinguishes the personal liability of the debtor with respect to any debt.⁵⁵ The chapter 7 discharge, however, leaves intact the liens against the debtor's property as *in rem* claims. See *Johnson v. Home St. Bank*, 501 U.S. 78, 84-85 (1991).

When faced with post-discharge foreclosure on their residence or other property, some debtors who have obtained a chapter 7 discharge seek further relief under the Bankruptcy Code by filing a reorganization case under either chapter 11 or chapter 13. Such filings are referred to by the pejorative euphemisms "chapter 18" or "chapter 20," respectively. The mortgage lien against the debtor's property that survives a chapter 7 discharge is a "claim" in the debtor's ensuing chapter 13 and subject to inclusion in the reorganization plan. See *id.* at 87.⁵⁶ By the same analysis, a surviving lien in a "chapter 18" case would likewise be a claim subject to inclusion in the subsequent chapter 11 plan.

A prior discharge in chapter 7 does not bar the filing of a chapter 11 or chapter 13 case, but does preclude discharge in a chapter 13 case filed within four years of the chapter 7 petition⁵⁷ or in a chapter 11 case filed within 8 years of the chapter 7 petition, if the plan is a

Bank of Keystone (In re Laskin), 222 B.R. 872 (B.A.P. 9th Cir. 1998), in which the Bankruptcy Appellate Panel for the Ninth Circuit applied the ruling in *Dewsnup* to preclude lien stripping in *any* chapter 7 case, albeit arguably in *dicta*. Accord, *In re Talbert*, 344 F.3d 555 (6th Cir. 2003); *Ryan v. Homecomings Fin. Network*, 253 F.3d 778 (4th Cir. 2001). See also *In re McNeal*, Case No. A09-78173-PWB (Bankr. N.D.Ga. April 9, 2010) (Bonapfel, B.J.) (appeal pending, N.D. Ga., Case No. 1:10-cv-01612-TCB) ("Section 506 was intended to facilitate valuation and disposition of property in the reorganization chapters of the Code, not to confer additional avoiding power on a Chapter 7 debtor."). Other bankruptcy judges in the Eastern District of New York have declined to follow *Lavelle*. See *In re Caliguri*, 2010 WL 1027411 (Bankr. E.D.N.Y. Mar. 17, 2010) (Trust, B.J.); *Pomilio v. MERS (In re Pomilio)*, 210 WL 681300 (Bankr. E.D.N.Y. Feb. 23, 2010) (Grossman, B.J.).

⁵⁵ See 11 U.S.C. § 524(a)(1).

⁵⁶ As explained in *In re Gounder*, 266 B.R. 879, 880-81 (Bankr. E.D. Cal.), *aff'd per curiam*, 2001 WL 1688479 (E.D. Cal. 2001), after strip-off, the claim is a general unsecured claim in the full amount of the pre-chapter 13 debt, even though it is nonrecourse as a result of the chapter 7 discharge. Accord, *Akrin*, *supra* at 373, 377-79.

⁵⁷ See 11 U.S.C. § 1328(f)

liquidation plan and the debtor does not engage in business after consummation of the plan.⁵⁸ “Chapter 18” may be more amenable to discharge because, pursuant to 11 U.S.C. § 1141(d)(3), limitation on discharge requires that all three sub-elements apply to the debtor’s plan. As a practical matter, where a prior Chapter 7 case filed less than 8 years earlier liquidated substantially all of the property of the estate, it is not likely that a subsequent Chapter 11 plan would provide for liquidation of all or substantially all of the remaining property of the estate, the condition described under 1141(d)(3)(A). Thus, Chapter 11 discharge following Chapter 7 discharge appears to be available in most cases.

In the absence of a discharge, can a chapter 11 or chapter 13 plan permanently lien strip?

