

Individuals in Chapter 11 of the Bankruptcy Code

Pilot Study Final Report

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Introduction

Prior empirical research has taught us a great deal about individuals who file under Chapters 7 and 13 of the Bankruptcy Code¹ and corporations that file under Chapter 11,² but we know relatively little about individuals who file under Chapter 11³—beginning with the rather startling fact that one-third of all Chapter 11 cases

¹ See, e.g., D. STANLEY & M. GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* 94 (1971); TERESA SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *AS WE FORGIVE OUR DEBTORS* (1989) [hereinafter “As We Forgive”]; TERESA SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT* (2000) [hereinafter “Fragile Middle Class”]; Robert Lawless, et al, *Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors*, 82 AM. BANKR. L.J. 349 (2008); Scott F. Norberg & Andrew J. Velkey, *Debtor Discharge and Creditor Repayment in Chapter 13*, 39 Creighton L. Rev. 473 (2006); Scott F. Norberg, *Consumer Bankruptcy’s New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415. See Robert M. Lawless & Elizabeth Warren, *The Myth of the Disappearing Business Bankruptcy*, 93 CAL. L. REV. 743 (2005).

² Arturo Bris, et al., *The Costs of Bankruptcy: Chapter 7 Liquidation versus Chapter 11 Reorganization*, 61 J. FIN. 1253 (2006)); LYNN LoPUCKI, *COURTING FAILURE* (2006). [haven’t figured out where else to put these cites] See, e.g., Edward R. Morrison, *Bankruptcy Decision Making: An Empirical Study of Continuation Bias in Small-Business Bankruptcies*, 50 J.L & ECON. 381 (2007) [hereinafter, “Bankruptcy Decision-Making”]; Edward R. Morrison, *Bargaining Around Bankruptcy: Small Business Workouts and State Law*, 38 J. LEGAL STUD. 255 (2009) [hereinafter, “Small Business Workouts”]; See Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603 (2009) [hereinafter “Success of Chapter 11”].

³ Professors Warren & Westbrook report some facts about individuals in Chapter 11 in two of their prior studies, but their focus was on business bankruptcy more generally. See Elizabeth Warren &

are filed by individuals.⁴ This study is intended to fill the gap in our knowledge about individual Chapter 11 cases.

Individual Chapter 11 cases inhabit a borderland between corporate bankruptcies and standard consumer bankruptcies. The debtors are individuals, but they are much more likely to operate a business than are individuals in Chapters 7 and 13,⁵ and they have substantially greater assets and debts.⁶ Even the rules governing an individual Chapter 11 are a blend of those applicable to more standard consumer and business bankruptcy cases. For example, there is no absolute priority rule in the more common form of individual reorganization—Chapter 13—but most courts have held the absolute priority rule applicable in Chapter 11 whether the debtor is a corporation or an individual.⁷ On the other hand, corporations in Chapter 11 receive a discharge upon confirmation of their plan of reorganization,⁸ but individuals in Chapters 11 and 13 do not receive a discharge until they have made the payments required by their plans.⁹ Because individual Chapter 11 cases inhabit this borderland, we look to the corporate and personal bankruptcy literature for informative comparison.

Jay Lawrence Westbrook, *Success of Chapter 11*, supra note 2; Elizabeth Warren & Jay Lawrence Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 AM. BANKR. L. J. 499 (1999).

⁴ See *infra* Table 1, and accompanying text.

⁵ See *infra* Section III.B.1.

⁶ See *infra* Tables 19-21, and accompanying text.

⁷ See note 77, *infra*, and accompanying text.

⁸ 11 U.S.C. § 1143(d)(1).

⁹ *Id.* at §§ 1143(d)(5), 1328. Both Chapter 11 and Chapter 13 grant the court the power to order a hardship discharge, *id.* but this power is almost never exercised. See *infra* notes Tables 7-9, and accompanying text.

The rich literature on personal bankruptcy provides many details about bankrupt debtors, and we summarize some of the main empirical findings. First, many bankrupt debtors are repeat filers, and this is especially true of those who filed under Chapter 13.¹⁰ Second, bankruptcy can cost several thousand dollars to file; nationally, the average attorneys' fees in Chapter 13 exceed \$2,500, and in some jurisdictions they approach \$5,000.¹¹ Third, most consumers have debts that are more than three times their yearly income.¹² Fourth, most bankrupt debtors are drawn from what a sociologist would characterize as the middle-class, though their incomes are much lower than those of most middle-class Americans.¹³ Fifth, about as many women as men file for bankruptcy, and some studies find that more women than men file under Chapter 13.¹⁴ Sixth although the official statistics substantially understate the importance of business debt in personal bankruptcy,¹⁵ most of the debt in personal bankruptcy was incurred for personal or household purposes.

¹⁰ See, e.g., Norberg & Velkey, *supra* note 1, at 500 (“[T]he available data indicate that, of the debtors who had filed a single previous petition, over 80% of those for whom the chapter of the previous filing is known filed the previous case under Chapter 13. Likewise, . . . of the debtors who have filed a single subsequent petition, over 75% filed the later case under Chapter 13.”).

¹¹ See Lois R. Lupica, *The Consumer Bankruptcy Fee Study: Final Report*, 20 AM. BANKR. INST. L. REV. 17 (2012).

¹² See, e.g., AS WE FORGIVE, *supra* note 1; FRAGILE MIDDLE CLASS, *supra* note 1; Lawless, et al, *supra* note 1. The self-employed have debts that are more than five times their yearly income. See ROBERT M. LAWLESS, *Striking Out on Their Own: The Self-Employed in Bankruptcy*, in KATHERINE PORTER, BROKE: HOW DEBT BANKRUPTS THE MIDDLE CLASS (2012).

¹³ *Id.*

¹⁴ See, e.g., Norberg & Velkey, *supra* note 1; Hulya Eraslan, et al, *The Anatomy of U.S. Personal Bankruptcy Under Chapter 13*, Working Paper 07-31 (September 2007).

¹⁵ See Lawless & Warren, *supra* note 1.

Many researchers believe that medical and credit card debt play an especially significant role in consumer bankruptcy.¹⁶

We do not try to replicate the surveys and massive case searches conducted in some prior projects, but our results do allow, or will allow, some comparisons. Although we need to check the filing histories of our debtors much more thoroughly, initial indications suggest that many individuals in Chapter 11 are, like other bankrupt debtors, frequent users of the bankruptcy courts. As we expected, individual Chapter 11 cases appear to be much more expensive than other individual bankruptcies. The median bill for the attorney's costs and fees in the cases we examined was over \$17,000—many times higher than the roughly \$2,500 national average for Chapter 13.¹⁷ Individuals in Chapter 11 also have dramatically higher debt to income ratios than other consumer debtors; in our sample the median ratio was nearly thirteen.¹⁸ As one would expect, individuals in Chapter 11 have much higher household incomes than individuals in Chapters 7 or 13,¹⁹ but their debt burdens are much larger, and more of their debt derives from some form of business or investment. Real estate debt plays a particularly prominent role, though this is perhaps due to the fact that we examined bankruptcies filed in 2010. Finally, we find that women account for a much smaller proportion of Chapter 11

¹⁶ See, e.g., RONALD MANN, CHARGING AHEAD (2007); Melissa Jacoby, et al, *Rethinking the Debates Over Health Care Financing: Evidence from the Bankruptcy Courts*, 76 N.Y.U. L. REV. 375 (2001).

¹⁷ See Lupica, *supra* note 11.

¹⁸ See *infra* Table 19, and accompanying text.

¹⁹ See *infra* Table 17, and accompanying text.

filings—six percent, rather than the one-third other studies have found in Chapter 13 filings.²⁰

Most or all of these differences are likely due to the higher cost of filing under Chapter 11, but they are still relevant for policy. If individuals in Chapter 11 looked just like those in Chapter 13 but with slightly larger debts, it would be very hard to justify the application of different legal rules. And the rules are very different. Chapter 13 provides more rigid rules (e.g. the debtor must propose a plan within fifteen days of filing,²¹ and the plan's payments cannot extend past five years),²² active oversight by a bankruptcy trustee and (relatively) low cost. Chapter 11, on the other hand, provides much greater flexibility, relies on the initiative of the debtor-in-possession and the participation of creditors, and costs substantially more. Of course, some may believe that Chapter 13 (or a version thereof) is more appropriate for nearly all debtors who want to reorganize, and others will favor something more like Chapter 11. Still others may prefer a very different resolution mechanism.

Much of the prior empirical bankruptcy literature tries to determine whether bankruptcy's reorganization chapters are successfully serving the interests of debtors and creditors. The most common definition of success focuses on the goals of the debtor and asks whether individuals receive a discharge in Chapter 13 or whether corporations confirm a plan of reorganization in Chapter 11.²³ Neither

²⁰ See *infra* Table 12, and accompanying text.

²¹ Bankruptcy Rule 3015.

²² 11 U.S.C. § 1322(d).

²³ See, e.g., Norberg & Velkey, *supra* note 1; Warren & Westbrook, *supra* note 2.

definition is appropriate for our undertaking because, unlike corporations, individuals do not receive their discharge until their plan is completed,²⁴ and few debtors will complete their plans within the four-year window in which we observed the cases.²⁵ We instead adopt a broader definition of success to include any case in which the debtor receives a discharge or avoids conversion and dismissal for four years. Based on this definition, we find a success rate of roughly one-third or about the same success rate found in the Chapter 13 literature.²⁶ Once again, however, we are using a much broader definition of success.

While discharge or confirmation may be the best definition of success that can be implemented, the literature recites a host of problems. Chief among these is the fact that many debtors do not belong in a reorganization chapter; an efficient bankruptcy system would quickly dismiss these cases or convert them so that the estates can be liquidated.²⁷ If we follow prior studies by measuring how long it takes bankruptcy courts to dispose of the “failed” reorganizations,²⁸ the individual Chapter 11s fare less well. More concretely, we find that it takes courts significantly longer to dismiss or convert failed individual Chapter 11 cases than prior scholars

²⁴ See 11 U.S.C. § 1143

²⁵ Many of the plans that our sample debtors proposed are scheduled to last thirty years. See *infra* Section III.C.

²⁶ See, e.g., As WE FORGIVE, *supra* note 1, at 339; Michael Bork & Susan D. Tuck, *Bankruptcy Statistical Trends: Chapter 13 Dispositions* graph 1 (Admin. Office of the U.S. Courts, Working Paper No. 2, 1994); Gordon Bermant & Ed Flynn, *Measuring Projected Performance in Chapter 13: Comparisons Across the States*, AM. BANKR. INST. J., July-Aug. 2000, at 22, 22; Henry E. Hildebrand III, *Administering Chapter 13-At What Price?*, AM. BANKR. INST. J., July-Aug. 1994, at 16, 16 Norberg & Velkey, *supra* note 1, at 505; Eraslan, et al, *supra* note 14.

²⁷ See, e.g., *Bankruptcy Decision Making*, *supra* note 2; *Small Business Workouts*, *supra* note 2; Warren & Westbrook, *supra* note 2.

²⁸ *Id.*

have found when studying Chapter 13 cases or corporate Chapter 11 cases. We suspect that the reason for this is the combination of a lack of rigid timing rules, the lack of a bankruptcy trustee, and fairly low stakes that limit creditor participation. The longer delay may also be a function of the major role played by real estate debt in our sample, given our focus on bankruptcies filed in 2010.

Section I summarizes the law that governs individual Chapter 11 filings and compares it to the law governing the far more commonly used individual reorganization chapter, Chapter 13.²⁹ Sections II and III present our empirical results. We divide our results into two sections because the data comes from two different sources.

Section II analyzes data drawn from spreadsheets created by the courts themselves. These spreadsheets allowed us to gather and analyze information on a massive number of cases in this pilot study. The disadvantages of this data set are that we were limited to the variables that the courts chose to code and that we did not have data from every jurisdiction. We did have data from thirty-four jurisdictions, however, accounting for about seventy percent of all Chapter 11 filings.

Section III analyzes a much smaller data set that we created by drawing a nearly random sample of all individual Chapter 11 cases filed in the United States. Due to the limited size of this data set (this is a pilot study), our conclusions remain

²⁹ See, e.g., Bruce A. Markell, *The Sub Rosa Subchapter: Individual Debtors in Chapter 11 After BAPCPA*, 2007 U. ILL. L. REV. 27.

very tentative. Section IV focuses on the critical questions we face in designing the larger study.

I. The Law of the Individual Chapter 11

a. Eligibility and Initial Filing

Although amendments to the Bankruptcy Code in 2005 inserted several provisions from Chapter 13 into Chapter 11, often with no modification in wording,³⁰ the two chapters remain quite different. Not all of those differences are significant to our study, and we do not propose to offer a complete survey. Nevertheless, a laundry list of substantive differences is pertinent and will be the focus of this discussion.

Section 109, which sets out the requirements for who may be a debtor in bankruptcy, provides that “a person that may be a debtor under chapter 7 . . . may be a debtor under chapter 11.”³¹ Since “person is broadly defined to include “individual, partnership, and corporation,”³² it would seem self-evident that individuals are eligible for Chapter 11. Nevertheless, it required a decision from the United States Supreme Court, *Toibb v. Radloff*,³³ to make that proposition clear.

Chapter 13 carries much more restrictive eligibility requirements. It may be filed only by an individual, who in addition has regular income, and who meets fairly

³⁰ See, e.g., Charles Jordan Tabb, *THE LAW OF BANKRUPTCY* 1037 (3d. ed. 2014) (“in 2005, Congress changed several of the foregoing rules [regarding chapter 11] for *individual debtors* to bring chapter 11 more into line with chapter 13.”).

³¹ 11 U.S.C. § 109(d). Other entities are specifically excluded from eligibility to file Chapter 7 or Chapter 11, but those details are irrelevant to our study.

³² § 101(41).

³³ 501 U.S. 157 (1991).

modest debt limitations.³⁴ One of the primary reasons a particular debtor may choose Chapter 11 is that he or she wishes to reorganize but cannot meet Chapter 13's debt limits; the only other bankruptcy choice would be liquidation under Chapter 7.³⁵

Every individual who files bankruptcy, regardless of chapter, must obtain the pre-filing "briefing" mandated by § 109(f). The same is not true for the financial management course required as condition of discharge for many individuals in bankruptcy. It applies only to individual debtors in Chapters 7 and 13, but not to most individuals in Chapter 11.³⁶ The only individual Chapter 11 debtors who must complete the course, as a condition of discharge, are (perhaps) those who propose a liquidating plan.³⁷

³⁴ These debt limits are adjusted every three years, under the mandate of § 104(a). As of April 1, 2013, the debt limits under § 109(e) are \$383,175 for unsecured debts and \$1,149,525 for secured debts. Between April 1, 2010 and March 31, 2013, the debt limits were \$360,475 and \$1,081,400, respectively. Thus, the debt limits changed during the year on which this Pilot Study focused.

In addition, the categories of unsecured and secured debts may include only obligations that are noncontingent and liquidated. The debt limits remain the same if an individual files jointly with his or her spouse.

³⁵ Chapter 12 may be available if a debtor is a "family farmer or family fisherman." § 109(f). We have not tracked Chapter 12 cases.

Because individuals meeting the Chapter 13 debt limits would be expected to choose that chapter (if, for no other reason, because it is substantially less costly), we have been particularly interested in debtors meeting those limits who nonetheless elect Chapter 11.

³⁶ Completion of the financial management course is required as a condition of discharge for debtors in Chapter 7 by § 727(a)(11), and, for debtors in Chapter 13, by § 1328(g).

³⁷ Under § 1141(d)(3), confirmation of the plan does not constitute discharge if three conditions are met: the debtor's plan provides for liquidation of all or substantially all of the property of the estate; the debtor does not engage in business after plan consummation; and the debtor would have been denied a discharge under § 727(a) if the case had been filed under Chapter 7. Usually, this subsection applies to corporations, liquidating under Chapter 11, who would be denied a discharge under § 727(a)(1).

The "perhaps" in the text accounts for the possibility that § 1141(d)(3) is inapplicable to individuals in Chapter 11. The text of the section sets out an exception to discharge upon confirmation, but confirmation of an individual debtor's Chapter 11 plan does not give rise to discharge in any event. § 1141(d)(5).

Chapter 13 cases are substantially less expensive than are Chapter 11s, beginning with the filing fees. Currently, the fee for Chapter 13 is \$310, compared with \$1717 for Chapter 11 cases.³⁸ Fees are also paid to the Chapter 13 standing trustee, generally calculated as a percentage of the amount of payments under the plan.³⁹ Quarterly fees, payable to the United States Trustee in a Chapter 11 case, are based on the amount disbursed during the relevant quarter. The fees range from \$325 for disbursements up to \$14,999.99, to \$30,000 for disbursements exceeding \$30,000,000.⁴⁰ Individual Chapter 11 debtors are highly unlikely to deal with such staggering sums, of course.

