Individual Chapter 11 Cases
and the Absolute Priority Rule
Navigating Absolute Priority Amid Differing Court Interpretations of the Rule

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1pm Eastern    |    12pm Central    |   11am Mountain    |    10am Pacific

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The Absolute Priority Rule: An Endangered Species in Individual Chapter 11 Cases?

The absolute priority rule of Section 1129(b) of the Bankruptcy Code is a fundamental creditor protection in a Chapter 11 bankruptcy case. In general terms, the rule provides that if a class of unsecured creditors rejects a debtor’s reorganization plan and is not paid in full, junior creditors and equity interestholders may not receive or retain any property under the plan. The rule thus implements the general state-law principle that creditors are entitled to payment before shareholders, unless creditors agree to a different result. Recent litigation has raised the issue whether the absolute priority rule continues to apply in Chapter 11 cases filed by individuals.

The absolute priority rule has played a prominent role in bankruptcy disputes, including a number of Supreme Court decisions. The current controversy concerns whether the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), which otherwise is a very creditor-friendly statute, modified the Bankruptcy Code in such a way as to eliminate the absolute priority rule if the debtor is an individual. The issue is particularly important because BAPCPA’s restrictions on eligibility for relief under Chapter 7 have made Chapter 11 the only realistic option for many debtors. (Even before BAPCPA, Chapter 13 contained limits on a debtor’s secured and unsecured debts, so it is not an option for many debtors who are likely to present absolute priority disputes.)

This Client Alert discusses the first appellate opinion on this issue, in which a divided panel of the Bankruptcy Appellate Panel of the Ninth Circuit held that the absolute priority rule no longer applies in individual Chapter 11 cases. Friedman v. P&P, LLC, No. 11-1105, 2012 WL 911545 (B.A.P. 9th Cir. Mar. 19, 2012). Two other appeals are in the works. On March 21, a bankruptcy judge in Texas certified his decision that the absolute priority rule continues to apply in individual Chapter 11 cases for direct appeal to the Fifth Circuit. In re Lively, No. 10-35471, 2012 WL 959286 (Bankr. S.D. Tex. Mar. 21, 2012). And the day after that, a panel of the Fourth Circuit heard oral arguments in a direct appeal from a Virginia bankruptcy judge’s ruling that the absolute priority rule survived BAPCPA. In re Maharaj, No. 11-1747 (4th Cir.).

Background of the Friedman Decision

The Friedmans filed Chapter 11 in Arizona in October 2007 to stay foreclosure by a junior lienholder of the debtors’ part-time residence in Breckenridge, Colorado. After relief from the automatic stay was granted to the senior lienholder, which then foreclosed, the junior lienholder’s claim against the bankruptcy estate of $556,000 was left unsecured. In their plan, the debtors proposed to pay $634 per month to unsecured creditors (including the junior lienholder), while retaining all of their interests in various pre-bankruptcy business ventures. Although these business were valued at more than $600,000, they yielded income to the debtors of...
only $2,000 per month. The junior lienholder objected to the plan, asserting that it violated the absolute priority rule because it permitted the debtors to retain valuable assets while unsecured creditors were not being paid in full. The bankruptcy court entered an order denying confirmation of the debtors’ plan because it violated the absolute priority rule, though the court recognized the split of authority as to whether the rule applies in individual Chapter 11 cases. After the debtors failed to amend their plan, the bankruptcy court converted the case to Chapter 7. The debtors appealed.

The BAP’s Decision

On appeal, the Bankruptcy Appellate Panel focused on language added to Section 1129(b)(2)(B)(ii) of the Bankruptcy Code by BAPCPA. That language, which creates an exception to the absolute priority rule, states that “in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115.” Section 1115, which also was added by BAPCPA, provides that if a Chapter 11 debtor is an individual, property of his or her bankruptcy estate “includes, in addition to the property specified in section 541,” property acquired by the debtor post-bankruptcy and the debtor’s post-bankruptcy earnings. Section 541 defines the baseline property of a debtor’s bankruptcy estate for purposes of cases under Chapters 7, 11, and 13—with some exceptions, it includes property owned by the debtor on the date of the bankruptcy filing and excludes post-bankruptcy earnings. The question for the BAP in Friedman, then, was whether “property included in the estate under section 1115,” which a debtor may retain without paying creditors in full, means all property of the bankruptcy estate (because Section 1115 incorporates Section 541 property) or property that is included in the bankruptcy estate solely because it is added by Section 1115 (essentially, post-bankruptcy earnings and acquisitions).

The BAP majority concluded that the plain meaning of the exception permits a debtor to retain all property of the bankruptcy estate without paying creditors in full. The BAP acknowledged that its decision (interpreting the exception broadly) is in the minority; most bankruptcy courts have interpreted the exception narrowly to include only post-bankruptcy earnings and acquisitions. Because it believed that the exception added by BAPCPA was unambiguous, the BAP declined to review legislative history or to consider the policies behind BAPCPA. In a vigorous dissent, Judge Jury chastised the majority for its “simplistic outcome,” “strained reading” of the statute, and “result-driven approach.” She also argued that the majority’s interpretation of the BAPCPA amendments violates several principles of statutory construction, including those disfavoring interpretations that render statutory language superfluous, produce absurd results, and are demonstrably at odds with the purpose of the statute.

Significance of Friedman

Friedman represents a significant shift in the balance of power in individual Chapter 11 cases. If a debtor may retain property without paying creditors in full, the debtor has little incentive to engage in negotiations toward a consensual plan, which is the typical resolution of a Chapter 11 case. Creditors retain other protections against abusive plans—for example, a plan must be proposed in good faith, and a dissenting creditor must receive at least as much as it would get in a Chapter 7 liquidation—but those remedies are dependent on judicial factfinding and, in many cases, the opinions of expert witnesses. The BAP’s conclusion that Congress eliminated the absolute priority rule strips creditors of a much more straightforward means to block the confirmation of a debtor-friendly plan or, more likely, to compel the debtor to negotiate an acceptable resolution.
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POST-BAPCPA ISSUES FOR ATTORNEYS REPRESENTING INDIVIDUAL CHAPTER 11 DEBTORS

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I. Introduction

As noted by Judge Bruce Markell (Las Vegas, NV), in his article: The Sub Rosa Sub Chapter: Individual Debtors in Chapter 11 after BAPCPA, flesh and blood individuals have had a hard and rocky path in Chapter 11. The passage of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) made this already dangerous path that much more treacherous by implementing many changes to how an individual must proceed in and confirm their Chapter 11 cases.