Generally, chapter 11 and chapter 13 plans will be confirmed if they meet the confirmation requirements of section 1129 or 1325, including the requirement that the plan be proposed in good faith.⁵⁹ Accordingly, some decisions considering lien-stripping in “chapter 20” turn on the factual question of whether the subsequent chapter 13 was filed in good faith.⁶⁰

Other courts considering lien stripping under chapter 20 have held that lien stripping with *res judicata* effect requires a chapter 13 discharge, not merely plan confirmation.⁶¹ Prior to BAPCPA, that meant the “chapter 20” debtor needed to wait until plan payments were complete to receive a discharge and, hence, permanent lien stripping.⁶² After BAPCPA added section 1328(f) to prevent discharge in any chapter 13 case filed within four years of a previous chapter 7 petition, this conclusion would prevent the “chapter 20” debtor from ever lien stripping in a “chapter 20” with *res judicata* effect.⁶³ Analogously, an

⁵⁸ See 11 U.S.C. §§ 727(a)(8) & 1141(d)(3).

⁵⁹ 11 U.S.C. §§ 1129(a)(3) & 1325(a)(3).

⁶⁰ See, e.g., *In re Quiles*, 262 B.R. 191, 194 (Bankr. D.R.I. 2001) (where debtors in “chapter 20” proposed to strip off the lien of, and pay nothing to the holder of, a second mortgage on their claim, the court found lack of good faith because “[t]he Debtors readily admit that, as they have no creditors, the only purpose of the Chapter 13 filing is to strip off the unsecured second mortgage. To confirm a plan on these facts would be antithetical to one of the basic purposes of Chapter 13, which is to propose, where possible, a plan to pay back creditors. These Debtors seek only the benefits of Chapter 13, and they shun all of the burden.”).

⁶¹ See, e.g., *In re Jarvis*, 390 B.R. 600, 604-06 (Bankr. C.D. Ill. 2008); *In re Akram*, 259 B.R. 371, 373 (Bankr. C.D. Cal. 2001).

⁶² See, e.g., *Jarvis*, *supra* at 604; *Akram*, *supra* at 37.

⁶³ See *In re Jarvis*, *supra* at 605-06; *In re Winitsky*, Case No. 1:08-bk-19337-MT (C.D. Cal. May 12, 2009) (Memorandum of Decision re: Motion to Value Property and Strip Fully Unsecured Lien, by B.J. Tighe, concurred in by B.J. Mund and B.J. Thompson) (unreported decision) (“At issue in this case is

individual chapter 11 debtor in a “chapter 18” would be able to lien-strip effectively only if he/she obtained a chapter 11 discharge (usually after completion of all payments under the plan⁶⁴) and (i) his/her chapter 11 plan was not a liquidating plan or (ii) he/she engaged in business after consummation of the plan.⁶⁵

One of your panelists, strongly disagrees with this line of authority and believes that confirmation of a plan in good faith in a “chapter 20” case should permanently modify and “strip off” a lien because, under section 1327(b) and (c), confirmation of the chapter 13 plan vests all property of the estate in the debtor, free and clear of all claims and interests of creditors provided for in the plan. Thus, the lien is stripped off by virtue of confirmation of the plan, not the discharge. In fact, recently some bankruptcy courts have held that obtaining a discharge in Chapter 13 is not a prerequisite to stripping off a wholly unsecured lien.⁶⁶

The analysis in “chapter 18” is somewhat different in that, under sections 1141(c), property dealt with by the plan is free and clear of the claims of creditors⁶⁷ with two

whether the Bankruptcy Code allows Chapter 13 debtors who received Chapter 7 discharges within the past four years to strip a completely unsecured consensual lien off their primary residence. This Court concludes that the Bankruptcy Code does not allow this because a discharge is required to lien strip in a Chapter 13 case.”)

⁶⁴ See 11 U.S.C. § 1141(d)(5).

⁶⁵ See 11 U.S.C. §§ 727(a)(8) & 1141(d)(3).

