

LECTURE ON TREATMENT OF INDIVIDUAL CHAPTER 11 BANKRUPTCIES

What is an individual Chapter 11 Debtor to do?

1. Similarities to Chapter 13.

- (a) The plan may not modify claims secured by debtor's personal residence except to cure defaults and reinstate its maturity (11 U.S.C. § 1123(b)(5) and 11 U.S.C § 1124(b)). The debtor may be required to commit disposable income over a maximum of five years in a Chapter 11 only if an unsecured creditor votes against the plan (11 U.S.C § 1129(a)(15)).

2. Differences.

- (a) All priority claims other than tax claims must be paid on the effective date of the plan.

3. Tax Differences.

- (a) There is a new taxable entity. The debtor's estate, not the individual debtor will incur tax liability at "married filing separately rates."

4. Amendments Applicable to all Individual Cases.

- (a) Domestic Support Obligations.
 - (i) Must provide notices regarding DSO Obligations 11 U.S.C. § 1106(A)(8).
 - (ii) DSO Obligations must be paid on the effective date of the plan.

5. Amendments Only Applicable to Chapter 11 Debtors.

- (a) 11 U.S.C. § 1115(a)(1), provides that any property specified in 11 U.S.C. § 541, after commencement of the case is property of the estate.
 - (i) In a conversion to a Chapter 7, that property is property of the Chapter 11 estate. A Chapter 13 debtor will be able to retain post-petition property upon conversion to Chapter 7.
- (b) Post-Petition earnings are property of the estate and 11 U.S.C. § 348(F) doesn't exclude them from a Chapter 7 estate upon conversion.

- (c) Authorities say that the plan must propose that the estate pay the individual Chapter 11 administrative expenses as part of its post-petition earnings. This has not been insisted upon so far.
- (d) Can the Court be induced to order that the individual debtor be limited to living expenses based on the Chapter 7 and Chapter 13 mean test standards?
- (e) A Chapter 11 individual debtor may ask the Court to use post-petition earnings to pay post-petition personal expenses in 11 U.S.C. § 363(b) not in the ordinary course of business (handled in 11 U.S.C. § 363(c) motion in any event).

6. Post-Petition Property of the Estate.

- (a) After acquired property as property of the estate under 11 U.S.C. § 1115(a)(1), debtor, unlike a Chapter 13 debtor, will be unable to retain post-petition property in a conversion.
- (b) Post-Petition property must be taken into account and in the best interests test.
- (c) Post-Petition earnings are property of the estate under 11 U.S.C. § 1115(a)(2)

Issue 1

- (i) Whether a Chapter 11 individual debtor is limited to means test for personal expenses?

Issue 2

- (ii) Does an individual Chapter 11 need to obtain court approval for payment of personal expenses?

- (d) The requirement under 11 U.S.C. § 1129(A)(15), that if one unsecured claimant objects, the disposable income test takes into effect. This means that it doesn't make any difference if a class of unsecured claims does not vote in favor of the plan. The absolute priority rule does not apply.
- (e) The only problem is that disposable income is required to be contributed to the plan. It doesn't mean that it must be contributed to the class of the unsecured creditors like in a Chapter 13.

Is this a boon for an administrative claim for debtor lawyers?

- (f) Post-confirmation modification.

- (g) New discharge rules.
- (h) The disposable income issue. What is the amount and what is the length of time? Do you follow Chapter 13 cases? What if there is no disposable income? Should projections be the basis of the feasibility of the plan and as the basis for establishing disposable income?

7. Closing a Chapter 11 Case.

- (a) Differences in prior law.
- (b) UST issue.
- (c) The dischargeability issue.
- (d) Has the estate been fully administered issue?

8. Example for Analysis.

Facts Scenario.

Debtor owns a number of residential and one commercial investment property. Debtor has three separate major lenders. Debtor also has a number of second mortgages on a number of different properties. One secondary lender is completely unsecured based upon valuation. The other secondary lender may be fully secured on a non-liquidation basis. Debtor can prove, on a liquidation basis, that the unsecured creditors get zero.

All three of debtor's lenders will approve the plan. The unsecured creditors committee will recommend not approving the plan, and has contemplated that at least one, if not more, unsecured creditors will vote against the plan.

Debtor's projections show minimum disposable income after business expenses and reasonable personal expenses. Debtor can only project three years forward because all of his loans mature at the latest of three years after the effective date of the plan.

At the hearing, debtor will show as follows:

1. That each mortgage on each of debtor's properties is one claim, even though two of the three lenders have loans out to more than one property. The debtor argues that this is being done to avoid unintentional cross-collateralization. The unsecured creditors committee objects. What is outcome?
2. The debtor proposes that disposable income will be permitted to the plan over five years but can only project three years forward.

The unsecured creditors committee maintains that personal expenses must utilize Chapter 7/13 means test guidelines.

3. Debtor maintains that unsecured creditors get nothing on liquidation. Debtor will bring in property appraisers to show that in this market, properties are worth 25-30% less on liquidation of fair-market values. The committee objects without proof.
4. Debtor claims that he will give a fully secured lender on a non-liquidation basis with blanket second mortgages by paying contract interest only payments for three years on a debt of approximately \$38,000.00. What are the issues and does the plan get confirmed?