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

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

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

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

Representing a corporation can present numerous problems for Estate Counsel, but representing individual Debtors in chapter 11 is even trickier: “The complex fiduciary duties of a chapter 11 debtor-in-possession and its counsel can become even more confused when the debtor(s)-in-possession are individuals.”

1 2007 U.Ill.L.Rev. 67 (2007) noting that until the U.S. Supreme Court decision in Toibb v. Radloff, 501 U.S. 157 (1991) there was even a serious question as to whether individuals could even file Chapter 11 cases.


4 However at least two cases, Hansen Jones & Lela P.C. v. Segal, 220 B.R. 434 (D. Utah 1998) and In re Sidco, Inc., 173 B.R. 194 (E.D. Col. 1994) have held that counsel owe duties to the Debtors-in-possession, not the estate.
Obviously, there is the metaphysical challenge of realizing that the human who hired you to file his chapter 11 petition is not your client in the bankruptcy case. Even though it’s fairly easy, at least in theory, to understand that the president of a corporation or the managing partner of a partnership is not your client when you are representing the business entity itself, it stretches the bounds of legal fiction to comprehend the difference between the Bankruptcy Estate of an individual (your client) and the individual himself (not your client).

Rapoport and Bowles at 70-71.

Two issues are critical to addressing the challenging ethical problems in individual Chapter 11 cases: (1) the individual debtor’s fiduciary duty to creditors and (2) the estate counsel duties to the client in an individual Chapter 11.5

One of the most difficult concepts Chapter 11 debtors have to grasp, when they file their bankruptcy is that they owe a fiduciary duty to their creditors 6 to act in the best interests of their bankruptcy estate. 7 Courts have universally held that individual chapter 11 debtors owe these duties just like other debtors-in-possession. 8

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

In the case of In re Bowman, 9 a Chapter 7 debtor objected to the Chapter of Trustee’s settlement of a lawsuit for an amount which would pay the debtor’s creditors in full, but not produce any distribution to the debtor. 10 The debtor exercised her right 11 to convert her case to a Chapter 11 case. The Court granted the debtor’s motion, but immediately reconverted the case to a Chapter 7 case finding the debtor’s insistence on further litigation of her claim was a violation of her fiduciary duty as a Chapter 11 debtor in possession. The Bowman court held:

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

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

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


9 181 B.R. at 836.

10 Id. at 841.

11 Id. citing In re Finney, 992 F.2d 43, 45 (4th Cir. 1993).
Likewise, in this case when Debtor must weigh whether to accept a prompt settlement that would substantially pay her creditors or to wait and gamble on a potential to receive a greater recovery, her creditors’ interests have a higher priority than the Debtor’s own; and they must take precedence. Debtor’s own statement that she “intends to proceed with litigation, through trial,” indicates her unwillingness to examine other interests above hers. But there is more to the conflict than mere unwillingness, it is an inherent conflict of interest between her duty as a fiduciary to the estate and her desire to maximize the amount of money she may recover for herself.12

In a similar fashion, the Court in In re Tel-Net Hawaii, Inc.13 removed the debtor in possession who was the corporation’s controlling shareholder due to its failure to pursue preference actions which would have increased its exposure on guaranteed debts.14 The Court found that in light of the conflicting interests of its controlling shareholder, an independent trustee had to be appointed.

Therefore, attorneys must be careful to advise potential Chapter 11 debtors of the full ramifications of a Chapter 11 filing. Further they must do this while being unable to give the individual (not in his role as debtor-in-possession) advice as to how he or she could improve their financial condition at the expense of the estate.15

III. Individual Chapter 11 and the Attorney Client Privilege

A problem which frequently arises in bankruptcy cases concerns the control of an individual’s attorney client privilege. The issue of who holds a Chapter 11 debtor’s attorney/client privilege has been often litigated16 and has been largely resolved in the area of business entities by the Supreme Court’s decision in Commodity Futures Trading Commission v. Weintraub.17 However, while the Weintraub Court held that the debtor in possession or trustee held a Chapter 11 corporate debtors’ attorney/client privilege18 and could waive it even over the objection of

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


14 Id. at 595.

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

16 See generally In re O.P.M. Leasing Services, Inc., 670 F.2d 383 (2d Cir. 1982); Citibank N.A. v. Andros, 666 F.2d 1192 (8th Cir. 1981).


18 Id. at 354.
the debtors’ pre-bankruptcy management, the Weintraub Court refused to extend its reasoning to individual debtors’ attorney/client privilege ruling:

[O]ur holding today has no bearing on the problem of individual bankruptcy, which we have no reason to address in this case. As we have stated, a corporation, as an inanimate entity, must act through agents. When the corporation is solvent, the agent that controls the corporate attorney-client privilege is the corporation’s management. Under our holding today, the power passes to the trustee because the trustee’s functions are more closely analogous to those of management outside of bankruptcy than are the functions of the debtor’s directors. An individual, in contrast, can act for himself; there is no “management” that controls a solvent individual’s attorney-client privilege. If control over that privilege passes to a trustee, it must be under some theory different from the one that we embrace in this case.[emphasis added]19

Lower courts have taken three general positions20 with regard to who holds an individual Chapter 11 debtor’s attorney/client privilege. One line of mainly older cases has held that an individual Chapter 11 debtor’s attorney/client privilege (for both pre- and post-bankruptcy periods) remains with the individual debtor and does not pass to the bankruptcy estate or a subsequently appointed trustee.21 These courts have generally held that due to the greater privacy concerns that arise when an individual holds an attorney/client privilege, there is no justification for the transfer of attorney/client privilege to either the bankruptcy estate or the individual debtor’s trustee.22

Another group of cases, led by In re Williams23, has held that the right to the attorney/client privilege does not change merely because a debtor is an individual and not a business entity.24 These cases have generally held that an individual debtor in possession must exercise its attorney/client privilege in a manner consistent with its fiduciary duty to creditors and that includes the transfer or waiver of its attorney/client privilege for the benefit of the estate.25 These courts have found that the individual Chapter 11 debtor’s attorney client privilege passes to his or her bankruptcy estate and does not remain in the hands of the individual.