⁶⁶ See *In re Tran*, Case No. 10-41032-EDJ (Bankr. N.D. Cal June 25, 2010)(Jellen, B.J.) "This court agrees with the decisions holding that the Bankruptcy Code does not condition a chapter 13 debtor's right to strip off a wholly unsecured junior lien on the debtor's eligibility for a discharge. Rather, such right is conditioned on the debtor's obtaining confirmation of, and performing under, a chapter 13 plan that meets all of the statutory requirements. At the same time, the court emphasizes that if a chapter 13 case is filed primarily to avoid a junior lien in an effort to skirt the Supreme Court's holding in *Dewsnup*, then such filing would not be in good faith, and such a case should be dismissed. . . . The starting point for statutory interpretation is the language of the statute. [citations omitted] In this respect, it is significant that § 109(a), (e), and (g), which set forth the eligibility requirements for chapter 13, do not condition a debtor's eligibility for relief under chapter 13 on the debtor's eligibility for a discharge. Nor does § 109 preclude chapter 13 relief to a debtor who has recently received a discharge in chapter 7. . . . It is equally significant that, although § 1325(a) and (b) sets forth numerous requirements for confirmation of a chapter 13 plan, nothing in § 1325 conditions confirmation on the debtor being eligible for a discharge." See also *In re Burnett*, 08-08519-PB13 (Bankr. S.D. Cal. April 2, 2010) **Error! Main Document Only**. There appears to be no rule that restricts a lien strip-off under § 1322(b)(2) to cases only where the debtor gets a discharge upon completion of the plan. Lien strip-off would be effective upon completion of the plan, which meant upon completion of the payments provided for in the plan.).

⁶⁷ See *In re Zook*, 2010 WL 2203172 (Bankr. D. Az. May 27, 2010)(Haines, B.J.) (“At least in this Circuit, the law is clear that confirmation of a Chapter 11 plan replaces all prepetition obligations and liens

exceptions, *i.e.*, the property is subject to claims excepted from discharge under section 523, and discharge is denied if it would have been denied under section 727(a) if the case were in chapter 7,⁶⁸ and the plan is a liquidating plan and the debtor does not engage in business after consummation of the plan.⁶⁹ Under section 727(a)(5), discharge is to be denied in a chapter 7 case if the debtor received a discharge in a prior chapter 7 case commenced within 8 years before the filing of the current petition.

7. What constitutes “cause” to grant the discharge upon confirmation rather than upon completion of plan payments?

Anyone’s guess. Recall that BAPCPA added subsection 1141(d)(5), which provides that an individual chapter 11 debtor will receive a discharge “on completion of all payments under the plan.”⁷⁰ This makes chapter 11 cases for individual debtors like chapter 13 where, under section 1328(a), both before and after BAPCPA, the chapter 13 debtor receives his or her discharge “after completion by the debtor of all payments under the plan.” However, Section 1328(a) does not provide, as new section 1141(d)(5)(A) does, that the court can, “for cause,” authorize discharge at confirmation.

BAPCPA provides no guidance as to what would constitute “cause” under section 1141(d)(5). Compare *In re Sheridan*, 391 B.R. 287 (Bankr. E.D.N.C. 2008) (court granted individual chapter 11 debtors their discharge at confirmation because there was a “strong probability” that the debtors would make all of their plan payments and their obligation to do so was secured by a second deed of trust on their home) with *In re Ball*, 2008 WL 2223865 (Bankr. N.D. W. Va. 2008) (desire to avoid paying U.S. Trustee’s quarterly fees and filing post-confirmation reports (at least in case where post-confirmation administration will not be lengthy) does not constitute “cause” to grant individual chapter 11 debtor his discharge before all payments under plan have been completed) and *In re Belcher*, 410 B.R. 206, 217-18 (Bankr. W.D. Va. 2009) (avoiding the obligation to pay U.S. Trustee’s quarterly fees is not sufficient “cause” to grant an early discharge because this reason is present in all individual chapter 11 cases; granting a discharge for “cause” after completion of

with the terms of a confirmed plan, effective immediately upon confirmation . . . because this modification of prepetition liens occurs pursuant to confirmation of the plan, the lien avoidance occurs pursuant to § 1141 rather than pursuant to § 506(d).”).

⁶⁸ See 11 U.S.C. § 1141(d)(2).

⁶⁹ See 11 U.S.C. §§ 1141(d)(3).