Spouses may file joint bankruptcy cases.⁴¹ Official Form 1, used for the filing of a voluntary petition, provides two boxes—one for the name of the debtor and the other for the debtor’s spouse. More often than not, apparently, the husband’s name is listed first, as “debtor,” when a case is jointly filed.

In the recent past, courts often held that same-sex couples were not eligible to file jointly,⁴² even when the parties were legally married in another jurisdiction.⁴³

³⁸ The statutory filing fees for Chapters 7 and 11 are \$235 and \$1167, respectively. 28 U.S.C. § 1930(a). Administrative fees, authorized by § 1930(b) and prescribed by the Judicial Conference of the United States, add an additional \$75 and \$550 for Chapters 7 and 11, respectively. That brings the total to \$310 for Chapter 7 and \$1717 for Chapter 11.

³⁹ *Id.*, § 1930(e). The statute prescribes a cap; the actual percentage varies from jurisdiction to jurisdiction.

⁴⁰ *Id.*, § 1930(a)(6).

⁴¹ Under § 302(a), “[a] joint case under a chapter of this title is commenced by the filing . . . of a single petition . . . by an individual that may be a debtor under such chapter and such individual’s spouse.” Other cases, if sufficiently related, may be administratively consolidated. [Cite?]

⁴² *See, e.g.,* Bone v. Allen (*In re* Allen), 186 B.R. 769 (Bankr. N.D. Ga. 1995)) (holding that term “spouse” as used in Bankruptcy Code does not apply to homosexual couple, but only to those legally married—a status determined under state law; allowing 20 days to dismiss one co-debtor or suffer dismissal of entire case).

That stance has changed since the United States Supreme Court invalidated § 1 of the Defense of Marriage Act (DOMA), which defined marriage as a union of a man and a woman for purposes of federal law.⁴⁴ Although little case authority has developed since the Court’s decision, bankruptcy courts are now likely to permit joint bankruptcy filings by same-sex couples.⁴⁵ The state of this issue as of 2010—the time frame upon which this Pilot Study focused—is less certain.

b. Involuntary Cases and Constitutional Issues

Involuntary cases, although quite rare, are permitted in Chapter 11 but not Chapter 13.⁴⁶ Congress considered the possibility of permitting involuntary Chapter 13 cases while the current statute was under consideration, but the Report of the

⁴³ See, e.g., *In re Kandu*, 315 B.R. 123 (Bankr. W.D. Wash. 2004) (holding debtors, legally married in Canada, ineligible for joint bankruptcy petition). *But see* *Rabin v. Schoenmann (In re Rabin)*, 359 B.R. 242 (B.A.P. 9th Cir. 2007) (holding debtors who were registered domestic partners under California law entitled to exemption rights identical to people who are married); *In re Balas*, 449 B.R. 567 (Bankr. C.D. Cal. 2011) (permitting same-sex couple to file joint bankruptcy petition).

⁴⁴ The Court held, in *United States v. Windsor*, 133 S. Ct. 2675 (2013), that application of this provision to deny the benefit of a spousal estate tax deduction under federal law unconstitutionally deprived a surviving spouse of equal protection under the fifth amendment.

⁴⁵ The question has been squarely presented in only one case so far—*In re Matson*, 509 B.R. 860 (Bankr. E.D. Wis. 2014). In *Matson*, as in *Windsor*, the couple had been legally married in a jurisdiction recognizing same-sex marriages—Iowa and Canada, respectively. The couple in *Windsor*, however, lived in a jurisdiction that recognized same-sex marriages (New York), while the couple in *Matson* lived in a jurisdiction (Wisconsin) with a constitutional ban on the recognition of same-sex marriages. Furthermore, the *Windsor* decision did not address the constitutionality of § 2 of DOMA, which provides that no state is required to give effect to “any public act, record, or judicial proceeding respecting a relationship between persons of the same sex.” 28 U.S.C. § 1738C. The court in *Matson* noted, however, that § 2 of DOMA “applies to states; it does not apply to federal courts and certainly does not apply to this Court.” 509 B.R. at 863. Thus, the court approached the issue—the right of same-sex spouses, married in a state recognizing such unions, to file a joint bankruptcy case in a state that does not recognize their marriage—as a matter of choice of law. The court applied the well-settled rule that the validity of a marriage is governed by the law of the place it was celebrated, and held that the parties were “spouses” for purposes of the Bankruptcy Code.

This holding is consistent with the Department of Justice’s announcement that, in light of *Windsor*, same-sex couples are to be treated like heterosexual couples for purposes of bankruptcy, even when the couple is now domiciled in a state that does not recognize their marriage. http://www.justice.gov/ust/eo/public_affairs/consumer_info/index.htm (last visited 10/17-14).

⁴⁶ Section 303(a) provides that involuntary cases “may be commenced only under chapter 7 or 11.”

House Judiciary Committee foresaw constitutional problems under the thirteenth amendment⁴⁷:

As under current law, chapter 13 is completely voluntary. This Committee firmly rejected the idea of mandatory or involuntary chapter XIII in the 90th Congress. The thirteenth amendment prohibits involuntary servitude. Though it has never been tested in the wage earner plan context, it has been suggested that a mandatory chapter 13, by forcing an individual to work for creditors would violate this prohibition.⁴⁸

Since that time, courts and commentators have voiced similar concerns,⁴⁹ albeit not without dissent.⁵⁰

The issue could not be tested, of course, since involuntary Chapter 13 cases were impossible. Now, however, the 2005 Amendments have created the very statutory configuration, in Chapter 11, that was thought, decades ago, to raise thirteenth amendment problems—that is, the possibility of an involuntary case against an individual debtor who would be required to devote future income to

⁴⁷ Section 1 of that amendment provides that “[n]either slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States.”

⁴⁸ H.R. REP. No. 95-595, at 120 (1977) (footnotes omitted), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6080-81 (1977).

⁴⁹ *See, e.g., In re Nahat*, 315 B.R. 368 (Bankr. N.D. Tex. 2004); *In re Graham*, 21 B.R. 235 (Bankr. N.D. Iowa 1982); *In re Noonan*, 17 B.R. 793 (Bankr. S.D.N.Y. 1982); G. Eric Brunstad Jr., *The Inapplicability of “Means Testing” to Cases Converted to Chapter 7*, AM. BANKR. INST. J., 1, 60 (Nov. 2005). *See also In re Powell*, 187 B.R. 642, 646 (Bankr. D. Minn. 1995) (“No where is the threat of impinging upon the protection afforded by the Thirteenth Amendment to the United States Constitution more real than in the case such as this where a creditor is attempting to harness the postpetition wages of individual debtors in a Chapter 11 proceeding.”).

⁵⁰ In *In re Graham*, 21 B.R. 235 (Bankr. N.D. Iowa 1982), debtor’s ex-wife moved to convert his chapter 7 case to a chapter 11, thereby enabling unsecured creditors (including herself) to impose a repayment plan that would reach his substantial postpetition income. The court noted that converting the case would divert the fruits of the debtor’s labors to his prepetition creditors, much like a mandatory chapter 13, but thought the constitutional concerns clearly overblown: “Such a mandatory repayment scheme is so radically different in character from the slavery that the thirteenth amendment was meant to abolish . . . that the Court questions whether the framers of that amendment had the prohibition of mandatory repayment plans in mind when they drafted it.” *Id.* at 238 n.3.

repayment of prepetition debts. Several changes have produced this possibility. First, the amendments added § 1115 to the Code. It includes as property of the estate “earnings from services performed by the debtor after the commencement of the case.”⁵¹ Second, the amendments added § 1123(a)(8), requiring that an individual debtor’s Chapter 11 plan “provide for the payment to creditors . . . of all or such portion of earnings from personal services performed by the debtor after the commencement of the case . . . as is necessary for the execution of the plan.” Finally, the amendments added § 1129(a)(15)(B), which requires, as a condition for confirmation, that the debtor commit his or her “projected disposable income” for the next five years to the plan.⁵²

These new provisions operate in conjunction with preexisting Chapter 11 rules: individual Chapter 11 debtors cannot convert an involuntary case to another chapter;⁵³ Chapter 11 plans have no statutory maximum time limit⁵⁴ and can be extended on a creditor’s motion;⁵⁵ unlike in Chapter 13,⁵⁶ creditors can propose a

⁵¹ § 1115(a)(2). Postpetition earnings are part of the Chapter 13 estate under § 1306(a).

⁵² § 1123(a)(8). This subsection applies only if an unsecured creditor objects to confirmation of the plan, § 1129(a)(15). In the alternative, a debtor may pay all allowed unsecured claims in full, § 1129(a)(15)(A).

The parallel provision under Chapter 13 is § 1325(b)(1)(B), which requires that a debtor devote all projected disposable income, during the applicable commitment period, to payment of unsecured claims. This provision is triggered when the trustee or an unsecured creditor raises an objection to plan confirmation, and the debtor does not choose to repay unsecured claims in full.

⁵³ § 1112(a)(2). A Chapter 13 debtor, in contrast, may convert to Chapter 7 “at any time.” § 1307(a).

⁵⁴ § 1129(a)(15)(B). A Chapter 13 plan may be no longer than five years. § 1322(d)(1).

⁵⁵ § 1127(e)(2).

⁵⁶ Section 1321 states that “[t]he debtor shall file a plan.”

plan in chapter 11 if the debtor has not;⁵⁷ and, finally, debtors in involuntary cases do not have an absolute right to dismiss the case.⁵⁸

Taken together, these provisions allow creditors to use an involuntary Chapter 11 bankruptcy to reach a debtor's future income, rendering the constitutional question no longer theoretical.⁵⁹

c. Controlling the Case

Chapter 13 cases are administered by a "standing" trustee,⁶⁰ who is responsible for duties such as examining proofs of claim, investigating the debtor's financial affairs, and making payments to creditors in accordance with the plan. This contrasts with the usual practice in Chapter 11 cases, in which the debtor becomes a debtor-in-possession, with the rights and powers of a trustee.⁶¹ Individual Chapter 11 cases are no different, and the oversight role falls to the United States Trustee. The United States Trustee is charged with carrying out administrative responsibilities such as reviewing fee applications and

⁵⁷ § 1121(c) (permitting creditors to file a plan if the debtor fails to do so within the first 120 days of the proceeding, or if the debtor's plan fails to garner the requisite support within 180 days).

⁵⁸ § 1112(b) (requiring a showing of cause). Under § 1307(b), the bankruptcy court "shall" grant dismissal of a Chapter 13 case upon the debtor's request, unless the case has been previously converted into Chapter 13.

⁵⁹ Virtually no bankruptcy cases, at present, are filed involuntarily by creditors against debtors. David S. Kennedy, James E. Bailey, & R. Spencer Clift, *The Involuntary Bankruptcy Process: A Study Of The Relevant Statutory And Procedural Provisions And Related Matters*, 31 U. MEM. L. REV. 1, 3 (2000) ("[L]ess than 1/1000 of one percent of all bankruptcy cases filed were commenced involuntarily."). Our own numbers are consistent. See *infra* Section !!.B. The numbers will not necessarily remain so low, however, once creditors become aware of the possibilities presented by the 2005 Amendments. See Lisa M. Schiller & Craig A. Pugatch, *The Bankruptcy Strategist* (May 29, 2007), http://www.lawjournalnewletters/issues/in_bankruptcy/24_7/news/148639-1.html (last visited 3/19/08) ("In the wake of BAPCPA's implementation, the expanded remedies available to recover from a debtor's property for the benefit of the estate make involuntary petitions an increasingly attractive tool in creditors' arsenal.") Nor are constitutional violations, if such they be, made more acceptable by infrequency.

⁶⁰ § 1302.

⁶¹ § 1107.

reorganization plans.⁶² Inevitably, the United States Trustee will be more active in a Chapter 11 case, particularly one filed by an individual, than in a Chapter 13 proceeding.

A debtor-in-possession may be replaced by an appointed trustee, but only under somewhat exceptional circumstances typically involving fraud, dishonesty, incompetence or gross mismanagement by the debtor-in-possession.⁶³ Such appointments are unusual.

d. Co-debtor Stay

Chapter 13 offers a stay, during pendency of the bankruptcy proceeding, against efforts to collect a consumer debt from an individual liable with the debtor on that obligation.⁶⁴ Chapter 11 has no similar provision, leaving co-debtors—such as nonfiling spouses—vulnerable to creditors' collection actions.

Neither chapter offers protection to co-debtors when nonconsumer debts are involved.

e. Amounts Payable to Creditors

Both Chapter 11 and Chapter 13 impose means tests, but those tests operate quite differently in the two chapters. Under Chapter 13, upon an unsecured creditor's objection to the plan, the debtor must either pay that claim in full or devote all of his or her "projected disposable income," for the "applicable commitment period," to payments to unsecured creditors.⁶⁵

⁶² 28 U.S.C. § 586(a).

⁶³ § 1107(a).

⁶⁴ § 1301(a).

⁶⁵ § 1325(b)(1).

The “applicable commitment period” is either three or five years, depending on whether the debtor’s income is above or below the state median for a family of that size.⁶⁶ Above-median debtors must undertake the longer repayment period.

Determination of “disposable income” requires calculation of income and expenses, and subtraction of the latter from the former. Income is, in fact, “current monthly income” as defined in § 101(10A). It is an average of all⁶⁷ income received over the six months preceding the filing of bankruptcy. Expenses will include “amounts reasonably necessary to be expended” for the debtor and his or her dependents.⁶⁸ For above-median debtors, post-2005, allowances for expenses are governed by the means test rules applicable in Chapter 7.⁶⁹ Reasonably necessary expenses for below-median debtors are determined in accordance with judicial discretion, as was done before the 2005 amendments. In addition, the debtor may deduct domestic support obligations arising postpetition, certain charitable contributions, and expenses necessary for the operation of any business in which the debtor is engaged.⁷⁰

After determining disposable income, the court must then predict the likely state of affairs over the course of the plan. According to the Supreme Court in *Hamilton v. Lanning*,⁷¹ this “forward-looking” approach requires the bankruptcy

⁶⁶ § 1325(b)(4)(A). A debtor’s plan can be shorter than three or five years, whichever is applicable, only if the plan repays all allowed unsecured claims, in full, in the shorter period. § 1325(b)(4)(B).

⁶⁷ There are only a handful of exclusions, the most common of which is Social Security benefits. § 101(10A)(B).

⁶⁸ § 1325(a)(3).

⁶⁹ § 1325(b)(93).

⁷⁰ § 1325(b)(2).

⁷¹ 130 S. Ct. 2464 92010).

court to take into account “changes in the debtor’s income or expenses that are known or virtually certain” to occur during the plan.⁷²

The means test applicable to Chapter 11 cases is much simpler although, as under Chapter 13, its application is triggered by an unsecured creditor’s objection to plan confirmation. Such an objection gives the debtor two choices. The first, as under Chapter 13, is full payment of the objecting creditor’s claim. The second alternative, however, merely requires that the debtor apply all of his or her projected disposable income, “as defined in § 1325(b)(2),” to repayments for five years.⁷³ The cross-referenced section is the one defining “disposable income” as current monthly income minus support obligations, charitable contributions and business expenses; it does not incorporate the means test of Chapter 7.

Payments to creditors by individual debtors in Chapter 11 are substantially complicated by the absolute priority rule, which is inapplicable in Chapter 13. The rule provides that no junior class of claims or interest may receive any part of the estate, on account if its claim or interest, if a senior objecting class is not paid in full.⁷⁴ How the rule applies when the debtor is an individual was made more complicated by two amendments in 2005. First, language was added to the subsection setting out the rule: “except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under § 1115,

⁷² *Id.* at 2478.

⁷³ § 1129(a)(15).

⁷⁴ § 1129(b)(2)(B)(2)(ii).

subject to the requirements of subsection (a)(14) of this section.”⁷⁵ Second, the amendments added § 1115, which defines property of the individual debtor’s bankruptcy estate to include postpetition earnings, “in addition to the property specified in § 541.” The issue is whether “all property . . . specified in section 541” and retained by the individual Chapter 11 debtor under § 1115(a) refers to all of the property in the estate, or only to a portion of that property.

Difficulties in meshing the language of §§ 1115 and 1129 have produced two lines of authority. Courts following the so-called “broad view” conclude that § 1129(b)(2)(B)(ii) allows an individual chapter 11 debtor to retain all property included in the bankruptcy estate by § 1115—that is, not merely certain postpetition assets, but everything included in the estate under § 541.⁷⁶ This approach effectively renders the absolute priority rule inapplicable in individual Chapter 11 cases. The competing view, often labeled the “narrow view,” reflects the position of a majority of courts, as well as the view of every circuit court to have examined the question to date.⁷⁷ According to these courts, the absolute priority

⁷⁵ *Id.* One of the statutory puzzles is whether the drafters meant to cross-reference § 1129(a)(15) rather than subsection (a)(14). The latter mandates payment of postpetition domestic support obligations, as a prerequisite for plan confirmation. Subsection (a)(15), on the other hand, is the disposable income test, discussed above.

