

APPENDIX Z

INDIVIDUAL CHAPTER 11 AFTER BAPCPA¹

Chapter 11 was dramatically changed by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)² in ways that make it more attractive to individual debtors. Because Chapter 11 is open to all individual debtors,³ there has always been a Chapter 11 alternative for individuals, especially those with small businesses. But for lots of good reasons—not the least of which were cost, complexity and voting by creditors—individual debtors rarely use Chapter 11 if they are also eligible for Chapter 13.⁴ Changes by BAPCPA make Chapter 11 more accessible to individual debtors and may even make Chapter 11 attractive to some individuals who are also eligible for Chapter 13. The general tenor of the BAPCPA changes was to import Chapter 13 concepts and tests into Chapter 11 cases.

The numbered paragraphs that follow are a summary of the important changes to Chapter 11 that might affect the decision whether an eligible individual will file a Chapter 11 or a Chapter 13 case. This is hardly an exhaustive discussion of the BAPCPA changes to Chapter 11. The discussion assumes some familiarity with Chapter 11 practice. This brief review suggests there will be more cross-training of debtors' and creditors' attorneys between the two chapters.

1. Section 1115 was amended by BAPCPA to redefine property of the estate in an individual Chapter 11 case along the lines of property of the estate in a Chapter 13 case under § 1306.⁵ The estate in an individual Chapter 11 case now includes all property of the kind specified in § 541 that the debtor acquires after the petition and includes “earnings from services performed by the debtor after the commencement of the case.”⁶ This change extends the automatic stay in Chapter 11 cases to an individual debtor's postpetition earnings and subjects those earnings to the various tests for confirmation of a Chapter 11 plan.

2. Section 1123(a)(8)—added to the mandatory contents of a Chapter 11 plan—was amended to resemble § 1322(a)(1):⁷

in a case in which the debtor is an individual, provide for the payment to creditors under the plan of all or such portion of earnings from personal services performed by the debtor after the commencement of the case or other future income of the debtor as is necessary for the execution of the plan.⁸

As always in Chapter 13 cases, § 1123(a)(8) now contemplates that a Chapter 11 plan can be funded from postpetition earnings with the important limitation that only the portion of the debtor's postpetition earnings that is necessary for execution of the plan shall be committed to creditors.

3. Before BAPCPA, a major obstacle to Chapter 11 reorganization for individual debtors was the voting rights of impaired classes. Oversimplified, if an impaired class of unsecured claims did not vote to accept the debtor’s plan, the plan could still be confirmed only if the requirements for “cramdown” were met. A class of unsecured claims could be crammed down over its rejecting vote only if the plan did not “discriminate unfairly and no junior holder of a claim or interest received or retained any property under the plan.”⁹ This last requirement—sometimes called the absolute priorities rule—had an exception or corollary known as the “new value corollary,”¹⁰ which, in so many words, allowed a Chapter 11 debtor to retain property of the estate under a plan if the debtor made a new and substantial contribution in money or money’s worth “reasonably equivalent” to the interest received or retained under the plan.

Many individual Chapter 11 debtors—especially those who own and live out of a family business—simply don’t have unencumbered assets or sources of new capital to satisfy the new value corollary. Absent a consenting vote from unsecured claim holders, individual Chapter 11 debtors rarely could fund a successful cramdown.

BAPCPA changed all of this by several related amendments. Section 1129(b)—the conditions for cramdown of a Chapter 11 plan—was amended to create a statutory exception to the absolute priorities rule: “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)[(15)]¹¹ of this section.”¹² BAPCPA then added a new subparagraph (15) to § 1129(a):

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

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

(B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.¹³

Section 1129(a)(15) is familiar to Chapter 13 practitioners because it is similar to the disposable income test in § 1325(b).¹⁴

Two important things to notice about this new exception to the absolute priorities rule in individual Chapter 11 cases. First, the cross-reference in § 1129(a)(15)(B) only captures the § 1325(b)(2) part of the disposable income test. Detailed elsewhere,¹⁵ the part of the disposable income test that resides in § 1325(b)(2) is the version that applies to debtors with current monthly income (CMI) less than applicable median family income. Section 1325(b)(2) is self-contained and does not further incorporate the over-median-income-debtor version of the disposable income test found in § 1325(b)(3).¹⁶

Second, pay careful attention to the wording of new § 1129(a)(15)(B): the section does not say that projected disposable income (as defined in § 1325(b)(2)) must be paid to unsecured creditors or committed to funding the plan as is required in Chapter 13 cases by § 1325(b)(1)(B); instead, § 1129(a)(15)(B) requires that “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 § 1325(b)(2)). Put another way, the absolute priorities rule can be satisfied in an individual Chapter 11 case if unsecured creditors will receive property under the plan that has value not less than the projected disposable income of the debtor without regard to whether the property distributed actually is the debtor's future income. Because the calculation of disposable income in § 1325(b)(2) starts with "current monthly income,"¹⁷ the minimum required distribution to satisfy the absolute priorities rule in an individual Chapter 11 case will be based on the debtor's historical income during the six months before the petition.