⁷⁰ A good argument has been made, although not treated in any reported cases, that an individual may need to remove the uncertainty of the conditional discharge in order to obtain necessary postconfirmation financing. See Gerald F. Munitz, *Confirming a Chapter 11 Plan in a Case Involving an Individual*, 906 PLI/Comm 755, 768 (2008).

payments to unsecured creditors, but prior to completion of payments on education loans or long term mortgage obligations, better meets intent of § 1141(d)(5)(A)).

8. Can the U.S. Trustee, a trustee or unsecured creditors obtain modification of a confirmed plan to require that the individual chapter 11 debtor pay more in the modified plan than was specified in the plan as confirmed?

It depends. The delay of the discharge for individual chapter 11 debtors makes the ability to modify important. For example, if assumptions made at confirmation prove unachievable, modification may be necessary in order for the debtor to obtain a discharge. BAPCPA addressed this issue by adding Section 1127(e) – modeled after Section 1329(a)(1)-(3) -- to chapter 11. This new section allows an individual debtor (along with the U.S. Trustee, a trustee and unsecured creditors) to modify the plan to increase or reduce payments, or to increase or reduce any repayment periods under the plan.

There is a split in the circuits as to whether a modification of a confirmed chapter 13 plan requested by the chapter 13 trustee or an unsecured creditor requires a substantial change in circumstances that could not have been anticipated at the time of confirmation. Compare *Arnold v. Weast (In re Arnold)*, 869 F.2d 240 (4th Cir. 1989) (limited to unanticipated substantial change in the debtor’s income or expenses) with *Barbosa v. Solomon*, 235 F.3d 31 (1st Cir. 2000); *In re Witkowski*, 16 F.3d 739 (7th Cir. 1994); and *Meza v. Truman (In re Meza)*, 467 F.3d 874, 877-78 (5th Cir. 2006) (res judicata not applicable; no threshold requirements besides compliance with the Code).

Arguably, a modification under 1127(e) requires meeting the other prerequisites to plan confirmation, including good faith.⁷¹

A lament on the looseness of this section can be found in Jerald I. Ancel, Marlene Reich & Jeffrey J. Graham, *Advising an Individual Chapter 11 Debtor on the Impact of 11 U.S.C. § 1129(a)(15), 1127(e): How Much and How Long?*, 27-May AM. BANKR. INSTIT. J. 20 (2008).

⁷¹ BAPCPA also added subsection 1127(f), which provides that “Section 1121 through 1128 and the requirements of section 1129 apply to modification under subsection (a).” A review of subsection 1127 suggests that the “(a)” may be a typo and was intended to be “(e).” A court willing to correct this “typo” would then subject plan modifications to the standards of sections 1121 through 1129.

9. Does an individual chapter 11 debtor have to keep paying U.S. Trustee’s fees until all plan payments are complete, or may the case be closed before the completion of payments and grant of the discharge?

Maybe. Depends on how savvy counsel is.

The best overview of this issue appears in *In re Ball*, 2008 WL 2223865 (Bankr. N.D. W. Va. 2008), which is worth quoting at length:

Section 350(a) of the Bankruptcy Code requires the court to close a case after the estate is fully administered. 11 U.S.C. § 350(a). A Chapter 11 case cannot be deemed fully administered until sometime after the plan is “substantially consummated.”

“Substantial consummation” is defined in 11 U.S.C. § 1101(2) to mean “(A) transfer of all or substantially all of the property proposed by the plan to be transferred; (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and (C) commencement of distribution under the plan.”

Fed. R. Bankr. P. 3022 governs the closing of a Chapter 11 case. It states that “[a]fter an estate is fully administered in a chapter 11 reorganization case, the court, on its own motion or on motion of a party in interest, shall enter a final decree closing the case.” *Id.* By drafting such loose language, “Congress intended that the bankruptcy courts set the procedure for the closing of a case under title 11.” 3 COLLIER ON BANKRUPTCY ¶ 350.02[2] (Alan N. Resnick and Henry J. Summer, eds., 15th ed. rev. 2008).