19 Id. at 356-357.
23 152 B.R. 123 (Bkrtcy N.D.Tx. 1992); See also In re Smith, 24 B.R. 3 (Bankr. S.D. Fla. 1982) (Pre Weintraub).
25 Id.
The final\textsuperscript{26} and largest line of authority concerning individual Chapter 11 debtor’s attorney/client privilege has stated that courts must determine who holds the attorney/client privilege on a case by case basis by balancing the policies underlying the attorney/client privilege and the potential harm of disclosure to the individual against the trustee’s duty to maximize the value of the estate.\textsuperscript{27}

Under this line of reasoning, courts have generally determined that an individual debtor has no attorney/client privilege for any \textit{post-petition discussions} the individual has with the estate counsel, holding that the estate counsel generally cannot give individuals legal advice, in their capacity as an individual, while acting as the estate’s counsel.\textsuperscript{28} These courts have also held that pre-bankruptcy discussions with attorneys are subject to an individual attorney/client privilege.

Under all of these lines of cases, the estate’s counsel should carefully advise the individual as to who they represent in the chapter 11 (the bankruptcy estate generally) and the issues that may arise related to the individual attorney/client privilege (or lack thereof) when filing a Chapter 11 case.

\textbf{IV. Credit Counseling for Individual Chapter 11 Debtors}

Section 109 of the Bankruptcy Code establishes the criteria for becoming a debtor in a bankruptcy proceeding. Each Chapter (i.e., 7, 11, 12 or 13) has different standards for eligibility. “One of the primary amendments enacted by BAPCPA, was a new eligibility requirement for individual debtors.” \textit{In re Dixon}, 338 B.R. 383, 386 (8th Cir. BAP Mo. 2006); \textit{see} 11 U.S.C. § 109(h).

Section 109(h)(1) of the Code provides:

\begin{quote}
Subject to paragraphs (2) and (3), and notwithstanding any other provision of this section other than paragraph (4) of this subsection, an individual may not be a debtor under this title unless such individual has, during the 180-day period ending on the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by
\end{quote}

\textsuperscript{26} There is also a group of cases involving the waiver of an individual debtor’s attorney/client privilege in the context of legal malpractice claims against a debtor’s attorney. In these cases bankruptcy courts have generally held that the trustee holds and has the right to waive the attorney/client privilege for the purpose of investigating the malpractice action. \textit{See In re Bazemore}, 216 B.R. 1020 (Bankr. S.D. Ga. 1998); \textit{In re Tomarolo}, 205 B.R. 10 (Bankr. D. Mass. 1997) \textit{But see McClarty v. Gudenau}, 166 B.R. 101 (E.D. Mich. 1994) (Individual Chapter 7 debtor holds attorney/client privilege as to file involved in malpractice action).


\textsuperscript{28} \textit{See In re Bame}, 251 B.R. 367, 375-376 (Setting forth a 5 part test to see if individual received individual legal advice from estate counsel [which would be subject to the individual’s attorney client privilege] or advice as debtor in possession [which would not be subject to the individual attorney client privilege, but to the bankruptcy estate’s privilege]).
telephone or on the Internet) that outlined the opportunities for available credit
counseling and assisted such individual in performing a related budget analysis. 29

During the one year period since BAPCPA became effective, many courts have addressed
§109(h). 30

While most of the cases address the credit counseling requirement in the context of Chapters 7
and 13 cases, § 109(h) does not except Chapter 11 debtors from its requirements. 31 Chapter 11
and Chapter 12 cases have also been dismissed due to a debtor’s failure to comply with §
109(h). 32 The courts deciding these cases followed the same line of reasoning in the consumer
cases cited supra, and dismissed them because the individual debtors did not obtain proper credit
counseling. 33

The failure to obtain credit counseling is a fatal flaw unless the debtor can satisfy one of two
exceptions or an exemption in § 109(h)(2), (3) and (4), respectively. 34

These exceptions or the exemption exist if the debtor cannot complete the credit counseling
requirement because: (i) the United States Trustee has determined that the credit counseling
agencies for an entire district “are not reasonably able to provide adequate services” for the
district (11 U.S.C. § 109(h)(2)(A)); (2) the debtor is granted a temporary deferral by the court
due to exigent circumstances (11 U.S.C. § 109(h)(3)); or (3) the debtor is incapacitated, disabled,


30  See Dixon, 338 B.R. at 386 (Specifically, §109(h) states that, as a general rule, all individual debtors must
receive an appropriate briefing during the 180 days preceding the date of filing). For example, see In re Rodriguez,
336 B.R. 462, 477 (Bankr. D. Idaho 2005) (eligibility requirements of § 109(h)(1) were not met); In re Talib, 335
also In re Burrell, 339 B.R. 664, 666 (Bankr. W.D. Mich. 2006) (“To be a debtor under Title 11 an individual must
have received credit counseling within 180 days preceding the date of filing the bankruptcy petition.”) (prior to 2010
Technical Corrections Act).

31  See Dixon, 338 B.R. at 386 (“It is the clear expectation of the statute that all individual debtors receive such
a briefing prior to filing.”)(prior to 2010 Technical Corrections Act).