4. Section 1141(d)(5) is amended by BAPCPA to delay entry of discharge in an individual Chapter 11 case until completion of all payments under the plan. Curiously, the bankruptcy court can "order[] otherwise for cause"¹⁸—at least opening the door to discharge in an individual Chapter 11 case before the completion of payments under the plan. BAPCPA also added a new § 1141(d)(5)(B), which permits discharge before completion of payments under conditions similar to "hardship discharge" in a Chapter 13 case under § 1328(b)¹⁹ except there is no requirement in § 1141(d)(5)(B) that the failure to complete payments under the plan is due to circumstances for which the debtor should not justly be held accountable.²⁰

5. BAPCPA also added a new subsection (e) to § 1127 to permit modification of a confirmed individual Chapter 11 plan, even after substantial consummation, for purposes similar to § 1329(a) prior to BAPCPA.²¹

There is much to chew on in the BAPCPA amendments to Chapter 11 with respect to individual debtors. An individual Chapter 11 case was remade to look more like a Chapter 13 case. Modified versions of several Chapter 13 confirmation tests were substituted for more onerous provisions of former Chapter 11.

There are still important differences between the two chapters. An individual debtor eligible for either Chapter 11 or Chapter 13 should consider the following:

- 1.** An individual Chapter 11 debtor has to generate a disclosure statement and wade through the solicitation and voting process. These undertakings are time consuming and expensive. The new exception to the absolute priorities rule and other provisions discussed above are likely to generate controversy and potentially expensive litigation. Individual debtors contemplating a Chapter 11 filing have to be prepared for substantially higher professional fees and longer time getting to confirmation.
- 2.** There is no codebtor stay in Chapter 11 like the § 1301 codebtor stay in a Chapter 13 case.²² The separate classification of co-signed consumer debts that is authorized in a Chapter 13 case by § 1322(b)(1)²³ has no counterpart in Chapter 11.
- 3.** Filing a Chapter 11 case may avoid the strange new valuation rules in § 506(a)(2)²⁴ and the even stranger new treatment of some car liens and other secured debts in the hanging sentence at the end of § 1325(a),²⁵ but aggressive use of an individual Chapter 11 case to realize lower valuations for personal property is almost certain to be a magnet for litigation.

4. Pension loans cannot be materially altered in a Chapter 13 case and repayment of a pension loan is excluded from the disposable income calculation only in a Chapter 13 case.²⁶ Debtors who cannot pay all unsecured claims in full who have a pension loan may find Chapter 13 more hospitable than Chapter 11.
5. The filing fee for a Chapter 11 case starts at \$1,167 and then there are quarterly fees to the U.S. trustee. The filing fee for a Chapter 13 case is \$235.
6. Although there is less “super discharge” in a Chapter 13 case after BAPCPA,²⁷ the discharge at the completion of payments in a Chapter 13 case is still broader than the discharge available to an individual debtor in a Chapter 11 case. An individual with debts for property damage as a result of willful and malicious misconduct²⁸ or an individual owing domestic nonsupport of the sort described in § 523(a)(15)²⁹ will be better off at discharge in a Chapter 13 case at the completion of payments under § 1328(a) than at discharge in a Chapter 11 case under § 1141(d)(2).³⁰

¹ Many thanks to Sally Neely of Sidley, Austin, Brown & Wood in Los Angeles, California, for sharing her research and ideas on how BAPCPA changed Chapter 11 for individual debtors.

² Pub. L. No. 109-8, 119 Stat. 23 (2005).

³ See *Toibb v. Radloff*, 501 U.S. 157, 111 S. Ct. 2197, 115 L. Ed. 2d 145 (June 13, 1991) (Even individuals not engaged in business are eligible for Chapter 11 relief.). See also § 5-13.5.

⁴ See § 5-13.5.

⁵ See §§ 45.1–47.8 and 403.1.

⁶ 11 U.S.C. § 1115(a)(1), (2).

⁷ 11 U.S.C. § 1322(a)(1) is discussed in § 203.3.

⁸ 11 U.S.C. § 1123(a)(8).

⁹ 11 U.S.C. § 1129(a)(8), (b)(1), (b)(2)(B).

¹⁰ See *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 60 S. Ct. 1, 84 L. Ed. 110 (Nov. 6, 1939).

¹¹ This cross-reference in § 321 of S. 256 reads “(a)(14).” New 11 U.S.C. § 1129(a)(14) addresses the payment of domestic support obligations in a Chapter 11 case and made little sense as a cross-reference in this new exception to the absolute priorities rule. It seems likely that (a)(14) was a mistake and should be a cross-reference to § 1129(a)(15).

¹² 11 U.S.C. § 1129(b)(2)(B)(ii).

¹³ 11 U.S.C. § 1129(a)(15).

¹⁴ See §§ 163.1–168.1 and 466.1–492.1.

¹⁵ See § 470.1.

¹⁶ See §§ 471.1–487.1.

¹⁷ See 11 U.S.C. § 101(10A), discussed in §§ 379.1 and 468.1.

¹⁸ 11 U.S.C. § 1141(d)(5)(A).

¹⁹ See §§ 352.1–354.1.

²⁰ See 11 U.S.C. § 1328(b)(1), discussed in § 353.1.

²¹ See §§ 253.1–268.1.

²² See §§ **84.1–90.1**.

²³ See §§ **149.1** and **150.1**.

²⁴ See § **450.1**.

²⁵ See § **451.1**.

²⁶ See 11 U.S.C. § 1322(f), discussed in § **491.1**.

²⁷ See §§ **548.1–556.1**.

²⁸ Compare 11 U.S.C. § 523(a)(6) (applicable at discharge in an individual Chapter 11 case) and 11 U.S.C. § 1328(a)(4) (applicable at discharge in a Chapter 13 case). See § **554.1**.

²⁹ See 11 U.S.C. § 523(a)(15) (applicable at discharge in a Chapter 11 case but not applicable at discharge in a Chapter 13 case at the completion of payments under the plan).

³⁰ 11 U.S.C. § 1141(d)(2) provides: “A discharge under this chapter does not discharge a debtor who is an individual from any debt excepted from discharge under section 523 of this title.”