⁷⁶ *See, e.g.,* Friedman v. P+P, LLC (*In re Friedman*), 466 B.R. 471, 482 (B.A.P. 9th Cir. 2012) (“A plain reading of §§ 1129(b)(2)(B)(ii) and 1115 together mandates that the absolute priority rule is not applicable in individual chapter 11 debtor cases.”); *In re O’Neal*, 490 B.R. 837 (Bankr. W.D. Ark. 2013) (same); *In re Tucker*, 479 B.R. 873 (Bankr. D. Or. 2012) (vacating prior order denying plan confirmation, in light of *Friedman*); SPCP Group, LLC v. Biggins, 465 B.R. 316, 320-23 (M.D. Fla. 2011) (same); *In re Shat*, 424 B.R. 854 (Bankr. D. Nev. 2010) (reviewing legislative history to 2005 amendments and addition to Chapter 11 of provisions modeled on Chapter 13).

⁷⁷ *Ice House Am., LLC v. Cardin*, 751 F.3d 734 (6th Cir. 2014); *In re Lively*, 717 F.3d 406 (5th Cir. 2013); *Dill Oil Co. v. Stephens* (*In re Stephens*), 704 F.3d 1279 (10th Cir. 2013); *Maharaj v. Stubbs & Perdue, P.A.* (*In re Maharaj*), 681 F.3d 558 (4th Cir. 2012).

rule continues to apply in individual Chapter 11 cases,⁷⁸ and permits the debtor to retain only property coming into the estate postpetition.

In the absence of circuit-level authority, it is difficult to ascertain the approach followed in a particular jurisdiction. The governing approach may differ from one judge to another, even if intermediate appellate authority is available.⁷⁹

Individual debtors in Chapter 11 cases have more flexibility than debtors in Chapter 13 to modify obligations to secured creditors other than holders of residential mortgages.⁸⁰ This flexibility is three-fold. First, because a Chapter 13 plan cannot go beyond five years,⁸¹ a debtor cannot restructure a mortgage on nonresidential property in that chapter. Such a restructuring is possible in Chapter 11. Second, the infamous “hanging paragraph,” codified at the end of § 1325(a)(9), applies only in Chapter 13. Thus, individual debtors in Chapter 11 may modify secured claims even though the collateral is an automobile purchased within 910 days before filing, or is another type of collateral securing a debt incurred within a year before the petition. Finally, the strictures of § 506(a)(2), requiring that personal property collateral be valued at replacement value, apply only in Chapters 7 and 13.

⁷⁸ See also *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988).

⁷⁹ Compare *In re Arnold*, 471 B.R. 578, 590 (Bankr. C.D. Cal. 2012) (holding bankruptcy court not bound by Bankruptcy Appellate Panel’s decision in *Friedman*, which took broad view) (certified for direct appeal to Ninth Circuit but settled and appeal withdrawn); with *In re Sample*, No. 2:10-38373-DPC, 2013 WL 3759795, at *2 (Bankr. D. Ariz. July 15, 2013) (“Although this Court tends to favor the dissenting decision of Judge Jury in *Friedman* . . . this Court feels duty bound to follow the majority’s holding.”).

⁸⁰ Both Chapters 11 and 13 prohibit the modification of obligations secured only by the debtor’s principal residence. §§ 1123(b)(5) & 1322(b)(2). Because the language of these sections is identical, the Supreme Court’s holding in *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993), interpreting § 1322(b)(2), is equally applicable to the interpretation of § 1123(b)(5).

⁸¹ § 1322(d)(2) (providing that “the court may not approve a period that is longer than 5 years”).

Priority claims are treated similarly. Both chapters require that priorities be paid in full over the life of the plan.⁸² This will include domestic support obligations, which are entitled to first priority.⁸³ In Chapter 11, however, claims entitled to priority under §§ 507(a)(2) and (3), as well as claims held by a dissenting class, must be paid in full, in cash, on the effective date of the plan.⁸⁴

f. Plans

The deadline for proposing a plan in Chapter 13 is exceedingly short—within 14 days of the petition, unless extended for cause⁸⁵—and only the debtor may file it.⁸⁶ Chapter 11, by contrast, has no deadline for filing the plan,⁸⁷ and the exclusivity period will expire in 4 to 6 months from the date of filing.⁸⁸

⁸² §§ 1129(a)(9) & 1322(a)(2). In both chapters, the holder of the claim may agree to different treatment.

Section 1129(a)(9) has an apparent drafting error—it does not, by its terms, cover the requirements regarding claims entitled to priority under §§ 507(a)(9 and (10). The error first appeared when the priorities were renumbered in 1994; it was not fixed in 2010, when a parallel error in § 726(b) was rectified.

⁸³ Prepetition domestic support obligations may be paid under the plan. Postpetition DSOs, on the other hand, must be satisfied before the plan can be confirmed. § 1129(a)(14) (requiring that the debtor “has paid . . . such obligation[s] that first become payable after the date of the filing of the petition”); § 1322(b)(8) (requiring that the debtor “has paid all amounts that are required to be paid under a domestic support obligation and that first become payable after the date of the filing of the petition”).

⁸⁴ § 1129(a)(9)((A) & (B).

⁸⁵ Rule 3015(b).

⁸⁶ § 1321.

⁸⁷ The exception is in small business cases, under which the plan must be filed within 300 days of the order for relief. § 1121(e)(2).

⁸⁸ § 1121(c) (terminating the exclusivity period, regarding a debtor who is not a small business, 120 days after the order for relief, or 180 days after such order if the plan has not been accepted by an impaired class); § 1121(e) (providing a 180-day exclusivity period for small business cases, subject to extension for cause, and the 300-day rule referred to above).

Payments under a Chapter 13 plan must begin 30 days after the filing of the petition,⁸⁹ but Chapter 11 has no such deadline. It merely requires that payments begin upon the effective date of the plan, which is normally shortly after confirmation.⁹⁰ This substantial delay in the requirement for beginning payments may benefit debtors who lack the wherewithal to pay creditors at the time of filing, but who anticipate income at a later date.

g. Small Business Debtors

Chapter 11 provides special rules, often in the form of streamlining, applicable to small business debtors. These rules have no equivalents in Chapter 13.

A small business debtor is a person engaged in commercial or business activities, except the owning and operating of real estate,⁹¹ whose debts total no more than \$2,490,925,⁹² and for whom no unsecured creditors committee has been appointed.⁹³ The supervisory role of the United States Trustee is enhanced in a small business case, both at the beginning of the case and during its pendency.⁹⁴ The small business debtor may use a simplified form for its disclosure statement, and, in addition to the special deadlines already mentioned, may use a single hearing to approve the disclosure statement and to confirm the plan.⁹⁵

⁸⁹ § 1326(a)(1).

⁹⁰ Rule 3021 provides that, after plan confirmation, “distribution shall be made to creditors whose claims have been allowed.”

⁹¹ This is an important exception in the context of this study, given the number of our debtors who owned multiple pieces of real estate.

⁹² § 101(51D). The dollar limitation is subject to adjustment every 3 years, under § 104(b).

⁹³ No committee will be appointed when the court so orders, for cause, under § 1102(a)(3).

⁹⁴ See 28 U.S.C. §§ 586(a)(3)(H) & 1116.

⁹⁵ § 1125(f)(3).

h. Conversion and Dismissal

Cases are often converted from one chapter to another, but the rules differ depending upon whether conversion is sought by the debtor or by another party, and upon the chapters involved.

A debtor in Chapter 7 has an apparently-absolute right to convert to another chapter, including Chapter 11, as long as the debtor is eligible under the destination chapter.⁹⁶ This apparently absolute right is subject to two exceptions, however—one statutory and the other judicial. The statutory exception is that conversion is unavailable if the case was previously converted into Chapter 7. The judicially-created exception applies when bad faith is involved. In *Marrama v. Citizens Bank of Massachusetts*⁹⁷ the Chapter 7 debtor attempted to hide assets from the trustee. When the trustee discovered those assets, the debtor sought to prevent their loss by converting from Chapter 7 to Chapter 13. The Court denied conversion on the basis of the debtor's bad faith.

A Chapter 11 debtor may convert into either Chapter 7, 12 or 13.⁹⁸ The right to convert to Chapter 7 is absolute if the case was filed voluntarily and no trustee has been appointed. Upon the request of a party in interest, the court may convert a Chapter 11 case to Chapter 7 for cause, unless appointment of a trustee or examiner would better serve the best interest of creditors.⁹⁹ No conversion is permissible if it does not serve the best interest of creditors, the debtor or another party in interest

⁹⁶ § 706(a).

⁹⁷ 549 U.S. 365 (2007).

⁹⁸ § 1112(a) & (d).

⁹⁹ § 1112(b)(1).

established that a plan is likely to be confirmed within designated time frames, and the reason for conversion includes an act or omission by the debtor that was reasonably justified and can be cured.¹⁰⁰

Conversion from Chapter 11 to Chapter 13 is governed by different rules. Such a conversion must be requested by the debtor and must occur before discharge¹⁰¹—a provision with entirely different bite now that, post-2005, individual Chapter 11 debtors are not discharged upon confirmation of the plan.

The debtor has the right to dismiss a Chapter 13 case “at any time.”¹⁰² The only exception applies when the case was previously converted into Chapter 13 at the debtor’s request (which is, of course, the only route into that chapter). A Chapter 13 case may also be dismissed for cause, such as unreasonable delay by the debtor and the improbability of successful rehabilitation.¹⁰³ The 2005 amendments added to the list the debtor’s failure to pay a domestic support obligation that first becomes payable postpetition.¹⁰⁴ In addition, the 2005 amendments added a provision permitting dismissal (or conversion, depending on the best interests of

¹⁰⁰ § 1112(b)(2).

¹⁰¹ § 1112(d).

¹⁰² § 1307(b). This right appears to be absolute, but some debate has arisen when the debtor has sought dismissal in order to thwart a creditor’s motion to convert the case to Chapter 7. *See, e.g.,* *Jacobsen v. Moser (In re Jacobsen)*, 609 F.3d 647 (5th Cir. 2010) (following Ninth Circuit’s opinion in *Rosson v. Fitzgerald (In re Rosson)*, 545 F.3d 764 (9th Cir. 2008), and holding that *Marrama*’s rejection of absolute right to convert under § 706 applies equally to supposed absolute right to dismiss under § 1307(b)).

¹⁰³ § 1307(c).

¹⁰⁴ § 1307(c)(11).

creditors and the estate) upon the debtor's failure to file four-year's worth of tax returns,¹⁰⁵ if the United States Trustee or a party in interests so requests.¹⁰⁶

A Chapter 11 debtor does not have the right to dismiss his or her case. Rather, dismissal (or conversion) depends upon a finding of "cause," which requires determination of the best interests of the creditors and the estate. The Code includes a laundry list of possible grounds giving "cause," including the debtor's failure to file documents required by the Code, gross mismanagement, and continuing losses coupled with no reasonable likelihood of rehabilitation.¹⁰⁷ Thus, an individual Chapter 11 debtor may be unable to get out of bankruptcy, once he or she gets in.

i. Closure During Payment Period, to Avoid Fees

Chapter 11 debtors are required to pay quarterly fees to the United States Trustee for each calendar quarter during which the case remains open, and is not converted, dismissed or closed.¹⁰⁸ Thus, debtors are often interested in closing the case while making payments under the plan, subject to reopening it in order to obtain a discharge.

The Code requires that the bankruptcy court close a case that has been "fully administered,"¹⁰⁹ but it does not define that phrase. Thus, courts usually look to the 1991 Advisory Committee Notes to Rule 3022, which lists relevant factors:

¹⁰⁵ Such a filing is required by § 1308(a).

¹⁰⁶ § 1307(e).

¹⁰⁷ § 1112(d)(4).

¹⁰⁸ 28 U.S.C § 1930(a)(6). Chapter 13 debtors also face administrative costs, but those fees typically are substantially less than costs incurred in Chapter 11.

¹⁰⁹ § 350(a).

Factors that the court should consider in determining whether the estate has been fully administered include (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 or 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.¹¹⁰

Most significantly, the Notes assert that “[e]ntry of a final decree closing a chapter 11 case should not be delayed solely because the payments required by the plan have not been completed.” The United States Trustee Program has stated that it “will not object to an individual chapter 11 debtor’s request to close the case before discharge, subject to reopening for the entry of a discharge upon the completion of plan payments, if the estate has been fully administered and any trustee has been discharged.”¹¹¹ In the absence of a trustee, the question turns on whether the case has been fully administered.

The authorities appear to be divided on the propriety of this strategy, although several clearly endorse this maneuver.¹¹² Even cases denying the debtor’s motion to close the case, however, are less than categorical.¹¹³

¹¹⁰ Fed. R. Bankr. P. 3022, Advisory Committee Note (1991).

¹¹¹ Walter W. Theus, Jr., *Individual Chapter 11s: Case Closing Reconsidered*, 29 AM. BANKR. INST. J., Feb. 2010, at 1.

¹¹² *In re Necaise*, 443 B.R. 483 (Bankr. S.D. Miss. 2010) (applying factors in Advisory Committee Note); *In re Johnson*, 402 B.R. 851 (Bankr. N.D. Ind. 2009) (granting motion after all issues pertaining to plan had been resolved, and noting that fees could continue for “potentially unlimited duration” if debtor’s mortgage were paid through the plan); *In re Sheridan*, 391 B.R. 287, 290 n.2 (Bankr. E.D.N.C. 2009) (noting that most cases in Eastern District of North Carolina are closed upon substantial consummation, to be reopened—without payment of fee—for entry of discharge).

¹¹³ See *Shotkoski v. Fokkena (In re Shotkoski)*, 420 B.R. 479 (B.A.P. 8th Cir. 2009) (affirming, under abuse of discretion standard, lower court’s refusal to close debtor’s case, and asserting that other cases might come out differently upon case-by-case inquiry); *In re Belcher*, 41 B.R. 206 (Bankr. W.D. Va. 2009) (finding Advisory Committee Notes inapplicable to individual Chapter 11 cases, and

j. Plan Modification

The rules governing the modification of plans under Chapters 11 and 13 are quite similar, albeit with a few notable differences.

A Chapter 13 plan may be modified either before¹¹⁴ or after confirmation.¹¹⁵ Only the debtor may modify a plan before confirmation, but postconfirmation modifications may also be sought by the trustee or the holder of an unsecured claim. Modification after confirmation must be sought before payments are completed, and may increase or decrease payments under the plan.

Postconfirmation modifications under Chapter 11 are similar in that parties with standing include the debtor, United States Trustee, any appointed trustee, and unsecured creditors.¹¹⁶ Other similarities are that such a modification may seek to increase or decrease payments, and must be sought before the completion of payments. One significant difference, however, is that such a modification may take place even though the plan has been substantially consummated.¹¹⁷ “Substantial consummation” is defined as the transfer of all or substantially all property the plan proposed to be transferred, assumption by the debtor or its successor of the

refusing to grant motion to close case, but observing that debtor could move to modify plan if fee obligation became too burdensome).

¹¹⁴ § 1323.

¹¹⁵ § 1329.

¹¹⁶ Before 2005, only the debtor and a plan proponent had standing to seek modification of a confirmed plan. That remains the rule, post-2005, for the plan of a Chapter 11 debtor who is not an individual. The 2005 amendments expanded the list of appropriate parties, when individual Chapter 11 cases are involved.

¹¹⁷ § 1129(e). Subsection (e), which applies only in individual Chapter 11 cases, was added to the Code in 2005. Pub. L. No. 109-8, § 321(e).

business or management of plan property, and commencement of distributions under the plan.¹¹⁸

Courts have not developed standards for postconfirmation modification of an individual debtor's Chapter 11 plan, although at least one court has imported chapter 13's standard—namely, a substantial change in the debtor's income or expenses that was not anticipated at the time of confirmation.¹¹⁹

k. Discharge

One of the most important changes wrought by the 2005 amendments was to move the moment of discharge for an individual debtor from the date of confirmation to the completion of the plan.¹²⁰ An exception, however, is available “for cause.”

In ascertaining “cause,” courts generally focus on the likelihood that creditors will be paid in accordance with the plan.¹²¹ In one of the few cases finding “cause” sufficient to support early discharge,¹²² *In re Sheridan*,¹²³ the court stated the usual rule—that creditors will receive amounts promised under the plan. The necessary

¹¹⁸ § 1101(2).

¹¹⁹ *In re Mercer*, 09-04088-8-ATS, 2013 WL 6507585, at *3-4 (Bankr. E.D.N.C. Dec. 12, 2013) (applying § 1329(a)'s standard to decide whether to grant modification to individual chapter 11 debtor; rejecting arguments for “more liberal standard”).