32  See In re Hedquist, 342 B.R. 295 (8th Cir. BAP 2006); In re Watson, 332 B.R. 740 (Bankr. E.D. Va. 2005);

33  The problem faced by debtors whose cases are dismissed involves the application of the automatic stay.
Section 362(c)(3) and (4) limit application of the automatic stay when a previous bankruptcy case was dismissed
within one year of the new filing. 11 U.S.C. § 362(c)(3) and (4). To avoid the possible inequitable result the
limitation on the automatic stay might impose on an unsuspecting debtor, bankruptcy courts have struck the case,
rather than dismissing it. See In re Elmendorf, 345 B.R. 486 (Bkrtcy. S.D. N.Y. 2006).  In Elmendorf, the
bankruptcy court struck a Chapter 7 case and two Chapter 13 cases filed before the debtors sought credit counseling.
The bankruptcy court determined it may decide, on case-by-case basis, whether to strike petitions filed in violation
of the credit counseling requirement. Id. at p. 499-500. But see In re Wilson, 346 B.R. 59 (Bankr. N.D. N.Y. 2006)
(the appropriate disposition, upon determination by bankruptcy court that debtors had not satisfied prepetition credit
counseling requirement, was to dismiss, not strike, bankruptcy case).

34  See In re Hedquist, 342 B.R. 295 (8th Cir BAP 2006) (“[T]he requirements of Section 109(h) are
mandatory; failure to meet them is a ‘fatal flaw’ rendering an individual debtor ineligible for bankruptcy relief.”).
or in active military duty in a defined combat zone (11 U.S.C. § 109(h)(4)). Subsections (h)(2) and (h)(4) are objective, so courts should have little difficulty determining whether a debtor satisfies their criteria. Subsection (h)(2) requires that the Office of the United States Trustee formally determine that credit counseling is not sufficiently available throughout the district. This occurred in areas ravaged by Hurricane Katrina. Under subsection (h)(4), the requirements for incapacity and disability are set out in the statute, and military duty in a war zone seems relatively easy to prove.

Therefore, the cases that address § 109(h) discuss the exception for exigent circumstances in §109(h)(3). Section 109(h)(3) has two subjective prongs and one objective prong. See Talib, 335 B.R. at 421. “The subjective tests require that the Court find that there are exigent circumstances that ‘merit a waiver’ … and that the Certification is ‘satisfactory to the Court.’” Id.; see also 11 U.S.C. § 109(h)(3)(A). “The objective requirement is that the Certification allege that the debtor requested credit counseling prior to the filing of the petition from an approved agency but was told that the services would not be available for more than five days subsequent to the date of the request.”

Most cases addressing §109(h)(3) were filed to prevent some imminent harm, such as a foreclosure sale. This argument is persuasive in some jurisdictions, but not others.

A further requirement is that the Court must accept the arguments in the certification. 11 U.S.C. § 109(h)(3)(C). Although this section seems to mimic the requirement that the exigent circumstances “merit waiver” in subsection (h)(3)(A), one court recognized that under general rules of statutory construction, the court must give it meaning if possible. The court, therefore, concluded that this subsection indicated Congress intended for the bankruptcy court to use its discretion when deciding issues under §109(h)(3).

It is also important to recognize that the exigency exception is only a temporary solution for the debtor. Unlike the subsection (h)(4) permanent exemption, a subsection (h)(3) exception requires credit counseling within thirty days, with one 15 day extension if allowed by the court. In Burrell, the debtor’s failure to “cure” his or her lack of credit counseling within this period appeared to have some relevance in the court’s refusal to recognize the exception.

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36 Section 109(h)(2) requires a review of the exception at least once a year. Based on information from the Office of the United States Trustee, it is understood this exception was not extended for areas affected by Hurricane Katrina when it came up for review.
40 Burrell, 339 B.R. 666-67
Recognizing that the statute makes pre-bankruptcy counseling mandatory except in the very restrictive circumstances discussed previously, the individual Chapter 11 debtors in *Hedquist* and *Watson* argued that the statute violated their constitutional right to equal protection and due process. The arguments were rejected because the credit counseling obligation did not violate any fundamental right and was not devoid of a rational justification. *Id.* In fact, the court found the requirement “was well within the policy judgment of the legislature.” *Hedquist*, 342 B.R. 300; *Watson*, 332 B.R. at 747.

Another debtor failed attempt to avoid dismissal for lack of credit counseling involved an argument of excusable neglect. The bankruptcy court discussed the requirements for excusable neglect, but would not grant relief from the dismissal order because the debtors could not prove they could satisfy the criteria of § 109(h)(3). *Id.* at 880.

The conclusion of the court in *In re Cleaver* accurately describes the conclusions of the courts addressing §109(h): “Pursuant to the newly enacted changes to the Bankruptcy Code, an individual must receive credit briefing prior to filing for bankruptcy protection, or he must submit a certification to the court describing exigent circumstances and detailing the unavailability of the credit briefing during the five days after requesting it.” Therefore, Chapter 11 attorneys must ensure compliance with these provisions to ensure that Chapter 11 will not “die” shortly after its inception.

V. Property of the Estate

Section 1115 of the Code, added by BAPCPA, radically changed the definition of what constitutes property of the estate. Its most important provision is that an individual’s “earnings from services performed” after the commencement of the case, but before the case is closed, constitute property of the estate.

11 U.S.C. § 1115 provides:

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

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

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

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

Prior to the enactment of § 1115, Courts were bitterly divided as to what portion, if any, of an individual debtor’s post-petition earnings were property of the estate under § 541. A majority of Courts held that under the earnings exception of § 541(c), post-petition earnings of a debtor were not property of the estate. However, a sizeable minority of Courts found that at least a portion of post post-petition profits generated by professionals and sole proprietors were not earnings subject to §541(a)(6) exception and therefore were property of the individual chapter 11’s bankruptcy estate.

While § 1115 resolves this split of authority, it leaves unanswered several practical questions of how an individual Chapter 11 debtor post-petition income will be treated in his or her Chapter 11.