The 1991 Advisory Committee Note to Rule 3022 lists non-exclusive factors to be considered in determining whether the estate has been fully administered:

- (1) whether the order confirming the plan has become final,
- (2) whether deposits required by the plan have been distributed,
- (3) whether the property proposed by the plan to be transferred

has been transferred, (4) whether the debtor or the successor of the debtor under the plan has assumed the business of the management of the property dealt with by the plan, (5) whether payments under the plan have commenced, and (6) whether all motions, contested matters, and adversary proceedings have been finally resolved.

Fed. R. Bankr. P. 3022, Advisory Committee Note.

These provisions -- which preexisted the Chapter 11 changes made by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") to individual cases like this one -- were aimed at closing Chapter 11 cases sooner rather than later, and payments under the plan did not have to be completed before the case was closed. Fed. R. Bankr. P. 3022, Advisory Committee Note; *see also In re Mold Makers, Inc.*, 124 B.R. 766, 768 (Bankr. N.D. Ill. 1990) (stating that cases may be closed before all that is called for under the plan has occurred). Thus, in a non-individual case, substantial consummation generally means the case is fully administered and can be closed. Robert J. Landry III, *Individual Chapter 11 Cases After BAPCPA: Can You Still Close the Case Early?* 25-6 A.B.I. J. 10, 10 (Aug. 2006); *cf. In re SLI, Inc.*, No. 02-12608, 2005 Bankr. LEXIS 1322 at *7, 2005 WL 1668396 (Bankr. D. Del. June 24, 2005) (noting that substantial consummation and full administration are not necessarily synonymous), *aff'd*, No. 04-4231, 2006 U.S. App. LEXIS 5188 (3d Cir. March 1, 2006).

After the passage of BAPCPA, however, the preexisting rules allowing for an early Chapter 11 case closing are in conflict with several provisions of the Bankruptcy Code governing the administration of an individual's case. For example: (1) property of the estate is now defined in 11 U.S.C. § 1115 to include the post-petition earnings of a debtor; (2) the debtor is explicitly allowed by § 1123(a)(8) to fund a plan from the debtor's post-petition earnings; (3) the holder of an unsecured claim now has the right under § 1127(e) to seek modification of a confirmed plan; (4) the debtor is subject to the best efforts test in § 1129(a)(15); and (5) pursuant to § 1141(d)(5), no

discharge may be entered until all payments have been made under the plan.

These changes mean that individual Chapter 11 cases are now more akin to the administration of cases under Chapter 13 than to the Chapter 11 reorganization of non-individual debtors. Of course, Chapter 13 cases are not closed until after all plan payments have been made and a discharge is entered. As stated by one commentator, these changes “call into question whether closing individual chapter 11 cases ‘sooner rather than later’ is intended post-BAPCPA.” Landry, *supra*, 25-6 A.B.I. J. at 10. At this time, guidance on this issue is left up to the courts. *Id.* at 60.

In re Ball, *supra* at *2-3. In *Ball*, the court found that, although the plan called for notes from the debtor, the payments under the notes were the transfers that counted, and found that the case could not be closed until all those payments were made.

Ball was distinguished, and an arguably contrary result (closing of the case and cessation of the accrual of U.S. Trustee’s fees) was reached in *In re Johnson*, 402 B.R. 851 (Bankr. N.D. Ind. 2009). There, the issue was whether to close an individual debtor’s chapter 11 case prior to his completion of payments and discharge, subject to reopening after all payments had been made in order to grant the debtor’s discharge, or for other purposes. The reason for closing the case was to eliminate ongoing quarterly U.S. Trustee’s fees. Only the U.S. Trustee objected. The court in *Johnson* granted the debtor’s motion to close the case based on the criteria set forth in the Advisory Committee Note (1991) to Rule 3022 after finding that

[t]he order confirming this debtor’s plan has become final, there was no deposit to distribute, any property the plan contemplates transferring has been transferred or otherwise disposed of, the reorganized debtor has begun to manage his affairs, payments to creditors have commenced, the plan has been substantially consummated, and all outstanding motions, adversary proceedings, and contested matters (save this one) have been resolved.