¹²⁰ § 1141(d)(5)(A).

¹²¹ See, e.g., *In re Grogan*, BR 11-65409-FRA, 2013 WL 4854313 (Bankr. D. Or. Sept. 10, 2013) (based on totality of the circumstances, debtor must establish “ability to make plan payments with a high degree of certainty”); *In re Beyer*, 433 B.R. 884, 888 (Bankr. M.D. Fla. 2009) (requiring more than “just substantial consummation” of the plan; rather, debtor must show ability to “make all future payments with a high degree of certainty”).

¹²² For an example of a case refusing early discharge, see *In re Beyer*, 433 B.R. 884, 889 (Bankr. M.D. Fla. 2009) (holding “unknown, potential federal tax liability,” that might be incurred upon surrender of real estate collateral to secured creditors in full satisfaction of obligations, insufficient to support early discharge).

¹²³ 391 B.R. 287, 291 (Bankr. E.D.N.C. 2008).

assurance was based on the stable income of one debtor (a lawyer), and the securing of obligations to otherwise unsecured creditors by a second deed of trust against the debtors' home with equity.

On the other hand, a desire to avoid the payment of quarterly fees to the United States Trustee is not cause for early discharge.¹²⁴

II. PACER Report Data

We begin our empirical analysis with data collected from spreadsheets created by the courts themselves.¹²⁵ We collected information on all bankruptcy cases filed in 2010 for thirty-four jurisdictions. These jurisdictions together accounted for sixty percent of all bankruptcy filings and seventy-two percent of all Chapter 11 filings in the United States in that year.¹²⁶ So that we could compare individual Chapter 11 filings to somewhat similar bankruptcy cases, we retained all cases for which PACER lists either Chapter 11 or Chapter 13 as the current or previous chapter. We were limited to the variables that the courts chose to record, but these variables still allow us to draw some interesting preliminary conclusions.

When deciding on the period to study, we faced a difficult trade-off. We wanted to choose a set of cases filed sufficiently long ago that the debtors had time to receive plan approval and then make payments for a number of years. Unlike Chapter 13 plans,¹²⁷ however, Chapter 11 plans can, and do, extend well beyond five

¹²⁴ *In re Belcher*, 410 B.R. 206, 217 (Bankr. W.D. Va. 2009).

¹²⁵ PACER provides a link to present reports in spreadsheet form. We began by downloading all bankruptcy cases filed in each jurisdiction of our study during 2010. Because this data set was so massive, we dropped cases in which neither the current nor previous chapter was Chapter 11 or 13.

¹²⁶ See <http://www.uscourts.gov/Statistics/BankruptcyStatistics.aspx>.

¹²⁷ § 1322.

years.¹²⁸ Thus, we expected that few of our debtors would have completed a plan of reorganization unless we examined cases filed far in the past. If we drew a sample of cases filed too long ago, on the other hand, our results would be skewed by the financial crisis and possibly even by BAPCPA. We settled on 2010. We recognized that many of our cases would still be active, but courts would have had four years to identify and dispose of the failures. We realized that our results would be skewed by the financial crisis and real estate collapse, but we hope that this bias is less pronounced than if we had looked at 2008 or 2009. We will discuss this problem more thoroughly in Section IV.

Part A provides some basic facts about individual Chapter 11s and compares these cases to Chapter 13s and to corporate Chapter 11s. Part B asks whether creditors are forcing individuals into Chapter 11 involuntarily. Part C asks whether Chapter 11 is “successfully” serving the interests of individuals and their creditors.

A. Some Basic Facts about Individuals in Chapter 11

PACER records a case as Chapter 11 if it is currently in Chapter 11 or if it was closed in Chapter 11. We were also interested in cases filed under Chapter 11 and then later converted to another chapter, however. We therefore designated a case as *all11* if the PACER Report states that the current or previous chapter is Chapter 11.¹²⁹ Among these cases, we were interested in those filed by an individual. Table 1 lists the type of debtor for these *all11* cases as listed in the PACER Reports.

¹²⁸ See, *infra* Section III.C.

¹²⁹ This approach may miss some cases that were once in Chapter 11, if they were later converted to two other chapters. For example, we would miss a case that was filed in Chapter 11, converted to Chapter 13 and then converted to Chapter 7. We suspect that such cases are extremely rare.

Individual filings comprise roughly thirty-one percent of all Chapter 11 cases in our sample. We will sometimes compare individual Chapter 11 cases to corporate Chapter 11 cases, another 64% of the Chapter 11s. We ignored the remaining five percent of cases in which the debtor is listed as a partnership or other. It is possible that a court could consolidate a corporate bankruptcy case with an individual case, but we will have to return to this issue in Section III as this data only identifies one type of debtor for each case.

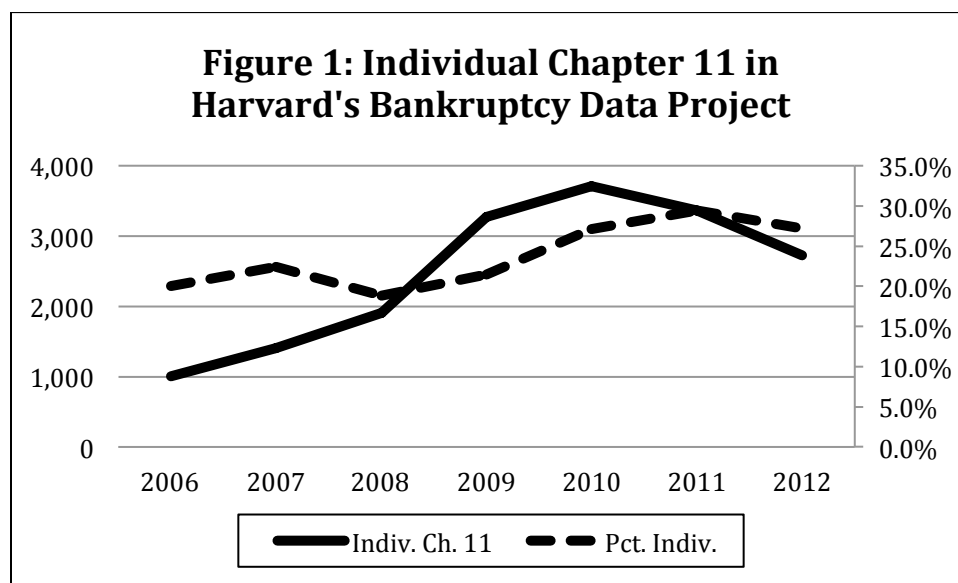
Table 1: Debtor Type for Chapter 11 Cases (*all11*)

Debtor Type	Frequency (Pct. Total)
Individual	3,312 (31%)
Corporation	6,746 (64%)
Partnership	371 (3%)
Other	189 (2%)

We are examining Chapter 11 filings from one year, 2010, and from a subset of districts. To get a sense of whether our data is representative of other districts and other years, we used Harvard’s Bankruptcy Data Project to estimate the number of individual Chapter 11 filings made across the nation in each year from 2006 to 2012, as well as the percentage of Chapter 11 petitions filed by individuals.¹³⁰ Figure 1 presents the results. The Bankruptcy Data Project’s estimate for the percent of Chapter 11 petitions filed by individuals in 2010—twenty-seven percent—is a little lower than our estimate of thirty-one percent. The difference is probably due to the fact that we are examining a subset of districts or that we are also examining cases converted into Chapter 11. Estimates from the Bankruptcy Data Project suggest that the number of individual Chapter 11 petitions rose

¹³⁰ See <http://bdp.law.harvard.edu/>.

significantly between 2006 and 2010, before falling (as did all bankruptcy filings),¹³¹ and that the percentage of Chapter 11 petitions filed by individuals rose throughout most of this period.¹³²



We will frequently compare Chapter 11 to Chapter 13, and so we constructed a similar set of all cases that are currently or have been in Chapter 13, *all13*. There is a small amount of overlap between the *all11* and *all13* cases because of conversion between the two chapters. We will come back to the issue of conversion in Part C, but Table 2 provides some summary statistics. In reading Table 2, note that we dropped all cases that have never been in Chapter 11 or 13 from our data set.

¹³¹ See, e.g., <http://www.abiworld.org/statcharts/Quarterlypersonal%20filingssthrough2Q2011.pdf>.

¹³² Coincidentally, Warren and Westbrook also found that thirty-one percent of the Chapter 11 cases in their 1994 sample were filed by individuals. See Warren & Westbrook, *supra* note 2, at 534.

Table 2: Conversion Between Chapters for Individual Bankruptcy

Converted Chapter	Initial Chapter				
	7	11	12	13	Total
7	n/a	784	n/a	29,243	30,027
11	76	n/a	1	238	315
12	n/a	1	n/a	15	16
13	3,390	37	3	n/a	3,446
No conversion	n/a	2,175 ¹³³	0	227,342 ¹³⁴	
Total	n/a	2,997	n/a	256,838	

Table 2 reveals that debtors sometimes convert from Chapter 11 to Chapter 13 and vice versa, but conversion from each chapter to Chapter 7 is far more common. Of the 2,997 cases initially filed in Chapter 11,¹³⁵ just 37 (1.2%) were converted to Chapter 13 while 784 (26.2%) were converted to Chapter 7. Similarly, of the 256,838 cases initially filed in Chapter 13, only 238 (0.1%) were converted to Chapter 11 while 29,243 (11.4%) were converted to Chapter 7. Another striking fact is that Chapter 11 cases are converted to Chapter 7 at twice the rate that Chapter 13 cases are converted to Chapter 7. We return to this fact when we discuss the “success” rate of Chapter 11 below.

Table 3 provides three pieces of information: the jurisdictions in which our cases were filed; that jurisdiction’s share of our total sample; and the percentage of Chapter 11 cases in that jurisdiction in which the debtor is an individual. Three western districts (Central District of California, Northern District of California, and

¹³³ This includes 5 cases in which Chapter 11 was listed as both the current and previous chapter.

¹³⁴ This includes 16 cases in which Chapter 13 was listed as both the current and previous chapter.

¹³⁵ We counted a case as initially filed in Chapter 11 if the previous chapter was listed as Chapter 11 or if the previous chapter was blank and the chapter was listed as Chapter 11. We had 2,997 cases “initiated” in Chapter 11. If we add the 315 cases converted into Chapter 11, this gives us the 3,312 *all11* cases disclosed in Table 1.

District of Arizona) account for over thirty-five percent of our sample, but there are significant numbers of individual Chapter 11 filings in other areas of the country, such as the Middle District of Florida and Maryland. There are extremely few individual Chapter 11 filings in some districts—notably, there were just seven such filings in Delaware. We also see dramatic variation in the share of Chapter 11 filings in which the debtor is an individual, from a low of less than one percent in Delaware to nearly two-thirds in the Northern District of California.¹³⁶

¹³⁶ The existence of substantial variation is consistent with the findings of Warren and Westbrook, *supra* note 2, at 573.

Table 3: Individual Chapter 11 Filings by District

District	Freq.	Pct. Sample	Indiv. as Pct. Ch. 11	District	Freq.	Pct. Sample	Indiv. as Pct. Ch. 11
ALND	38	1.1%	41.8%	NCED	62	1.9%	38.3%
ARWD	15	0.5%	24.2%	NE	22	0.7%	27.8%
AZ	294	8.9%	42.0%	NJ	93	2.8%	27.0%
CACD	581	17.5%	46.6%	NV	200	6.0%	40.5%
CAED	118	3.6%	48.2%	NYED	43	1.3%	15.0%
CAND	312	9.4%	65.4%	NYSD	66	2.0%	6.4%
CASD	77	2.3%	52.7%	OHND	21	0.6%	19.1%
CO	59	1.8%	30.7%	OR	26	0.8%	38.8%
CT	42	1.3%	28.2%	PRSC	60	1.8%	35.5%
DE	7	0.2%	0.9%	SC	40	1.2%	44.0%
FLMD	232	7.0%	29.1%	TNED	38	1.1%	36.5%
GAND	68	2.1%	20.4%	TNMD	94	2.8%	53.7%
ID	31	0.9%	46.3%	TXED	27	0.8%	20.0%
ILND	82	2.5%	26.0%	TXND	56	1.7%	14.0%
INSD	16	0.5%	14.0%	TXWD	67	2.0%	26.0%
MA	125	3.8%	47.2%	UT	21	0.6%	23.6%
MD	153	4.6%	48.9%	WAWD	126	3.8%	41.0%

Bankruptcy petitions ask the filer to disclose whether her debts are “primarily business debts” or “primarily consumer debts,” and the Administrative Office reports bankruptcy statistics by the debtor’s choice. According to the Administrative Office, about 86% of Chapter 11 filings made in 2010 (11,774 of 13,713) were business filings while less than one percent of Chapter 13 filings

(4,174 of 438,913) were business filings.¹³⁷ These commonly reported statistics cause us to think of Chapter 11 as business bankruptcy and Chapter 13 as consumer or non-business bankruptcy. The statistics relevant to Chapter 11 are for all Chapter 11 filings, however, not those made by individuals.

The PACER Reports we gathered also indicate whether the debtor claimed primarily business or consumer/non-business debt, and roughly forty percent of individuals in our Chapter 11 sample (1,339 of 3,312) report that their debts are primarily business-related. While this is less than the overall proportion of business filings in Chapter 11, it is still dramatically higher than the percentage of Chapter 13 filers who claim that their debts are primarily business-related; both the Administrative Office and our sample give this fraction as less than one percent.

Prior research has shown that consumers will check the box claiming primarily consumer debts with little or no thought, and that almost twenty percent of Chapter 13 filings may be business-related if one adopts a broad definition.¹³⁸ Even if we adopt this higher estimate for Chapter 13 and make no adjustments to the self-reporting of Chapter 11 debt, however, it is still true that an individual Chapter 11 case is more than twice as likely to be business-related than is a Chapter 13 case. Because there are so many more Chapter 13 filings than Chapter 11 filings, however, there are still significantly more business Chapter 13 filings, in absolute numbers, than business individual Chapter 11 filings.

¹³⁷ <http://www.uscourts.gov/Statistics/BankruptcyStatistics/12-month-period-ending-december.aspx>.

¹³⁸ See Lawless & Warren, *supra* note 1.

Table 4: Primary Nature of Debt

	Individual Chapter 11	Chapter 13
Business	1,339 (40.4%)	2,285 (0.9%)
Consumer/Non-business	1,973 (59.6%)	257,983 (99.1%)
Total	3,312	260,268

Some special procedural rules apply to small business debtors,¹³⁹ defined as someone engaged in business and who owes less than roughly two and a half million dollars in non-contingent liquidated debts.¹⁴⁰ Bankruptcy petitions contain a box indicating whether the debtor is a small business debtor,¹⁴¹ and the PACER Reports record the debtor’s answer. Table 5 presents the results broken down by debtor type. PACER did not report responses for 67.6% of the individuals who filed under Chapter 11. (Either they did not answer the question or PACER recorded some responses and not others.) A small percentage of the debtors in our study—6.3%—did state that they were small businesses. Perhaps the relative unimportance of small business debtors in individual Chapter 11 should not surprise us, given that debtors with sufficiently small debts to qualify as a small business debtor are likely to have sufficiently small debts to qualify for Chapter 13 as well.

Table 5: Small Business Debtors

	Individual	Corporation	Partnership & Other	All
Yes	208 (6.3%)	1,305 (19.3%)	89 (15.9%)	1,602 (15.1%)
No	864 (26.1%)	4,567 (67.7%)	412 (73.6%)	5,843 (55.0%)
Blank	2,240 (67.6%)	874 (13.0%)	59 (10.5%)	3,173 (29.9%)
Total	3,312	6,746	560	10,618

¹³⁹ See, e.g., 11 U.S.C. §§ 362(n), 1121(e).

¹⁴⁰ *Id.* at § 101(51C). The current dollar limit is \$2,490,425. It is adjusted periodically for inflation. § 104(a)..

¹⁴¹ The petition asks the debtor to check either “Debtor is a small business debtor as defined in 11 U.S.C. § 101(51D)” or “Debtor is not a small business debtor as defined in 11 U.S.C. § 101(51D).”