VI. Chapter 11 personal expenses after BAPCPA.

Another issue confronting both attorney and individual chapter 11 debtors is whether an individual debtor’s “living expenses” can be paid as ordinary course of business expenses under § 363(c)(1) and § 1108 or whether notice and a hearing under § 363(b)(1) is required for living expenses to be paid.

Prior to the enactment of § 1115, few cases addressed the issue of whether a debtor had to get court approval for the payment of living expenses. Some courts which considered the question held that normal living expenses of an individual Chapter 11 debtor did not need court approval, while others indicated that some form of court approval would be necessary at least

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48 11 U.S.C. § 363(c)(1) provides: If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

49 11 U.S.C. §1108 provides: Unless the court, on request of a party in interest and after notice and a hearing, orders otherwise, the trustee may operate the debtor’s business.

50 11 U.S.C. § 363 (b)(1) provides in pertinent part that: “The Trustee, after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate.”

in cases of significant expenses.\(^5\) Indeed one early pre-BAPCPA decision *In re Vincent\(^5\)* held there was no authority for the payment of living expenses from the Chapter 11 estate for a Chapter 11 individual debtor and his family under the Bankruptcy Code. Given § 1115 and Chapter 11 debtors’ fiduciary duty to creditors, individual debtors should give serious thought to having a budget for living expenses approved by their Court in order to avoid challenges to the spending later in the case.\(^5\)

A related problem concerns what constitutes “reasonable” living expenses for purposes of § 363? For example will judges take into account the debtor’s standard of living in determining what constitutes reasonable living expenses.\(^5\) Should Courts adopt a disposable income test similar to § 1325(b) or 1129(a)(15)\(^5\) or will they impose the “minimal” standard of living tests imposed on parties seeking to discharge student loans.\(^5\) While none of these questions have clear answers, some courts will expect lower standards of living during the pendency of their Chapter 11s.\(^5\)

Finally, there is the question of whether individual Chapter 11 debtors can pay reasonable living expenses for members of their family. Consider whether a bankruptcy court would permit a corporate Chapter 11 debtor to pay the living expenses of a president’s son, brother-in-law or other relative, if they provided no value to the debtor’s estate?

\(^{52}\) See generally *In re Harp*, 166 B.R. 740, 755 – 756 (N.D. Ala 1993)(discussing violation of fiduciary duties by paying for rental of vacation homes, sponsoring a large pre-game Alabama-Auburn brunch and taking a vacation to an exclusive resort in the Netherland Antilles).


\(^{55}\) While isolated cases have approved indirectly expenditures of an affluent nature, see *In re Bradley*, 18 B.R. at 11 (refusing to impose a budget on individual Chapter 11 debtor; *In re Rodriguez*, 41 B.R. 774 (Bankr. S.D. Fla. 1984) (approving personal expenses of $7,000 per month); *In re Warner*, 141 B.R. 762 (M.D. Fl 1992)(criminal defense attorney could be paid); *In re Goldstein*, 383 B.R. 496 (Bankr. C.D. Calif 2007)(divorce counsel ok), most Courts have refused to consider status or lifestyle in determining what constitutes reasonable living expenses. See generally *In re Cardillo*, 170 B.R. 490 (Bankr. D.N.H. 1994); *In re Jones*, 55 B.R. 462 (Bankr. D. Minn. 1985); *In re Gray*, 2009 WL 2475017 (Bankr. N.D.. W.Va. 2009)(Court determined expenses for care of 15 dogs and duplication of internet and cable providers as being unreasonable.).

\(^{56}\) See generally *In re Watson*, 403 F.3d 1 (1\(^{st}\) Cir. 2005) (private school tuition not a reasonably necessary expense); *In re Gleason*, 267 B.R. 630 (Bankr. N.D. Iowa 2001) (recreation and gift expenses not reasonably necessary); *In re Dick*, 222 B.R. 189 (Bankr. D. Mass. 1998) (payment on non-income producing vacation home not a reasonably necessary expense).

\(^{57}\) See generally *In re Hornsby*, 144 F.3d 433 (6\(^{th}\) Cir. 1998); *In re Clark*, 34 B.R. 238 B.R. 238 (Bankr. N.D. Ill. 2006); *In re Southard*, 337 B.R. 416 (Bankr. M.D. Fla. 2006).

While spouses, former spouses, children of the debtor and other designated parties are entitled to first priority payments for their domestic support obligations, and Chapter 13 debtors are expressly authorized to pay for the support of their dependents in their cases, there appears to be no similar direct and expenses authorization in Chapter 11 of the Bankruptcy Code permitting an individual Chapter 11 debtor to pay for his or her family’s support from estate funds. Indeed in a pre § 1115 individual Chapter 11 case, *U.S. v. Sutton*, the Fifth Circuit overruled a lower court decision which allowed living expenses of the individual Chapter 11 debtor’s spouse and minor children to be paid from estate funds. While Courts should be able to distinguish *Sutton* on its unique facts, it does illustrate the problems with new § 1115.

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

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

For some unknown reason, BAPCPA did not make this section applicable to Chapter 11 despite the amendments to Chapter 11 that made the treatment of individuals in Chapter 11 similar to Chapters 12 and 13. Consequently individuals in Chapter 11 cases are unable to hire counsel for personal services such as criminal, divorce, exemption, discharge, or tax matters that do not benefit the estate.