402 B.R. at 856. Further, because the plan provided for payments to creditors out of future earnings for five years, with secured and priority creditors paid first, general unsecured creditors, not the debtor, would benefit from closing the case and cutting off U.S. Trustee’s

fees; their estimated recovery would increase from approximately \$38,000 to approximately \$51,000. The court noted that the *Johnson* case differed from *Ball*, where the creditors' recovery would not be affected by avoiding U.S. Trustee's fees. While recognizing the argument that closing the case would make it more difficult for creditors to monitor the debtor's activities and, if appropriate, seek modification of the plan or dismissal or conversion of the case, the court indicated that the creditors had opted to receive the additional money. Further, "nothing about this case suggests that there is any need for the increased oversight that would be facilitated by leaving the case open or that the debtor cannot be trusted to properly perform post confirmation obligations." 402 B.R. at 858.

Ensnuing cases have come down on both sides of the issue. The court in *In re Hilburger*, 2009 WL 1515125 (Bankr. W.D.N.Y. May 29, 2009), faced the same issue as the Johnson court, and reached the same conclusion.⁷² In *In re Belcher*, 410 B.R. at 219, the court declined to follow *Johnson*, finding that the factors listed in the Advisory Committee Note to Bankruptcy Rule 3022 "are not appropriate to the new post-BAPCPA world of chapter 11 plans funded by post-filing and post-confirmation earnings by individual debtors."⁷³ The court also felt that requiring the debtors to bear a share of the cost of the U.S. Trustee system was not unreasonable, particularly since, "[i]f it proves more than the Belchers can reasonably pay, they may . . . seek a modification of the terms of the confirmed plan." *Id.* The Eighth Circuit Bankruptcy Appellate Panel in *Shotkoski v. Fokkena (In re Shotkoski)*, 420 B.R. 479 (B.A.P. 8th Cir. 2009), affirmed the bankruptcy court's denial of the debtors' motion for final decree (filed on the date the order confirming their plan was entered), using an abuse of discretion standard, deferring to the bankruptcy court's "experience and oversight of the case." However, the court also made it clear that it was

⁷² However, the court in *Hilburger* warned that "gaming the system" will not be tolerated. In some cases, the quarterly fees would not substantially injure creditors; the Plan would simply have to run longer, delaying creditors somewhat, but not reducing the "present value" of whatever portion of their claim will be paid. For example, when a plan is "driven" by the Chapter 7 test (e.g., nonexempt equity in realty or other property), the case might remain open unless its early closure is necessary for substantial consummation, such as where a refinancing will fund the plan or make it otherwise feasible, and the lender conditions the refinancing on closing the case.

Hilburger, at *1.

⁷³ Because the plan could be modified prior to the completion of payments and "[p]lan obligations [were] to be satisfied from property of the estate not yet in existence," the court in *Belcher* was not persuaded that the case had been "'fully administered' within the meaning of . . . § 350(a)." 410 B.R. at 219.

not holding that every individual Chapter 11 case must remain open until such time as all long-term plan payments have been completed and a discharge is entered. In fact, since the Bankruptcy Code expressly contemplates the reopening of cases and the exercise of continuing jurisdiction by the bankruptcy court (see 11 U.S.C. § 350(b)), we do not disagree with those courts choosing, for purposes of convenience and efficiency, to close individual Chapter 11 cases prior to completion of payments and entry of discharge. Again, we believe it is a case-by-case analysis best left to the discretion of the bankruptcy judge.

Id. (emphasis in original).

The Office of the U.S. Trustee has recently taken the position that, despite the changes in chapter 11 as applied to individuals, it “will not normally object to an individual chapter 11 debtor’s request to close the case before discharge once the estate has been fully administered,” as described in the Advisory Committee Note to Rule 3022. Walter W. Theus, Jr., *Individual Chapter 11s: Case Closing Reconsidered*, 29-Feb. Am. Bankr. Inst. J. 1, 63 (2010) (author is a trial attorney with the Executive Offices for U.S. Trustees).

Dated: July 14, 2010