Bankruptcy petitions also contain a box that the debtor checks if he or she believes that “after any exempt property is excluded and administrative expenses paid, there will be no funds available for distribution to unsecured creditors.” The Administrative Office records such filings as “No Asset” cases, and the PACER Reports contain a field for these cases. Prior studies have found that more than ninety percent of Chapter 7 filings are no asset cases,¹⁴² but both individual Chapter 11 debtors and Chapter 13 debtors appear to be very optimistic about their ability to pay at least something to unsecured creditors. About eighty-six percent of individual Chapter 11 debtors indicated that there would be assets available for general creditors (2,837 of 3,312); about 90% of Chapter 13 debtors indicated that general creditors would receive something (233,059 of 269,268). Whether this optimism was warranted is something we cannot tell from this data, but there are good reasons to be skeptical. At least two prior studies have found that most Chapter 13 debtors pay nothing to unsecured creditors.¹⁴³

Table 6: Assets Available for General Creditors

	Chapter 11	Chapter 13
No	454 (13.7%)	27,045 (10.4%)
Yes	2,837 (85.7%)	233,059 (89.6%)
Unknown or blank	21 (0.6%)	164 (0.06%)
Total	3,312	260,268

B. Involuntary Chapter 11 Cases

¹⁴² Ed Flynn, *Chapter 7 Asset Cases and Trustee Compensation*, ABI Journal, June 2014.

¹⁴³ See Eraslan, *et al*, *supra* note 14 (studying Chapter 13 cases filed in Delaware); Norberg & Velkey, *supra* note 1, at 543.

Creditors cannot commence a Chapter 13 case with an involuntary petition.¹⁴⁴ The standard justification for this limitation is that creditors should not be able to force an individual into a bankruptcy regime that requires him or her to pay with future income.¹⁴⁵ Chapter 11 also requires the individual to devote future income to a plan,¹⁴⁶ however, and creditors can begin a Chapter 11 case involuntarily.¹⁴⁷ This fact has generated a substantial amount of criticism from scholars, including one of us.¹⁴⁸ We do not revisit this debate here. Rather, we show that the ability of a creditor to file an involuntary Chapter 11 petition against an individual likely has little or no practical significance.

According to the PACER Reports, just fourteen of the 3,312 individual Chapter 11 bankruptcies in our sample (0.4%) were started with an involuntary petition. Because there were so few involuntary petitions, we examined each one. We found only two instances that could possibly be described as situations in which the debtor was involuntarily pushed into Chapter 11, and no case in which the debtor was forced into a plan of reorganization. Three involuntary petitions were filed by mistake. Two of these were filed, and then dismissed, by debtors who were

¹⁴⁴ 11 U.S.C. § 303.

¹⁴⁵ See, e.g., Margaret Howard, *Bankruptcy Bondage*, 2009 U. Ill. L. Rev. 191; Robert J. Keach, *Dead Man Filing Redux: Is the New Individual Chapter Eleven Unconstitutional?*, 13 Am. Bankr. Inst. L. Rev. 483, 483 (2005) (“Since the passage of the 1978 Bankruptcy Code, conventional wisdom has held, as an article of faith grounded in fundamental bankruptcy policy, that a provision allowing initiation of an involuntary chapter 13 case would violate the Thirteenth Amendment’s prohibition on involuntary servitude.”).

¹⁴⁶ 11 U.S.C. § 1129(a)(15).

¹⁴⁷ 11 U.S.C. § 1129(a)(15).

¹⁴⁸ See Howard, *supra* note 145.

trying to file voluntary petitions,¹⁴⁹ and another was mistakenly filed by a bankruptcy clerk in violation of an automatic stay from another case.¹⁵⁰ One involuntary petition was transferred to another court, given a new case number, and counted as another of our involuntary bankruptcies.¹⁵¹ Six more petitions were dismissed for lack of prosecution or because the creditors moved to withdraw their petition or the debtor successfully controverted the filing; in none of them did the court enter an order for relief.¹⁵² Two more involuntary petitions were actually involuntary Chapter 7 petitions that the debtor later voluntarily converted to Chapter 11.¹⁵³

Both of the two “real” involuntary petitions in our sample led to an order for relief, but neither stayed in Chapter 11 long enough for anyone to propose a plan. In one case the debtor’s husband had voluntarily filed under Chapter 11 and the couple owned most of the relevant assets jointly. The debtor-wife consented to the filing, the cases were consolidated, and they were later converted to Chapter 7.¹⁵⁴ In the other case, an order for relief was entered after the debtor failed to respond in a timely manner. The case then lingered in bankruptcy for a few months before dismissal.¹⁵⁵

¹⁴⁹ CASD 10-18064-LT11; TXWD 10-50799-lmc

¹⁵⁰ CACD 2:10-bk-33893-RN

¹⁵¹ CACD 2:10-bk-16229-VK

¹⁵² CACD 1:10-bk-11943-GM CACD 1:10-bk-12836-GM CACD 2:10-bk-54048-SK CACD 2:10-bk-53949-ER CAND 10-30453 CAND 10-58775

¹⁵³ NY Southern District case number 10-12721-rdd and Oregon case number 10-39795-tmb11. In the Oregon case the debtor filed a voluntary Chapter 11 after the involuntary Chapter 7 petition had been filed, and the cases were later consolidated.

¹⁵⁴ MD 10-29568

¹⁵⁵ UT 10-20901

Our results should not be surprising. Even if we look at bankruptcy more broadly, involuntary petitions are exceedingly rare. In 2010, just 978 of 1,572,597 bankruptcy petitions (0.06%) were involuntary petitions.¹⁵⁶ If we look for the intersection of involuntary petitions and the almost equally rare individual Chapter 11 petitions, we are likely to find a negligible number of cases.

We have not definitively proved that the ability to file an involuntary Chapter 11 petition against an individual is a non-issue. Involuntary Chapter 11 cases may be more common in other years or in districts we did not study. Additionally, the threat of an involuntary filing may be enough to change the debtor's behavior, prompting a voluntary filing or the repayment of debts. We believe that these are unlikely possibilities, however, and that the ability to file an involuntary Chapter 11 petition against an individual debtor is not a fruitful area for future empirical research.

C. Is Chapter 11 Succeeding?

We now turn to a central question that motivates much of the empirical bankruptcy literature—whether bankruptcy successfully serves the interests of individual debtors and their creditors. Many scholars begin with a debtor-centric definition of success, such as whether the debtor receives a discharge or confirms a plan of reorganization.¹⁵⁷ Part 1 will use a modified version of this definition and ask whether individuals receive a discharge or at least avoid dismissal for several years.

¹⁵⁶ <http://www.census.gov/compendia/statab/2012/tables/12s0776.pdf>.

¹⁵⁷ See, e.g., Warren & Westbrook, *supra* note 2; Norberg & Velkey, *supra* note 1.

This definition may be the best we can implement, but it does have some fairly serious problems. First, this may not be the right measure, even from a debtor-centric viewpoint, because it may not capture the debtor's primary goals. For example, Chapter 13 is often criticized for seldom leading to a discharge,¹⁵⁸ but relatively few Chapter 13 debtors list the receipt of a discharge as their primary goal; most commonly, the primary goal is to save the debtor's home.¹⁵⁹ Therefore, some scholars argue that bankruptcy can successfully serve the debtor's interests without leading to a discharge, but others strongly disagree.¹⁶⁰ Second, a successful bankruptcy process should provide relief appropriate to a particular debtor, and this is particularly true of the reorganization chapters. An optimal bankruptcy process would quickly and accurately identify those debtors who will not be able to successfully reorganize and either dismiss or convert the case to a Chapter 7 liquidation. As a result, some scholars have measured bankruptcy's success by the length of time it takes courts to dismiss or convert failed reorganizations.¹⁶¹ Part 2 will apply a version of this definition to individual Chapter 11s.

1. Do Individuals Receive a Discharge or At Least Avoid Dismissal

The data we use in this Section II do not reveal whether the court confirmed a Chapter 11 plan, but they do record the disposition of the case. Because there may be more than one debtor, the reports contain a field for the first debtor and another

¹⁵⁸ See, e.g., Katherine Porter, *The Pretend Solution: An Empirical Study of Bankruptcy Outcomes*, 90 TEX. L. REV. 103 (2011).

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ See Morrison, *supra* note 2; Warren & Westbrook, *supra* note 2.

field for the second debtor (if any). Table 7, however, summarizes the disposition for the first debtor only.

Table 7: Chapter 11 Outcomes (Percent Excludes Procedural Outcomes)

	All Indiv. Chapter 11		Business		Non-Business	
	No.	Pct.	No.	Pct.	No.	Pct.
Standard Discharge	870	26.7%	387	30.9%	483	26.1%
Hardship Discharge	0	0.0%	0	0.0%	0	0.0%
Blank	443	13.6%	189	15.1%	254	13.7%
Discharge Not Applicable	417	12.8%	178	14.2%	239	12.9%
Total "Success"	1,730	53.0%	754	60.1%	976	52.7%
Dismissed	1,319	40.4%	422	33.7%	741	40.0%
Discharge Denied, Revoked or Withheld	208	6.4%	76	6.1%	132	7.1%
Discharge Waived	6	0.2%	2	0.2%	4	0.2%
Total "Failure"	1,533	47.0%	500	39.9%	877	47.3%
Case Transferred	48		9		5	
Other	1		0		1	
Total "Procedure"	49		9		6	
Total	3,312		1,263		1,859	

Because this part focuses on the debtor’s perspective, we count as failures all those cases that have been dismissed or in which discharge was withheld, denied or waived.¹⁶² And we omit those few cases that did not reach a substantive result because they were transferred, split, etc.

We begin with a naïve definition of success that includes debtors who received a discharge as well as cases for which the result field was left blank or coded as “Discharge Not Applicable.” Corporations receive a discharge upon confirmation of a Chapter 11 plan of reorganization, unless they are using Chapter

¹⁶² It is not worth debating whether a waived discharge is really a failure because these waivers account for a negligible percentage of the cases.

11 to liquidate.¹⁶³ By contrast, individuals do not receive a discharge in Chapter 11 until they complete their plan¹⁶⁴ unless the court orders a discharge earlier for cause (a hardship discharge).¹⁶⁵ The PACER data do not reveal any hardship discharges in Chapter 11, suggesting that debtors who are unable to complete or modify their plans of reorganization face conversion to Chapter 7 or dismissal of their cases.

Because we examined cases filed in 2010 during the summer of 2014, many cases were not yet completed. We counted open cases as successes because the debtor had avoided conversion or dismissal for approximately four years. Some of these debtors could still be trying to approve a plan, but Section III suggests that in most of the open cases the debtor is still making the payments required by a confirmed plan.¹⁶⁶ We suspected that cases in which the disposition code was blank were likely to be open cases, and we checked fifty randomly selected individual Chapter 11 cases with a blank disposition field. Forty-seven of the fifty were indeed live cases as of June 1, 2014. We could not determine the status of one of the remaining three because the docket was not available electronically. The last two cases had been administratively closed. A debtor in Chapter 11 must continue to pay trustee fees while the case is still open. In an effort to save the individual from having to pay these fees, many courts will temporarily or administratively close the case after the confirmation of the plan and then reopen the case upon completion of

¹⁶³ § 1141(d)(1), (3).

¹⁶⁴ § 1141(d)(5).

¹⁶⁵ *Id.* Conditions surrounding the hardship discharge include the requirement that unsecured creditors have received at least as much as they would have in Chapter 7.

¹⁶⁶ See *infra* Table 25, and accompanying text.

the plan so that the debtor can receive a discharge.¹⁶⁷ Courts that administratively close a case more typically code the disposition as “discharge not applicable,”¹⁶⁸ and we count this disposition as a success as well.

Table 7 also provides the outcome for business and non-business individual Chapter 11s separately. Given our current definitions, the data suggest that business cases succeed at a higher rate than non-business cases. In a future draft we could use a regression to test whether business cases are more likely to succeed after controlling for district and the type (male/female/joint) of debtor.

The most striking statistic from Table 7 is that over half of all individual Chapter 11 cases appear to be “successes.” However, this does not mean that individual Chapter 11s have a much higher success rate than the one-third success rate typically found in studies of Chapter 13¹⁶⁹ because we are using a different definition of success. First, we are counting as successes cases in which the debtor received a discharge after converting to Chapter 7, and one can reasonably argue that these cases should count as failures because the debtor could have saved time and money for herself, her creditors, and the court by starting in Chapter 7. Table 8 therefore counts all cases that convert to Chapter 7 as failures. The Individual Chapter 11 “success” rate drops to about one-third (32.5%), and cases in which the debtor has received a discharge fall to less than ten percent of the sample. Cases in

¹⁶⁷ See *supra* Section I.i.

¹⁶⁸ Judge Collins of the Bankruptcy District of Arizona first explained this coding system to us, and Nancy Dickerson, Chief Deputy Clerk of the Bankruptcy District of Arizona, confirmed this to be true. We searched twenty randomly selected individual Chapter 11 cases in which the disposition was coded as “discharge not applicable” and found just one with a disposition inconsistent with this explanation. That case was voluntarily dismissed prior to plan approval.

¹⁶⁹ See *supra* note 26.

which the debtor's debts are primarily business related still tend to succeed more often than non-business cases.

Table 8: Outcomes with Conversion to Chapter 7 as Failure

	All Individ. Chapter 11		Business		Non- Business	
	No.	Pct.	No.	Pct.	No.	Pct.
Standard Discharge	315	9.6%	164	12.5%	151	7.7%
Hardship Discharge	0	0.0%	0	0.0%	0	0.0%
Blank	331	10.1%	143	10.9%	188	9.6%
Discharge Not Applicable	414	12.7%	176	13.4%	238	12.2%
Total "Success"	1,060	32.5 %	483	36.7 %	577	29.6 %
Converted to Ch. 7	784	24.0%	307	23.3%	477	24.5%
Dismissed	1,219	37.3%	454	34.5%	765	39.3%
Discharge Denied, Revoked or Withheld	201	6.2%	72	5.5%	129	6.6%
Discharge Waived	2	0.1%	1	0.1%	1	0.1%
Total "Failure"	2,206	67.5 %	834	63.3 %	1,372	70.4 %
Case Transferred	45		22		23	
Other	1		0		1	
Total "Procedure"	46		22		24	
Total	3,312		1,339		1,973	

A second problem with comparing our results to those of the Chapter 13 scholarship is that we are counting cases as successes even if the debtor has not yet received a discharge. To see the consequence of this definition, we apply it to the Chapter 13 cases in our sample as well. Like individuals in Chapter 11, debtors in Chapter 13 do not receive a discharge until they have completed all plan payments (unless the court gives a hardship discharge),¹⁷⁰ and debtors may propose plans

¹⁷⁰ § 1328.

that last up to five years.¹⁷¹ Table 9 applies our definition of success to Chapter 13 cases (and corporate Chapter 11 cases)¹⁷² and finds a success rate of over forty percent—higher than the estimates of prior scholars.¹⁷³ Note, however, that cases in which the debtor has actually received a discharge account for just eleven percent of our cases; most of our “successes” are cases for which the PACER Reports left the disposition field blank. We used Bloomberg Law to check fifty randomly selected Chapter 13 cases in which the disposition code was blank. We could not find any that were clearly closed by June 1st, 2014, though we could not find three of the cases.

¹⁷¹ § 1322(d).

¹⁷² Comparing Chapter 11 filings for individuals and corporations is more problematic because the debtors receive discharges at very different times. The corporate results also reveal two puzzles. First, over a third of corporate filings result in “discharge not applicable,” while only two percent receive a “Standard Discharge.” Corporations that liquidate in Chapter 11 do not receive a discharge, but this cannot be the full explanation. We suspect that many corporations that receive a discharge after a confirmed plan are coded as “discharge not applicable.” Because we are not focusing on corporations in this study, however, we have yet to test this hypothesis. A second puzzle is that there are fewer cases of “standard discharge” in Table 10 than in Table 8 despite the fact that corporations are not supposed to receive discharges in Chapter 7. We checked a few of these cases, and the PACER records do seem to list a standard discharge as the outcome in Chapter 7. These cases did not appear to have individual co-debtors.

¹⁷³ See *supra* note 26.

Table 9: Outcomes of Chapter 13 and Corporate Chapter 11 Cases

	Chapter 13		Corporate Chapter 11	
	No.	Pct.	No.	Pct.
Standard Discharge	28,388	10.9%	136	2.1%
Hardship Discharge	276	0.1%	0	0.0%
Blank	84,275	32.4%	463	7.0%
Discharge Not Applicable	172	0.1%	2422	36.5%
Total "Success"	113,111	43.5%	3,021	45.6%
Converted to Chapter 7	29,251	11.3%	873	13.2%
Dismissed	116,356	44.8%	2726	41.1%
Discharge Denied, Revoked or Withheld	1,030	0.4%	7	0.1%
Discharge Waived	7	0.0%	0	0.0%
Total "Failure"	146,644	56.5%	3,606	54.4%
Case Transferred	406		110	
Other	176		9	
Total "Procedure"	582		119	
Total	260,337		6,746	

Table 10 presents a summary of the results by district as well as a success rate calculated as the ratio of the number of cases that remain open or in which the first debtor received a discharge in Chapter 11 divided by all Chapter 11 cases that did not terminate for procedural reasons. We caution against using this preliminary data to draw conclusions about the possible importance of differences between districts, such as whether the courts apply a strict absolute priority rule or whether the jurisdiction provides a model Chapter 11 form for individuals. First, many of the jurisdictions have few cases and so the success rate is measured imprecisely. Second, it is always dangerous to draw conclusions from cross-sectional data with a limited number of observations as one cannot possibly control for all of the factors that might matter. We might be able to overcome this second problem if we gather

data from multiple years. This panel approach would allow us to focus on how the success rates change when something about a jurisdiction changes. A third problem would still remain, however—we would be unable to control for selection effects. A jurisdiction might have a low success rate not because it handles the cases poorly but because it makes Chapter 11 accessible to those who have little chance of success. For example, a model Chapter 11 plan may make Chapter 11 accessible to debtors who would otherwise have filed under another chapter or avoided bankruptcy altogether. Still, it may be worth testing for a correlation between the success rate and these differences between jurisdictions in a future draft.