**VII. Estate Exemptions of Post-Petition Earnings in Chapter 11 Cases**

An area of possible confusion concerns an individual Chapter 11 debtors’ right to claim exemptions both before and during their Chapter 11s. First, how do you claim exemptions in an

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


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

62 See *In re Meill*, 2009 WL 2253256 (Bankr. N.D. Iowa July 27, 2009) (“Only attorneys employed by Trustee under § 327 with Court approval are entitled to compensation under § 330(a), and then only to the extent that the legal services benefit the bankruptcy estate. . . . The Court may not alter the Bankruptcy Code compensation scheme through the use of § 105(a). Retainers received by Debtor's attorneys, whether in connection with the case or not, constitute property of the estate to the extent the funds have not yet been applied to pay for prepetition services as of the petition date. . . . Trustee is entitled to an accounting of retainers held in Debtor's attorney's trust accounts. She is also entitled to turnover of such funds. If funds remain unadministered at the closing of the case, or if funds revest in Debtor after confirmation of a plan, which are not otherwise obligated under the Plan, the Bankruptcy Code does not restrict Debtor from paying his attorneys with those funds.”); *In re Weaver*, 336 B.R. 115 (Bankr. W.D. Tex. 2005). *Accord In re Polishuk*, 258 B.R. 238 (Bankr. N.D. Okla. 2001)(attorney representing debtor in state court divorce action was entitled to be compensated from estate for time spent in trial of divorce action and in obtaining equitable distribution of marital property, but not for litigating child support and custody issues, given lack of any real “benefit” from such services to estate).
individual Chapter 11 case? As a Chapter 11 debtor owes a fiduciary duty to his creditors, can he or she take assets “away” from the creditors by claims of exemptions? Also would Chapter 11 debtors have a duty to oppose their claimed exemptions?

A new issue arising under the BAPCPA is whether an individual Chapter 11 debtor can exempt a portion of his post petition earnings from services performed under applicable state exemption law. For example under Kentucky law a significant portion of “disposable earnings” (which include earnings from services) are exempt from garnishment by creditors. While Kentucky law provides that this exemption does not apply to “[a]ny order of any court of bankruptcy under Chapter 13 of the Bankruptcy Code”, it apparently still applies in individual Chapter 11 cases. The question which may shortly confront Courts and debtors is whether an individual Chapter 11 debtor can use state law to exempt from estate property, some or all post petition wages. In addition, since most such laws are time period based, can those exemptions be asserted for each applicable post petition time period and if so, how can they be asserted?

VIII. Bankruptcy Code vs. the Internal Revenue Code

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

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

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

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

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

The IRS Notice also requires debtors and the estate to attach a schedule to their income tax returns allocating pre- and post-petition income. This is typically based on a simple percentage

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63 KRS 427.010.
method, but can be done in any fashion as long as the debtor and the estate are in agreement. If an agreement cannot be reached, the debtor and the trustee should seek a court determination under §505.

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

IX. Involuntary Chapter 11!?

Prior to the enactment of the BAPCPA, involuntary Chapter 11’s of individuals were legally possible but of little value as an individual’s post-petition income was not property of the estate. However, with the enactment of § 1115 post-petition income is now property of the estate. This, coupled with the liberal discovery provisions of Rule 2004, limitations our use of estate property and the debtor’s inherent fiduciary duty to creditor, involuntary Chapter 11 may become a more attractive creditor option.

By allowing an involuntary Chapter 11 against an individual, the provisions of the BAPCPA related to individual Chapter 11 may be unconstitutional as violating the Thirteenth Amendment’s prohibition against Involuntary Servitude. The Thirteenth Amendment provides:

Neither slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States, or any place subject to their jurisdiction.

Prior to the passage of the BAPCPA, the Supreme Court has found serious constitutional questions with forced assignment of future earnings, both in bankruptcy and non-bankruptcy cases. Indeed in a case involving the assignment of future wages, the Supreme Court stated:

When a person assigns future wages, he, in effect, pledges his future earning power. The power of the individual to earn a living for himself and those

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66 However, as noted by Professor Roy Warner in Garnishment, there may be constitutional limitations on the amount of post-petition income which can become estate property in an involuntary individual Chapter 11.


68 See Pollock v. Williams, 322 U.S. 4, 24 (1944) (holding states cannot “directly or indirectly command involuntary servitude, even if it was voluntarily contracted for.”); Taylor v. Ga., 315 U.S. 25, 29 (1942) holding that “peonage” is a form of involuntary servitude within the meaning of the Thirteenth Amendment); Bailey v. Ala., 219 U.S. 219, 240, 241, 243-244 (1911) (noting that the Thirteenth Amendment prohibits all kinds of “slavery,” including labor in payment of debt).
dependent upon him is in the nature of a personal liberty quite as much as, if not more than, it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern. From the viewpoint of the wage earner, there is little difference between not earning at all and earning wholly for a creditor. Pauperism may be the necessary result of either. The amount of the indebtedness, or the proportion of ages assigned, may here be small, but the principle, once established, will equally apply where both are very great. The new opportunity in life and the clear field for future effort, which it is the purpose of the Bankruptcy Act to afford the emancipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy.69

As noted by the scholarly article on this issue: Dead Man Filing Redux: Is the New Individual Chapter Eleven Unconstitutional?70, there are serious questions concerning the constitutionality of the individual Chapter 11 provisions of BAPCPA. While Congress clearly intended to make individual debtors’ post-petition earnings a required part of creditors’ potential repayment, there remains the question of whether those protections will remain.71

X. Confirmation of Individual Chapter 11s after BAPCPA.

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

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

2. Section 1129(a)(15) was added to permit confirmation of a plan notwithstanding the objection of an allowed unsecured claim so long as the individual debtor pays either property valued as of the effective date of the plan in an amount equal to the creditor’s allowed unsecured claim or the debtor distributes an amount equal to or greater than the projected disposable income of the debtor, as defined under § 1325(b)(2), during a five-year


71 See In re Clemente, 409 B.R. 288 (Bankr. D.N.J. 2009)(A voluntary filing does not waive a debtor’s Thirteenth Amendment rights. Court used its equitable powers to grant the debtor’s motion to convert eventhough a trustee had been appointed.).
period beginning on the date the first payment is due under the plan or during the period for which the plan provides payments, whichever is longer. The effect of this modification is to incorporate the Chapter 13 disposable income concept into Chapter 11 cases filed by individuals. This has been interpreted to allow the debtor to confirm a plan that is not limited by the commitment periods set forth in Chapter 13 cases. Section 1129(a)(15) refers to the projected disposable income of the debtor “during a five-year period,” and fails to establish a time period under which such money should be paid to creditors.