Table 10: Outcomes in Individual Chapter 11 Cases by District

Dist.	Disch.	Blank or Discharge Not Applicable	Dismissed or Discharge Denied, Revoked or Waived	Converted to Chapter 7	Procedure	Percent "Success"
ALN D	8	11	15	4	0	50.0%
ARW D	0	3	8	4	0	20.0%
AZ	79	90	68	50	7	58.9%
CAC D	50	87	284	144	16	24.2%
CAE D	10	19	50	38	1	24.8%
CAN D	27	45	136	102	2	23.2%
CAS D	0	11	46	20	0	14.3%
CO	9	10	19	21	0	32.2%
CT	1	11	20	8	2	30.0%
DE	0	2	2	3	0	28.6%
FLM D	28	55	120	27	2	36.1%
GAN D	1	12	31	23	1	19.4%
ID	1	14	7	8	1	50.0%
ILN D	2	13	41	25	1	18.5%
INSD	4	4	2	6	0	50.0%
MA	10	40	41	34	0	40.0%
MD	6	27	54	66	0	21.6%
NCE D	16	28	9	9	0	71.0%
NE	1	9	9	3	0	45.5%
NJ	10	7	52	24	0	18.3%
NV	10	83	83	20	4	47.4%
NYE D	0	4	23	15	1	9.5%
NYS D	2	20	28	13	3	34.9%
OHN D	5	7	7	2	0	57.1%

OR	7	7	6	6	0	53.8%
PRS C	3	9	37	11	0	20.0%
SC	0	11	17	12	0	27.5%
TNE D	2	20	7	7	2	61.1%
TNM D	0	41	38	15	0	43.6%
TXE D	1	6	14	5	1	26.9%
TXN D	6	13	25	12	0	33.9%
TXW D	6	8	41	10	2	21.5%
UT	1	4	7	9	0	23.8%
WA WD	9	14	75	28	0	18.3%

2. How Long Does it Take Courts to Kick Out “Failed” Cases

Other scholars have pointed out that a good bankruptcy system will sort between cases that should be reorganized and those that should not, dismissing the latter set quickly.¹⁷⁴ Morrison examined ninety-one cases filed in 1998 in the Northern District of Illinois by corporations that: i) were not single-asset real estate cases, ii) were not using Chapter 11 to sell assets or settle a dispute with a particular creditor, iii) were not “dead on arrival,” iv) were not publicly traded, v) did not lack sufficient information, and vi) were not pushed into bankruptcy involuntarily.¹⁷⁵ He found that sixty-two percent of the businesses in his sample were shut down or

¹⁷⁴ See Morrison, *supra* note 2; Warren & Westbrook, *supra* note 2.

¹⁷⁵ Morrison, *supra* note 2 at 385-86. Morrison also consolidated the cases of affiliates and dropped repeated filings.

forced to exit Chapter 11.¹⁷⁶ Of these cases, half of the firms were shut down within three months and seventy percent within five months.¹⁷⁷

Warren and Westbrook looked at 437 “business”¹⁷⁸ cases filed under Chapter 11 in 2002. Those scholars found that “of all the cases that were eventually pushed out of Chapter 11 without a plan having been filed, more than half were gone in less than six months, 70% were gone by nine months, and more than 80% were gone within a year. By eighteen months, more than 90% of all the cases that will exit Chapter 11 without a plan on file had already.”¹⁷⁹

We do not claim to update the Morrison or Warren and Westbrook results for 2010. Their samples were hand-coded, allowing them to focus on particular subsets of cases such as those not operating in particular industries or those for which no plan was proposed. We instead used much cruder measures, but with a much larger and more recent data set.

Table 11 presents the number of days to conversion or dismissal for those cases for which PACER provided the relevant dates. We present the time to “failure” (that is, conversion or dismissal) for individual Chapter 11 cases. To provide some frame of reference, we include this same time to failure for corporate Chapter 11s, small business corporate Chapter 11s, and Chapter 13 cases.

¹⁷⁶ *Id* at 389.

¹⁷⁷ *Id* at 382.

¹⁷⁸ Warren and Westbrook defined business to include: i) all cases in which the debtor checked “business,” ii) all cases organized as a corporation, partnership or LLC, and iii) all cases in which there was a business name in the title. Warren & Westbrook, *supra* note 2 at 609.

¹⁷⁹ *Id.* at 630.

Table 11: Days to conversion or dismissal for "failed" cases

Percent of Failures Converted or Dismissed	Indiv. Chapter 11	Corp. Chapter 11	Small Bus. Chapter 11	Chapter 13
10%	52	42	27	22
25%	110	98	59	57
50%	253	223	152	186
75%	443	411	314	545
90%	706	677	552	952
Mean	319.57	301.02	230.25	347.49
S.D.	286.59	269.9	243.52	371.16
Obs	2,159	3,587	879	147,758

The median time to conversion or dismissal for individual Chapter 11 cases is 253 days, or about eight and a half months. At fourteen and a half months, seventy-five percent of the failures had been kicked out of the system. It took 110 days—between three and four months—to kick out just twenty-five percent of the failures. This time to dismissal is substantially longer than the times estimated by Morrison and Warren and Westbrook, but, as noted above, measurements are not directly comparable given the differences in their samples and ours.

A comparison between individual and corporate Chapter 11 cases is made more difficult because of the different rules for discharge. Once a corporate Chapter 11 debtor confirms a plan, it will receive a discharge in short order.¹⁸⁰ If it later cannot pay the obligations set forth in its plan, it may re-enter bankruptcy, but its initial bankruptcy will not be dismissed. By contrast, an individual debtor does not receive his or her discharge until plan payments are complete.¹⁸¹ We should

¹⁸⁰ § 1143(d).

¹⁸¹ *Id.*

therefore expect individual Chapter 11 cases to last longer before dismissal, and this is indeed what we find. The median time to dismissal for corporate Chapter 11 cases is 223 days, thirty days shorter.

A trustee monitors Chapter 13 cases,¹⁸² and the debtor must meet strict deadlines. For example, a Chapter 13 debtor must propose a plan of reorganization within fourteen days of filing.¹⁸³ One should therefore expect failed Chapter 13 cases to be kicked out more quickly, especially at the beginning of the process. This is indeed what we find. It takes just 57 days to kick out twenty-five percent of the Chapter 13 failures (about half the time it takes in individual Chapter 11), and just 186 days (as opposed to 253) to kick out half of the failures. The last few failures, however, will be cases in which the debtor fails to comply with a confirmed plan, and there is little reason to think that Chapter 13 will identify and kick out these cases more quickly. Consistent with this, we find that courts dismiss seventy-five percent of the failed individual Chapter 11 cases more quickly than they dismiss seventy-five percent of the failed Chapter 13 cases. We revisit the timing issue in Section III.

III. Individual Case Data

In Part II we worked with an extremely large data set, but we were limited to the variables that PACER chose to code. This section instead makes use of a much smaller set of cases, but examines them in much greater detail. Our goal this summer was to conduct a pilot study, and so our conclusions are extremely

¹⁸² § 1302.

¹⁸³ Bankruptcy Rule 3015.

tentative for two reasons. First, we examined a very small number of cases. Second, we are still trying to determine the right questions to ask and how to ask them. The main goal of this section is to demonstrate the types of conclusions that we might be able to draw once we collect enough data and to invite comments and suggestions from advisory committee and other readers.

Our goal was to draw a random sample of all individual Chapter 11 cases across the country, but we have done so imperfectly because circumstances cut short our planning time. When we began the project we had few PACER waivers, and so we turned to Bloomberg law to construct a random sample of cases that reflected the nation as a whole. For each district we first tried to count the total number of individual Chapter 11 cases in 2010.¹⁸⁴ Using these counts, we used a random number generator to determine how many cases to draw from each district and again to determine which cases to draw from within each district. While our process was good, it was not perfect. First, we could not precisely estimate the number of individual Chapter 11 cases in each district because we could not always identify cases originally filed under Chapter 11 and later converted to another chapter. We identified many of these cases by searching dockets for some derivation of the word “convert,” but Bloomberg does not always update a docket to allow a text search. Second, we started the coding process before we had a good estimate of the number of individual Chapter 11 cases in each district. We therefore coded two cases from districts that were not ultimately selected by our weighting

¹⁸⁴ We identified Chapter 11 cases by using Bloomberg’s classification of the case and by using text searches to find cases that were converted from Chapter 11. We identified cases filed by individuals by searching for cases in which there was a social security number or in which the case title listed an individual name.

process. If these districts are not selected in a future round of weighting we can simply drop the cases, but they are included in the results in this rough draft. Third, we have yet to code all of the cases selected by our process; we have three more to go. We must also include a caution about the accuracy of our data because we have not had time to do a sufficient level of checking.

Our main goals are to determine whether Chapter 11 debtors look like Chapter 13 debtors, whether debtors appear to be making good use of the flexibility afforded by Chapter 11, whether creditors are actively participating in the process, and whether Chapter 11 seems to be effectively serving the interests of debtors and creditors.

A. Do Individuals In Chapter 11 Look Like Those in Chapter 13?

One of the motivating questions for this project is whether individuals who are in Chapter 11 really belong in something like Chapter 13. This is more plausible if the debtors in Chapter 11 look a lot like the stereotypical Chapter 13 consumer debtor but with just a bit too much debt to qualify for that chapter. It is less plausible (but still possible) if the Chapter 11 filers have much more complicated financial lives. We use this section to begin to sketch a portrait of the debtors who file under Chapter 11.

1. Demographic Information

We begin with some basic demographic information, for two reasons. First, we can check for consistency between our Section II and Section III data. If they are inconsistent, it suggests that either the subsample of districts that we examine in Section II is not representative of the nation as a whole or that our randomization

strategy in Section III was seriously flawed. Second, we can check for consistency between our data and prior studies of Chapter 13.

Our data suggests that in some ways the population of Chapter 11 debtors is quite different than the population of Chapter 13 debtors. Table 12 reports the gender of the Chapter 11 filers and the results of prior studies of the gender of Chapter 13 filers.¹⁸⁵ Of the forty-nine cases we have coded to date, twenty-seven (55%) were filed jointly with a co-debtor. This is a little higher than the percentage of joint filings that prior studies found in Chapter 13, but the most striking disparity is the lack of women (other than joint filers) in our sample. While other studies have found that more than a third of Chapter 13 filers are women filing alone, such debtors make up just six percent of our sample. We have not classified three debtors because their names are commonly used by both men and women (Alex, Robin, Shawn), but even if all three are women we would still have far fewer women than have been found in prior studies of Chapter 13.

Since something appeared to be wrong upon our first calculation of these numbers, we selected 100 Chapter 11 cases (either the current or previous chapter was Chapter 11—*all11*) from Section II and coded them based on the names of the debtors in the case titles. We found fewer joint filers in this data,¹⁸⁶ but the percent of women filers was about the same.¹⁸⁷ We do not know what explains the lack of women in Chapter 11 (other than joint debtors). Perhaps women entrepreneurs are

¹⁸⁵ See Norberg & Velkey, *supra* note 1; Eraslan, *supra* note 14.

¹⁸⁶ We wonder if some courts only listed the first debtor in the case title. It appears that the case titles almost always list the male first in a joint filing (if there is one—there could be same-sex marriage filers).

¹⁸⁷ For this sample the ninety-five percent confidence interval is plus or minus 4.7%.

likely to intermingle their affairs with their husbands so that joint filings are necessary; we did find about a third (five of fourteen) of the men who filed alone and completed schedules listed a spouse on these schedules while none of the three women who filed alone listed a spouse. Perhaps women are more likely to file under Chapter 13 because they are more willing to let a trustee have some control over their businesses or they are less willing to pay the greater costs of Chapter 11. All of this is speculation, but the result does stand in sharp contrast to the existing literature. We need to code this more generally in Section II. Finally, in the future we should code the gender of a sample of Chapter 13 filers to see if the differences are due to the passage of time.

Table 12: Joint Filers and Gender

	Section II Data (Chapter 11)	Section III data (Chapter 11)	Eraslan, Li & Sarte (Chapter 13)	Norberg & Velkey (Chapter 13)
Joint Filing	40% (40)	55.1% (27)	35.1%	25.5%
Male	47% (47)	32.7% (16)	29.8%	34.8%
Female	6% (6)	6.1% (3)	35.1%	34.3%
Unknown	7% (7)	6.1% (3)		5.3%

We next examined the family structure of our debtors. Most of the debtors (26 of the 48 who completed the relevant schedule) did not list any dependents, and no debtor had more than four. Nearly all dependents were children, though one debtor claimed two mothers-in-law. In the next draft we will also calculate household size to facilitate comparisons to prior work.

Table 13: Dependents

Dependents	Frequency	Percentage
0	26	54.2%
1	8	16.7%
2	6	12.5%
3	6	12.5%
4	2	4.2%
5+	0	0.0%

2. Related Bankruptcies

Eight of the forty-nine debtors listed a prior bankruptcy filing, and at least four of these were filed within twelve months of the filing included in our sample. Instructions to the research assistants may not have been sufficiently clear, and we need to recheck the dates of two prior filings for which the research assistants did not provide data. We were surprised that a large percentage of the prior filings were in the prior year, but this is consistent with the findings of Norberg and Velkey. We need to go back and determine the chapter of the prior filing, and whether our bankrupt debtors filed subsequently. To do this we will search Bloomberg Law for the names of our debtors. We can exclude most false-positives because we have the last four digits of each social security number.

Five of our debtors disclosed an affiliate bankruptcy on their petition, usually a corporation controlled by the debtor. We see other signs that our debtors were conducting business. Twenty-six of our forty-nine debtors (53%) said that their debts were primarily business debts. This is higher than the 40% found in the last section. This may be due to our small sample size, the fact that Section III's data is drawn from the entire country, or some failure in our randomization process.

Below we will look at the nature of the debtor's income and assets to find other signs of business activity.

3. Complexity

We close this section with some statistics on the number of entries on the debtor's dockets to give a sense of the complexity of the cases. The complexity of the cases is important for two reasons. First, complexity makes it much more difficult to code the cases and increases the chance of an error. For example, many debtors amend their schedules several times over the course of their bankruptcy, and we tried to use the most recent schedules available. We may have missed some revisions, however, or interpreted some amended schedules as replacements when they were really meant to supplement prior disclosures (or vice versa). Second, complexity makes it harder to argue that these cases belong in something like Chapter 13. An analogy to tax law might help. Many Americans use forms 1040A or 1040EZ to file their taxes. These simple forms are designed for individuals with very simple financial affairs. Arguably, the same is true of Chapter 13. To the extent that individuals in Chapter 11 do not have simple affairs and have more active creditors, they are likely to have longer dockets. We are hoping to use the number of docket entries as a crude proxy for complexity, but we need to code the number of docket entries in a sample of Chapter 13 cases to provide a comparison group.

The shortest docket had just three entries; the longest had 1,783. The average case had 241 entries, and Table 14 provides a sense of the distribution.

Table 14: Docket Entries in Individual Chapter 11

Docket Entries	Freq.	Percent
1000+	2	4.1%
500 to 1000	2	4.1%
400 to 500	1	2.0%
300 to 400	5	10.2%
200 to 300	6	12.2%
100 to 200	19	38.8%
0 to 100	14	28.6%

B. The Debtor’s Financial Condition

We next turn to the debtors’ schedules to try to summarize their financial conditions.

1. Occupation, Income and Expenses

Sullivan, Warren and Westbrook famously argued that most consumers in bankruptcy are “middle class,” though with lower incomes.¹⁸⁸ Much of their supporting data was drawn from surveys that we did not try to replicate. However, we can get some sense as to characteristics of individual Chapter 11 filers by examining their occupation, income, and expenses.

¹⁸⁸ See *Fragile Middle Class*, *supra* note 1.

Table 15: Occupation of First Debtor Listed on Schedule I

Occupation	Freq.	Percent
Self-employed	12	26%
CEO, President or Owner	8	17%
Manager (Manager, Construction Manager, Senior Account Manager)	3	7%
Attorney (2), Doctor, Dentist, Engineer, Pharmacist or Veterinarian	7	15%
Nurse	2	4%
Realtor or Mortgage Broker	3	7%
Sales	3	7%
Other: Farmer, Aerialist, Videographer, Camp Counselor, Machinery Designer, Teacher, Office Administrator, Loan Officer	8	17%

We begin with the debtor’s occupation. At least fifty-nine percent of the debtors in our sample worked as professionals in highly paid fields (attorney, dentist, physician, veterinarian, pharmacist and engineer), ran a business (President, CEO or Owner), or were self-employed. We suspect, and will try to confirm, that some of the other debtors (professionals, such as realtors and mortgage brokers, as well as debtors in the “other” category—farmer, aerialist and videographer) were also self-employed. This finding, if confirmed in a larger sample, is important for two reasons. First, it suggests that a very large proportion of Chapter 11 debtors are operating businesses as their primary occupations. Second, it may say something about whether bankrupt debtors in Chapter 11 are “middle-class,” though this term can take on an extremely expansive meaning, and neither self-employment nor even the ownership of a small business necessarily indicates what one might call high-living. We therefore turn to the debtors’ income and expenses in a moment.

Before doing so, however, we pause briefly to note the very long job tenure claimed by the individuals in Chapter 11. Several of our debtors (usually the self-employed) did not respond to Schedule I's inquiry "How long employed." The thirty-six that did, however, claimed a median employment tenure of seven years and an average tenure of over eleven and a half years. By contrast, in their study of debtors who filed in Chapters 7 or 13 in the early 1980s, Sullivan, Warren and Westbrook found that the median job tenure was just eighteen months.¹⁸⁹

Table 16: Employment Duration

Years	Frequency	Percent of Responses
20+	7	19.4%
10 to 20	6	16.7%
5 to 10	10	27.8%
3 to 5	3	8.3%
1 to 3	7	19.4%
0 to 1	3	8.3%
0	1	

Table 17 provides the distribution of current monthly income and expenses of the thirty-six debtors for whom we have data. Our debtors had a mean current monthly income of \$15,245 per month (about \$183,000 per year), though it is probably better to focus on the median income of \$8,912 (about \$107,000 per year) as the mean is skewed by a few extremely high incomes. The highest reported current monthly income in our sample was \$76,501 (over \$900,000 per year), and the second highest was \$69,812 per month. Regardless of whether one focuses on the median or the mean, these debtors have much higher incomes than Chapter 13 debtors. In their study of consumers who filed for bankruptcy in 2007, Lawless et

¹⁸⁹ See *As We Forgive*, *supra* note 1, at 96.

al. found a median income for Chapter 13 filers of \$35,688 per year, or about \$37,532 in 2010 dollars. Only five of our debtors had household incomes below this amount.¹⁹⁰

Table 17: Monthly Income and Expenses

Range	Income Freq.	Income Pct.	Expense Freq.	Expense Pct.
>30K	6	16.7%	5	13.9%
15K to 30K	3	8.3%	6	16.7%
10K to 15K	7	19.4%	3	8.3%
7.5K to 10K	7	19.4%	6	16.7%
5K to 7.5K	6	16.7%	7	19.4%
2.5K to 5K	2	5.6%	8	22.2%
0 to 2.5K	4	11.1%	0	0.0%
0	1	2.8%	1	2.8%

In addition to coding the level of income, we tried to code its source. We were missing data from two debtors, but twenty-six of the remaining forty-seven disclosed either business income or real property income.

It may seem surprising that someone would need bankruptcy with an income in the high six-figures, but those debtors' expenses were almost equally as large. The median monthly expense was \$8,026, and the mean was \$14,901. Table 17 gives the distribution of claimed expenses. To get a better sense of the nature of their expenses, we coded a few individual items.

Some of the largest expenses were business-related. Fifteen debtors itemized business operating expenses of at least \$1,000 per month; the median expense was \$10,698, and the largest was \$66,593. Thirty-nine debtors disclosed

¹⁹⁰ This is using average monthly income from line 16 of Schedule I.

some rent or mortgage. Of these, the median was \$2,765, and the largest was \$21,000.¹⁹¹ Twenty-three debtors itemized medical expenses of at least \$100 per month. Of these, the median expense was \$300. It does not appear that medical problems are a major factor in the individual Chapter 11 bankruptcies.

We were curious if debtors were filing for Chapter 11 in an attempt to avoid a trustee’s scrutiny of their expenses. We therefore looked for an item that reportedly draws the attention of trustees—tuition for college and private schools. This did not seem to be a significant issue in individual chapter 11 filings. Just five of our debtors reported any expenses for colleges or private schools, claiming \$80, \$285, \$1519, \$2333 and \$2800 per month in expenses.

2. Debt

Table 18: Distribution of Indebtedness

Range	Total Debt	Secured Debt	Priority Debt	Unsecured Debt
>10M	8	4	1	6
5M to 10M	2	5	1	1
2M to 5M	9	6	1	7
1M to 2M	14	13	1	8
500K to 1M	10	11	2	10
250K to 500K	3	5	2	5
100K to 250K	1	3	5	3
1 to 100K	1	2	13	7
0	0	0	23	1

The median value of our debtors’ total liabilities disclosed on the summary of schedules was \$1,597,855 with a mean of over \$8,500,000; Table 18 provides the

¹⁹¹ Note that the U.S. numbers vary significantly by location.

distribution of the total debt as well as its components. The median level of secured debt was \$1,340,000 with a mean of \$4,427,292. Thirty of the forty-eight debtors who completed the schedule listed junior liens while eighteen did not. The median value of priority debt was \$1,630, with a mean of \$136,016. These priority debts are primarily tax debts. Only one debtor listed domestic support obligations. There were no DUI debts, and only three debtors listed student debts. The median value of unsecured debt was \$211,507 and the mean was \$4,345,889.

Even though our debtors had very high incomes, they still had enormous debt to income ratios. While Lawless, et al., found a median debt to income ratio of 3.3 in their sample of bankrupt debtors filing in 2007,¹⁹² the median debt to income ratio in our sample was 12.9.¹⁹³

Table 19: Debt to Income Ratio

Undefined - zero income	3
0 to 3.3	3
3.3 to 5	2
5 to 10	9
10 to 20	13
20 to 40	4
Greater than 40	15

Based on the summary of schedules, twelve of our forty-nine debtors may have been eligible to file for Chapter 13 because their secured and unsecured debts were sufficiently small.¹⁹⁴ The true number of debtors eligible for Chapter 13 could

¹⁹² See Lawless, *et al supra* note 1.

¹⁹³ This Report used the average monthly income above and, here, the current income from the summary of schedules. The two are usually close, but they are not always the same.

¹⁹⁴ Until April 1, 2010 debtors could not file under Chapter 13 if their secured debts exceeded \$1,010,650 or their unsecured debts exceeded \$336,900. After April 1 the dollar limits were raised to

have been lower or higher. Some of these debtors may not have been eligible because they lacked regular income, and others may have been eligible because some of their obligations were contingent or unliquidated. We will try to check this more explicitly when we conduct the full study.

The median amount of credit card debt was \$34,842, though again some debtors did not estimate their credit card debt. Credit card debt was not the primary problem of many debtors, however. Table 20 expresses credit card debt as a percentage of total unsecured debt; the median amount is 10%. Among those with credit card debt equaling at least 50% of their total unsecured debt, the median amount of credit card debt was \$41,068 and the mean was \$61,208. These debtors had filed for bankruptcy to take care of their secured debt.

Table 20: Credit Card Debt as Percent of Unsecured Debt

	Frequency	Percent		Freq.	Percent
90 to 100%	4	9.1%	30 to 40%	4	9.1%
80 to 90%	2	4.5%	20 to 30%	2	4.5%
70 to 80%	1	2.3%	10 to 20%	3	6.8%
60 to 70%	2	4.5%	0 to 10%	13	29.5%
50 to 60%	1	2.3%	0%	10	22.7%
40 to 50%	2	4.5%			

We thought that many of our debtors would have been brought into bankruptcy by guarantees issued for related entities. Nine of our 48 debtors disclosed some sort of guarantee.

\$1,081,400 and \$360,475, respectively. <http://www.gpo.gov/fdsys/pkg/FR-2010-02-25/pdf/2010-3807.pdf>.

Real estate played an enormous role in the bankruptcies in our study. One way to demonstrate this is to examine the contents of the debtors' disclosure statements. Of the twenty-two debtors in our sample who filed a disclosure statement and gave some reason for their bankruptcy or choice of Chapter 11, seventeen gave a reason related to real estate such as "stressed real estate market" or "modify mortgage." We recognize that this may be an artifact of the year that we chose to study. We also welcome advice as to other ways to identify "real estate bankruptcies."

3. Assets

The debtors in our sample hold very substantial assets. We begin with the value of their real property as disclosed on the summary of schedules. Forty-seven of the debtors in our sample provided estimates of the value of their property. The median value of real property assets was \$823,000; the mean was about \$2,000,000, and the highest value was over \$15,000,000. The median value of personal property assets was \$85,554, the mean was about \$2,250,000, and the highest value was \$67,470,078. Table 21 provides the distribution.

Table 21: Assets

	Real Property	Personal Property
>10M	2	2
5M to 10M	1	0
2M to 5M	10	0
1M to 2M	8	5
500K to 1M	10	3
250K to 500K	8	6
150K to 250K	6	6
100K to 150K	0	9
1 to 50K	0	16
0	2	0

Most of the debtors in our sample owned their own home as well as other real property. We coded the claimed value of the debtor's home because we thought it would indicate how lavish a lifestyle the debtor was living. The median home value was just \$347,000 and the mean was \$689,764. To put these figures in perspective, the median sales price for homes in the United States in 2010 ranged between 200,000 and 250,000.¹⁹⁵ Of our debtors with mortgage data, 24 claimed to be underwater while 16 claimed to have equity in their homes. More strikingly, thirty-seven of the forty-six debtors for whom we have data disclosed ownership of real property other than their home, and many of these properties were clearly purchased for investment purposes.

The fact that we pulled cases from 2010 probably explains why real estate plays such an outsized role. Other signs of business activity were also present, however. We looked for entries on lines 13 and 14 of Schedule B that revealed business assets. We found these for 34 of the 47 debtors who completed this schedule. Most of these assets were interests in partnerships, LLCs or corporations, and many of the debtors listed the value of these items as "unknown." As a result, the asset holdings we list above may understate the wealth of the Chapter 11 debtors.

We looked for debtors likely to have significant and *liquid* exempt assets. Thus, we focused on exempt liquid assets (e.g. cash, bank accounts, stock, etc.) in

¹⁹⁵ <http://research.stlouisfed.org/fred2/series/MSPNHSUS>.

excess of \$100,000.¹⁹⁶ We found nine such debtors. We also summed the total value of exempt property (not just liquid assets) claimed by our debtors. The median value was \$34,950, and two debtors claimed exempt property of over \$1,000,000. Table 22 provides the distribution.

Table 22: Total Exempt Assets

Range	Freq.	Pct.
>1M	2	4.3%
500K to 1M	2	4.3%
200K to 500K	3	6.4%
100K to 200K	6	12.8%
50K to 100K	8	17.0%
30K to 50K	5	10.6%
15K to 30K	7	14.9%
1 to 15K	13	27.7%
0	1	2.1%

B. Is Chapter 11 Working as Intended

As noted in the introduction, Chapter 11 provides the debtor with much more discretion and relies on the creditors to police the debtor’s decisions; there is no bankruptcy trustee. In this section we ask whether the debtor is using this discretion wisely, whether creditors are indeed engaged, and whether the U.S. Trustee steps into the void left by the absence of a bankruptcy trustee.

1. How Much Does Chapter 11 Cost?

All of our data is extremely preliminary, but we are especially uncertain about our data on attorneys’ fees and costs. We think that we gathered total fees and expenses for thirty cases. The median amount of fees and expenses was \$17,234; the mean was \$20,220. Table 23 provides the distribution. In future drafts

¹⁹⁶ We took this as an arbitrary figure. It will be reconsidered in the Final Study.

we will associate fees with the status of the case. Cases that are quickly dismissed should be cheaper.

Table 23: Total Fees and Expenses

Range	Freq.	Percent
>50K	1	3.3%
40K to 50K	1	3.3%
30K to 40K	5	16.7%
25K to 30K	1	3.3%
20K to 25K	3	10.0%
15K to 20K	7	23.3%
10K to 15K	6	20.0%
5K to 10K	3	10.0%
0 to 5K	3	10.0%

2. Does the Case Progress in a Timely Manner?

Unlike Chapter 13, Chapter 11 does not provide individuals with strict deadlines. To ascertain how quickly they push their cases through bankruptcy we began by measuring how long it took debtors to file their schedules. The median debtor filed schedules fourteen days after the filing date, and the average was twenty-five days. Many schedules were later amended or supplemented, however. The median time between filing of the petition and the filing of the last schedules was 21 days, with an average of 89 days.

Table 23: Time to Filing of Schedule

Range	First Schedule		Last Schedule	
	Freq.	Pct.	Freq.	Pct.
> 1 Year	1	2.1%	5	10.6%
6 mo. To 1 Yr	1	2.1%	3	6.4%
3 mo. To 6 mo.	0	0.0%	4	8.5%
2 mo. To 3 mo.	0	0.0%	2	4.3%
1 mo. To 2 mo.	7	14.9%	9	19.1%
20 to 30 days	6	12.8%	1	2.1%
10 to 20 days	11	23.4%	8	17.0%
1 to 10 days	4	8.5%	3	6.4%
0 days	17	36.2%	12	25.5%

Thirty-three of our debtors proposed a plan and twenty-five had a plan approved. This is substantially higher than the 30 to 33% confirmation rate found by Warren and Westbrook in their study of all Chapter 11 filings.¹⁹⁷ It took many of our debtors several tries to achieve plan confirmation.

Table 24: Amendments Before Plan Approval

Amendments	Freq.
0	9
1	7
2	2
3	1
4	0
5	1

The time until confirmation appears to be much longer than that found by Warren and Westbrook. In their study, about 74% of the plans that would be confirmed were confirmed within six months.¹⁹⁸ In our study, the median time to

¹⁹⁷ See Warren & Westbrook, *supra* note 2.

¹⁹⁸ *Id.* at 623.

even propose a plan was substantially longer at 279 days. The median time to plan approval was 510 days.

Table 25: Timing of First Plan Proposal and Plan Approval

	First Proposed	Pct Proposed	Approved	Pct Approved
> 2 years	0	0.0%	4	16.0%
1.5 to 2 years	2	6.3%	6	24.0%
1 to 1.5 years	5	15.6%	7	28.0%
6 mo. To 1 year	15	46.9%	6	24.0%
3 to 6 mo.	6	18.8%	1	4.0%
2 to 3 mo.	1	3.1%	1	4.0%
1 to 2 mo.	0	0.0%	0	0.0%
15 days to 1 mo.	1	3.1%	0	0.0%
0 to 15 days	2	6.3%	0	0.0%

3. Creditor Engagement and the Role of the U.S. Trustee

A trustee is always appointed in Chapter 13,¹⁹⁹ in part because Congress feared that unsecured creditors might not have enough at stake to look after their own interests. The problem of creditor disengagement is more general, however. Thus, we wanted to ascertain whether it appears that creditors are monitoring the debtor’s use of Chapter 11 and whether the U.S. Trustee fills the void left by the absence of a bankruptcy trustee.

Before addressing this question generally, we first focused on the debtor’s choice of attorney. In Chapter 13 the attorney represents the debtor, but in Chapter 11 the attorney represents the estate. We found three cases in which another party objected to the debtor’s choice of attorney. One objection was brought by the U.S.

¹⁹⁹ 11 U.S.C. § 1302.

Trustee, another was brought by both a creditor and the trustee in an affiliate's bankruptcy, and we failed to code the party raising the objection in the third case. In one other case the coder stated that the debtor objected to the debtor's choice of attorney.

Next we asked whether a trustee replaces the debtor in possession or whether an examiner is appointed. We saw several trustees appointed once a case was converted to Chapter 7 or 13, but we found only one case in which a trustee was appointed in Chapter 11, and we want to recheck this case. The research assistants identified three examiners who were appointed, but two appear to have been merely appraisers. We will need to improve our coding instructions in the full sample.

We asked the research assistants to code administrative or substantive or consolidation. They found three cases of the former and one case of the latter.

We were looking for ways to code creditor involvement. We tried coding objections to the plan. Of the 32 cases for which we have data, at least one party objected in 22 cases. We found one case in which a creditor proposed a plan, but we suspect that this may have been coded in error. We would welcome suggestions for better ways to code creditor participation.