3. The absolute priority requirements imposed by Code § 1129(b)(2)(B)(ii) were waived by permitting a debtor to retain property included in the estate under § 1115. Although § 1115 was added by BAPCPA to include post-petition property and earnings, it also incorporates property of the estate under § 541, and accordingly it is assumed that the debtor shall be entitled to retain property under § 541 as well. A more narrow interpretation would cause this amendment to have little effect. Nevertheless, a split exists among the Bankruptcy Courts as to whether §1115 includes the broader property of the estate under §541.

A majority of the courts have adopted the narrow interpretation. Cases adopting the broader view are listed below.

4. Section 1123(a)(8) was added to allow a plan to provide for the payment of creditors through post-petition earnings from personal services performed by the debtor. As it relates to individuals, this provision likely overrules the Supreme Court decision in In re Ahlers,75 which stated that the new value exception, if it exists at all, could not be satisfied by the contribution of post-confirmation personal services (“sweat equity”) that a farmer may contribute in growing crops.

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

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72 See § 1129(a)(15).
73 See In re Ghadebo, 431 B.R. 222 (Bankr. N.D. Calif. 2010)(Plan not confirmed because bad faith, 1129(a)(15), and absolute priority rule. Court held that §1129(b)(2)(B)(ii) means that the debtor may retain only the property added to the estate by §1115 and not all property under §541. This court concluded that to rule otherwise would make the voting of unsecured creditors meaningless and is contrary to the general purpose of BAPCPA to increase payouts to creditors.). Accord In re Mullins, 435 B.R. 352 (Bankr. W.D. Vir. 2010); In re Gelin, 437 B.R. 435 (Bankr. M.D. Fla. 2010); In re Steedley, 2010 WL 3528599 (Bankr. S.D. Ga. 2010)(debtor may retain exempt property only); In re Stephens, 445 B.R. 816 (Bankr. S.D. Tex. 2011); In re Walsh, 447 B.R. 45 (Bankr. Mass 2011); In re Maharja, 449 B.R. 484 (Bankr. E.D. Vir. 2011); In re Draiman, 450 B.R. 777 (Bankr. N.D. Ill. 2011); In re Kamell, 451 B.R. 505 (Bankr. C.D. Cal. 2011); In re Lindsey, 453 B.R. 886 (Bankr. E.D. Tenn 2011); In re Borton, 2011 WL 5439285 (Bankr. Idaho 2011); In re Karlovich, 456 B.R. 677 (Bankr. S.D. Cal. 2010); In re Tucker, 2011 WL 5926757 (Bankr. Or 2011); In re Lively, 2011 WL 6936363 (Bankr. S.D. Tx 2011).
74 In re Shat, 424 B.R. 854 (Bankr. D. Nev. 2010)(holding that Congress intended to make individual Chapter 11 cases more like Chapter 13 and there is no “absolute priority rule in Chapter 13 cases). Accord In re Roedemeier, 374 B.R. 264 (Bankr. D. Kan. 2007); In re Tegeder, 369 B.R. 477 (Bankr. D. Neb. 2007); In re SPCP Group, LLC, 465 B.R. 316 (M.D. Fla. 2011); In re Friedman, 466 B.R. 471 (9th Cir. BAP 2012).
amount that such claims would have been paid if the debtor had been liquidated under Chapter 7. See § 1141(d)(5). Courts permit the debtor to close the case after the confirmation of the plan and then reopen the case when the plan is complete in order to enter the discharge order. This allows the debtor to operate during the plan without having to pay U.S. Trustee fees.

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

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

XI. Chapter 11 v. Chapter 13

The following is a comparison of the differences that now exist between Chapter 11 and Chapter 13.

A. Advantages of Chapter 11

1. No secured or unsecured claim limit for eligibility under § 109(e).

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

77 391 B.R. 287 (Bankr. E.D. N.C. 2008). See also, In re Brown, 2008 WL 4817505 (Bankr. D.D.C. 2008)(The existence of a long term debt does not prevent the debtor from filing a motion to obtain a discharge.).


79 In re Necaise, 443 B.R. 483 (Bankr. S.D. Miss. 2010).
2. The debtor does not have to have a regular income to be eligible to file.

3. The Chapter 11 filing creates a new estate that can be taxed as a separate entity under 26 U.S.C. § 1398. This may be an advantage to the individual who has capital gains upon the sale of an asset since the tax liability will be paid by the estate.

4. The value of purchase money secured claims is based on the value of the collateral and not the amount of the debt as required by the hanging paragraph following § 1325(a). See § 506(a)(2).

5. “Projected disposable income” determines the amount of funds that must be “distributed under the plan”, whereas in a Chapter 13 case the “projected disposable income” must be paid monthly during the “applicable commitment period.” See §1325(b)(1)(B) & (b)(4). Thus in a Chapter 11 case, the plan is not limited to 36-60 months.

6. “Projected disposable income” applies to the “value of the property to be distributed under the plan” in a Chapter 11 case, whereas in a Chapter 13 case the “projected disposable income” must be paid to unsecured creditors. Thus, in Chapter 11, the debtor may be able to use disposable income to pay all obligations under the plan which will include secured creditors. Compare § 1129(a)(15) with § 1325(b)(1)(B).

7. Chapter 11 debtors may not have to use the IRS standard deductions in determining “project disposable income,” even though the debtor does not pass the means test under §707(b)(2). See § 1129(a)(15). See In re Roedemeier, 374 B.R. 264 (Bankr. D. Kan. 2007).

8. There is no subsequent discharge limitation under §1141. See §1328(f).

9. Chapter 11 does not require debtors to complete an instructional course before a discharge is granted. See §1328(g)(1).

B. Advantages of Chapter 13

1. Chapter 13 is exempt from an involuntary petition under § 303(b).

2. A co-debtor stay applies in Chapter 13 cases under §1307.

3. The filing fees are significantly cheaper for Chapter 13 cases ($1039 vs $274).

4. Priority claims may be paid without interest over the term of the plan. This may be particularly beneficial if the debtor has significant domestic support obligations. Compare §1129(a)(14) with § 1322(a)(2). Additionally, under § 1322(a)(4), less than full payments of domestic support obligations that have been assigned to the government is possible if all of the debtor’s “projected disposable income” is applied to payments under the Chapter 13 plan for a five year period. No similar provision exists under Chapter 11.
5. Plan payments may be less than the “projected disposable income” over 60 months. See § 1325(b)(4). Also Chapter 13 plan payments are limited to 60 months, with the exception of long term debt payments. A similar exception does not exist in Chapter 11, and thus a long term mortgage may continue the obligation to pay “projected disposable income” until the long term debt is paid in full.

6. Debtor’s counsel may be paid for services that may not benefit the estate. See §330(a)(4)(B).

7. The Chapter 11 debtor may be classified as a “small business debtor” and will have to follow the reporting and time restrictions imposed by BAPCPA on such debtors. Unless a representative unsecured committee is active, a debtor is a "small business debtor" if the debtor has aggregate noncontingent liquidated secured and unsecured debts less than $2 million. See § 101(51C) & (51D). BAPCPA added the following:

   (i) Additional reporting and filing requirements under § 1116.
   (ii) Stricter deadlines for filing and confirming a plan under § 1121(e) and 1129(e).

8. In a Chapter 11 case, the debtor may have to get court permission to use post-petition wages to pay personal expenses. Presumably the payment of post-petition personal expenses would not be in the ordinary course of “business” under § 363(b).

9. The following debts are dischargeable:

   (i) Property settlement debts arising under a divorce decree are dischargeable. See § 523(a)(15).

   (ii) Willful and malicious injury to the property of another are dischargeable. See § 523(a)(6).

   (iii) Nonpecuniary tax penalties and debts incurred to pay a nondischargeable tax are dischargeable. See § 523(a)(7) & (a)(14), (a)(14A), (a)(14B).

   (iv) Other types of debts described in §§ 523(a)(10), (a)(11), (a)(12), (a)(16), (a)(17), (a)(18), and (a)(19).

10. The Debtor may dismiss a Chapter 13 case at any time. Compare § 1112(b) with § 1307(b). Furthermore, Chapter 13 debtors are not subject to the new standards for the appointment of a trustee or conversion or dismissal of cases under §1104 & 1112.

11. The Chapter 13 plan process is faster and cheaper. For example, no disclosure statement is required and consequently no discussion of potential tax consequences is necessary. See § 1125(a)(1).

12. A Chapter 11 plan has more confirmation requirements to satisfy under §1129(a). Further, the 11th Circuit has held that the court has an affirmative duty to ensure that
the cramdown requirements under §1129(b) are satisfied even though an objection is not filed by the non accepting class. See In re Lett, 632 F.3d 1216 (11th Cir. 2011).

13. A Chapter 13 plan can be approved without the acceptance of classes of creditors as required in Chapter 11 cases. Nevertheless, a Chapter 11 plan can be approved without satisfying § 1129(a)(15) eventhough the class of unsecured creditors voted against the plan if none of the unsecured creditors filed an objection to the Chapter 11 plan. See In re Washington, 2010 WL 1417708 (Bankr. N.D. Tex. 2010)( § 1129(a)(15) did not apply to that debtor’s plan because there were no objections to the plan.).

14. Upon conversion, the debtor is able to retain post-petition wages unless the debtor converts the case under bad faith. This also means that the liquidation value needed to confirm a Chapter 13 plan is less than in a Chapter 11 case because the debtor’s post-petition wages are included in the Chapter 7 estate if the Chapter 11 case is converted. See § 348(f).

15. Payments under a Chapter 13 plan may be reduced by the actual amount expended by the debtor to purchase reasonable and necessary health insurance for the debtor and any dependent of the debtor.

16. The U.S. Trustee, in addition to the debtor, trustee, or the holder of an allowed unsecured claim, may request that a Chapter 11 plan may be modified. Compare § 1127(e) with § 1329(a).

C. Calculation of “Projected Disposable Income”

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

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

(a) maintenance or support of the debtor or dependent,

(b) post-petition domestic support obligations;

(c) charitable contributions (not to exceed 15% of gross income of the debtor for the year in which the contributions are made); and

(d) if the debtor is engaged in business, the payment of expenditures necessary for the continuation , preservation, and operation of the business.

“Current monthly income” is to be calculated pursuant to Form B22B (copy attached), which is designed for Chapter 11 debtors. Although the purpose of the calculation is to determine “projected disposable income,” note that the “current monthly income” is a six
month average of the debtors prepetition income—thus it is not necessarily “current” or “monthly” and often will not be the “projected” income of the debtor during the term of the plan.

In Chapter 13 cases, the deductions to the “current monthly income” calculation depends on whether the debtor passes the “means test” under § 1325(b)(3) (see Form B22A attached). If the debtor passes the “means test,” the calculation is determined in accordance with the wording of paragraph 1 above as interpreted by case law. If the debtor is over the median income, the debtor must apply amounts specified under § 707(b)(2), which applies the IRS National Standards and Local Standards and the debtor’s actual monthly expenses for the Other Necessary Expense category. In summary, in Chapter 13 cases, the “reasonable necessary” calculation becomes a mathematical formula which deducts (without review for reasonableness or necessity) the amounts set forth in Form B22C, attached. Since § 1129(a)(15) only refers to the calculation of “project disposable income” in §1325(b)(2), the more objective mathematical calculation under §1325(b)(3) presumably was not intended to apply in Chapter 11 cases. The Committee Note to Form B22B supports this interpretation, and thus Form B22B does not include the mathematical calculation under § 1325(b)(3). On the other hand, an argument can be made that the IRS standards should apply because §1325(b)(3) is an extension of §1325(b)(2).