The U.S. Trustee is very active in these cases. Even if we restrict attention to "major" motions (that is, objections to a plan or disclosure statement, and motions to dismiss or convert, or to appoint a trustee or examiner), we still find the U.S. Trustee participating in 19 of the cases. Again, we welcome suggestions for coding U.S. Trustee participation.

4. The Nature of the Plan

Finally, we turn to the terms of the plan. Chapter 13 requires that all plan payments be made within five years,²⁰⁰ but Chapter 11 does not contain such a restriction. Do debtors make use of the greater flexibility afforded by Chapter 11? With respect to priority and unsecured debt, they do not. Of the Nineteen plans for which we could discern the proposed terms, just one proposed payments to unsecured creditors beyond five years (a 10 year proposal), and another one proposed payments to priority debtors that would extend beyond five years (six years). Payments to secured creditors are a very different matter. Fifteen of the nineteen proposed payments extending beyond five years (often 30 years), and it is likely that another did as well.

IV. Conclusions and Next Steps

The primary purpose of a pilot study is to refine research questions and methods, and we have prepared this very rough draft to solicit the advisory committees' help. A number of our questions are embedded in the foregoing discussion, and we welcome the committees' advice as to which questions are uninteresting, which need to be modified, and what additional questions we should include. We also want to highlight two more general questions.

First, we were unaware of the ability to create PACER Reports when we began our project, but we were very pleasantly surprised by the amount that we learned. We are unsure, however, if the marginal return to greatly expanding the

²⁰⁰ § 1322(d).

use of these PACER Reports will be very high. We will almost certainly create PACER Reports for the remaining jurisdictions for which we have fee waivers.

As we noted above, we chose to study cases filed in 2010 to balance competing considerations. On the one hand we want to study cases filed sufficiently long in the past to allow us to observe what happens in the case. On the other hand, older cases are likely to be severely impacted by BAPCPA and/or the financial crisis. But the 2010 cases were almost certainly affected by the crisis as well, particularly the collapse in real estate prices. In the Final Study, we expect to include data from three additional years: 2004, 2007 and 2013. The disadvantage of including 2013 cases is that we cannot examine outcomes in any meaningful sense; sufficient time for confirmation and implementation of a plan will not have passed. The overall additional samples, however, could provide guidance as to whether real estate continues to play a major role in Chapter 11, and will provide longitudinal information about individual Chapter 11 cases.

NCBJ Classic Fact Pattern
Edge of the Black Chest:
An Individual Chapter 11 Fact Pattern

Hector B. Rossa (“Rossa”) is a financial consultant, artist (d/b/a Black Chest Creations and Dead Women’s Pearls) and the 100% owner of Calipso Enterprises PSC (“PSC”), a financial advising service that employs five people. Unfortunately, an investment by Rossa in Isle De Mortra Spa Inc. (“Isle”) went bad due to the apparent fraud by the island’s owner, Charlie “Lord” Beckett (“Beckett”). Hector financed his investment in Isle with a personal guarantee of Isle’s mortgage and the pledge of a \$2,000,000 CD, owned by PSC, to Isle’s secured lender, Aztec Ltd. Bank (“Aztec”).

Due to a mix up by PSC’s non-bankruptcy counsel, Rageatti and Pintel (“R&P”), Rossa does not have any form of employment contract with PSC, although he thought he had a contract and has been paid \$75,000 per month for his services for the last 5 years.

At the present time Rossa and PSC’s balance sheets look as follows:

Assets

	Rossa Assets	PSC Assets
Cash	\$50,000	\$25,000
Accounts Receivable		\$675,000 (all collectible)
Real Estate	\$1,000,000 (Home) Vacation home in Aspen \$500,000 \$1,500,000 (Total)	
Total Service Contracts		4 deals (?): each with \$100,000 per month base compensation
Personal Property	\$2,250,000 Total PSC Stock \$500,000 (Est.) \$250,000 Household & personal items 1,000,000 art work \$500,000 investment in other companies	\$25,000 \$2,000,000 CD (Pledged on the Aztec debt)
Intellectual and	(?)	(?) Value of Good Will

Other Property	Lawsuit against Beckett for fraud	
Total Assets	\$3,800,000+	\$2,725,000+

Liabilities

	Rossa Liabilities	PSC Liabilities
Taxes Due	\$400,000 (2014 Income Tax) 2015 taxes are estimated at \$400,000.	None Current on tax liabilities
Secured Debt	Residence \$1,500,000 (ABC Bank) Vacation Home \$100,000 (Gibbs Nat'l Bank) \$1,600,000 (Total)	\$1,100,000 ABC Bank All assets
Unsecured Business Debt		\$500,000
Attorney Fees	(R&P \$75,000)	\$100,000
Unsecured Consumer Debt	\$400,000	
Guaranteed Debts	\$4,000,000 (Isle debt w/Aztec)	\$4,000,000 (Isle debt w/Aztec)
Total Liabilities	\$6,475,000	\$5,700,000
Total Assets	\$3,800,000 (+)	\$2,725,000 (+)
Total Debts	\$6,075,000	\$5,700,000

\$1.1 million of the ABC Bank debt and all of the guaranteed Isle debt are owed both by Rossa and PSC. Isle is totally “under water” and it has no assets to satisfy the Guaranteed Debt. PSC also has a 10-year lease on its offices with Norington Properties.

Rossa and PSC have the following monthly income and expenses (averaged for past 12 months). Rossa is married to Mary Clung and has two sons, Jocard and James.

	Rossa Monthly Income	PSC Monthly Income
(“Base Salary”)	\$75,000	
Bonus	\$10,000	
Business Income		\$225,000
Other Income	\$10,000 (art sales)	\$200,000 (“Success fees”)
Total Income	\$95,000	\$425,000

	Rossa Expenses Family monthly Living Expense
Food	\$8,000
Auto	\$9,000
Country Club Dues	\$9,000
Mortgages	\$12,000
Credit Cards for personal living expenses	\$18,000
Misc. Household Expenses	\$5,000
Private Schools	\$8,000
Insurance	\$8,000
Taxes	\$27,000
Total	\$98,000

	PSC Monthly Business Expenses
Office Rent	\$80,000
Furniture and Equipment Rent	\$60,000
Salaries Bonus Benefits & Withholding	
Rossa	\$85,000
Other Employees	\$110,000
Interest Expense	\$25,000
Other Business Expenses	\$60,000
Total	\$420,000

Rossa and PSC just lost the Aztec lawsuit two days ago and were denied a stay of execution pending appeal. Both Rossa and PSC need to file bankruptcy to protect themselves against aggressive garnishments by Aztec's law firm Turner & Swan (T&S).

Rossa's business is highly variable with earnings dependent on the market and Rossa's referral network. Rossa's art business, gold jewelry, is very stable and could expand if Rossa devoted more time to his work. Rossa is the Driving force behind PSC's Business and does not want his or his family's standard of living.

QUESTIONS ABOUT EXPENSES AND INCOME

1. Rossa asks you if there is any exemption planning you can do for him prior to his bankruptcy filing. He notes that he lives in Florida and he knows there are several exemptions available. Specifically he would like to sell his vacation home and use the equity to pay his taxes and convert as many of his non-exempt assets to exempt assets. Can you advise him on his exemption issues and still be his counsel in an individual Chapter 11 case?

2. Rossa does not want to reduce any of his living expenses. On the second day of his bankruptcy, Aztec files a motion to limit Rossa's living expenses to the \$12,000 in mortgage payments, his taxes of \$27,000 and \$10,000 for all other expenses.
 - (a) Can you represent Rossa in opposing this motion assuming you are bankruptcy counsel in Rossa's individual Chapter 11? Can you be awarded fees for this representation?

 - (b) Assuming you can represent Rossa, what should you advise Rossa to do in his Chapter 11 concerning his expense situation?

 - (c) Assuming Aztec does not file a motion would you be required to seek Court approval under Section 363 to use post petition earnings (property of the estate) to pay the \$98,000 in monthly expenses?

 - (d) What expenses can Rossa reasonably expect to be allowed to incur post petition?

3. Rossa takes eight weeks of vacation each year. If he worked on his jewelry business four more weeks per year instead of traveling, his monthly expenses would go down \$5,000 per month on average and his monthly income would go up \$10,000 on average. What advice should you give Rossa concerning his fiduciary duties to maximize earnings for the bankruptcy estate?

BACKGROUND AND LEGAL DISCUSSION

One of the most vexing questions confronting both attorney and individual chapter 11 debtors is whether an individual debtor's "living expenses"¹² can be paid as

¹ In re Webb, 262 B.R. 685 (Bkrtcy.Ed.Tx. 2001) (Discussing reasonable and necessary expenses in context of a Chapter 13).

² 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.

ordinary course of business expenses under 11 U.S.C. § 363(c)(1) and 11 U.S.C. § 1108³ or whether notice and a hearing under 11 U.S.C. § 363(b)(1)⁴ is required for living expenses to be paid.

Prior to the enactment of 11 U.S.C. § 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 approval⁵, while others indicated that some form of court approval would be necessary at least in cases of significant expenses⁶. Indeed one early pre-BAPCPA decision In re Vincent⁷ 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 11 U.S.C. § 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.⁸

Perhaps the best analysis of the need for oversight of expenses of individual chapter 11 cases in 11 U.S.C. § 1115 is In re Villalobos, 2011 Bankr. LEXIS 4329 (BAP 9th Cir. July 21, 2011). There, the debtor filed his individual chapter 11 and requested approval of his post-petition expenses of \$128,052 per month including payments on five luxury cars, college tuition for grandchildren, and various other "variable" expenses. Over the objection of creditors, the full budget was approved by the court without any specific findings. The BAP reversed, holding: "individual chapter 11 debtors no longer have the option to pay expenses with post-petition income Instead, individual chapter 11 debtors must now seek payment of personal expenses from estate property which may create problems"

A related problem concerns what constitutes "reasonable" living expenses for purposes of 11 U.S.C. § 363? For example will judges take into account the debtor's standard of living in determining what constitutes reasonable living expenses⁹. Should

³ 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.

⁴ 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."

⁵ See In re Murray, 216 B.R. 712 (Bankr. W.D. N.Y. 1998); In re Keenan, 195 B.R. 236 (Bankr. W.D. N.Y. 1996); In re Bradley, 185 B.R. 7 (Bankr. W.D. N.Y. 1995).

⁶ See generally In re Harp, 166 B.R. at 755 – 756 (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)

⁷ 4 B.R. 21 (Bankr. M.D. Tenn. 1979). See also In re Walter, 83 B.R. 14 (9th CAP 1988)

⁸ See In re Harp, 166 B.R. at 755; see also In re Roland, 223 B.R. at 506; In re Weber, 209 B.R. 793 (Bankr. D. Mass. 1997) (discussing expenditures of non-estate property in connection with determination of debtors' good faith). See also In re Villalobos, 2011 Bankr. LEXIS 4329 (BAP 9th Cir. 2011).

⁹ 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), 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).

Courts adopt a disposable income test similar to 11 U.S.C. § 1325(b) or 1129(a)(15)¹⁰ or will they impose the “minimal” standard of living tests imposed on parties seeking to discharge student loans¹¹.

While none of these questions have clear answers yet it seems apparent that individual Chapter 11 debtors who are accustomed to leading affluent lifestyles will no longer be able to maintain such standards of living during the pendency of their Chapter 11s.¹² However even in the leading case on this issue, Villalobos, while the court considered the issue of what constituted reasonable living expenses, it refused to articulate a specific standard for determining what expenses were reasonable.

Finally, there is the question of whether individual chapter 11 debtors can pay reasonable living expenses for members of their family. While this question almost seems to be the paranoid fears of a madman, 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?

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 funds¹³. Indeed in a pre-11 U.S.C. § 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 funds¹⁴. While Courts should be able to distinguish Sutton on its unique (and very bad) facts, it does illustrate the problems with 11 U.S.C. § 1115¹⁵.

¹⁰ See generally In re Watson, 403 F.3d 1 (1st 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).

¹¹ See generally In re Hornsby, 144 F.3d 433 (6th 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).

¹² See generally In re Wood, 68 B.R. 613 (Bankr. D. Hawaii 1986) (large expenditures on pet care demonstrated mismanagement of debtor’s business affairs).

¹³ See 11 U.S.C. §§ 101(14A); 507(a)(1) and 1112(b)(4)(P).

¹⁴ 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).

¹⁵ For a discussion of this issue in the context of chapter 7 and 13 cases, see In re Webb, 262 B.R. 685 (Bkrcty.Ed.Tx. 2001) (Discussing reasonable and necessary expenses including the cost of monthly hair care) and In re Butler 277 B.R. 917 (N.D. Iowa 2002) (Dismissing a chapter 7 as being filed in bad faith where debtor, a **disabled veteran** who had no work or travel obligations, and who had stable income of \$4,179.00 per month in disability benefits, had ability, by modifying his spending choices to “a reasonable extent”, to pay off two-thirds to three-quarters of unsecured debt with no hardship).

QUESTIONS ABOUT ATTORNEY CLIENT PRIVILEGE IN INDIVIDUAL CHAPTER 11

4. Assuming Rossa files and individual chapter 11 and either the case is converted to a Chapter 7 or a chapter 11 Trustee is appointed, who will control the Rossa's attorney client privilege? Rossa or his Trustee
5. What happens if both Rossa and PSC file chapter 11s and are jointly represented by the same firm. If a Trustee is appointed for PSC or PSC is converted to a Chapter 7 would the Trustee be able to obtain documents and discovery attorney client privileged discussions?

BACKGROUND AND LEGAL DISCUSSION

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. Weintraub¹⁷. 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 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

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).

¹⁷ 471 U.S. 343 (1985).

¹⁸ Id. at 354.

¹⁹ Id. at 356-357.

²⁰ In re Bame, 251 B.R. 367, 377-378 (Bkrcty. D.Minn. 2000).

post-bankruptcy periods) remains with the individual debtor and does not pass to the bankruptcy estate or a subsequently appointed trustee²¹. 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 trustee²².

Another group of cases, led by In re Williams²³, has held that the right to who holds the attorney/client privilege does not change merely because a debtor is an individual and not a business entity. 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 estate²⁴. 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 individual²⁵.

The final²⁶ 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 estate²⁷.

Under this line of reasoning, courts have generally determined that an individual debtor has no attorney/client privilege for any 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.

²¹ See In re Hunt, 153 B.R. 445 (Bkrcty. N.D.Tx. 1992) (Trustee under confirmed plan not entitled to waive the attorney/client privilege); In re Silvio De Lindegg Ocean Dev. Of America, Inc., 27 B.R. 28 (Bankr. S.D. Fla. 1982) (same)

²² In re Hunt, 153 B.R. at 454. But see In re Fairbanks, 135 B.R. 717 (Bkrcty. D.N.H. 1991) (Finding "other theory" to hold that trustee controlled chapter 11 debtor's attorney/client privilege).

²³ 152 B.R. 123 (Bkrcty N.D.Tx. 1992); See also In re Smith, 24 B.R. 3 (Bkrcty. S.D. Fla. 1982) (Pre Weintraub)

²⁴ In re Williams, 152 B.R. at 128 (noting that under Toibbv Radloff, 501 U.S. 157 (1991) (Individual Debtor had fiduciary responsibilities of a corporate debtor in possession).

²⁵ See e.g. In re Wittmer, 2011 Bankr. Lexis 4727 (Bankr. N.D. Ohio 2011) (trustee of an individual Chapter 7 debtor investigating legal malpractice claim against could waive the Privileges attorney could not raise Privilege claims to thwart discovery against them); In re Tarkington, 2010 Bankr. Lexis 1208 (Bankr. E.D. N.C. 2010) (2004 exam of individual Chapter 11 debtor's counsel allowed to go forward to determine assets in corporation owned by debtor)

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. See In re Bazemore, 216 B.R. 1020 (Bkrcty. S.D. Ga. 1998), In re Tomarolo, 205 B.R. 10 (Bkrcty. D. Mass. 1997) 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).

²⁷ See generally In re Foster, 188 F.3d 1259 (10th Cir. 1999); In re Benum, 339 B.R. 115 (Bkrcty. D.N.J. 2006); In re Eddy, 304 B.R. 591 (Bkrcty. D. Mass. 2004); In re Miller, 247 B.R. 704 (Bkrcty. N.D. Ohio, 2000).

These courts have also held that pre-bankruptcy discussions with attorneys are subject to an individual attorney/client privilege²⁸.

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.

I. General Overview of Attorney/Client Privileges In Joint Client Situations

Initially, it is well settled that the trustee or DIP of a corporate Chapter 11 debtor holds the attorney/client privilege of that legal entity. See *Commodity Futures Trading Commission v. Weintraub*, 471 U.S. 343 (1985) (trustee succeeds to attorney/client privilege of debtor corporations). The Sixth Circuit, in *Reed v. Baxter*, 965 F.2d 126 (6th Cir. 1992) states that:

The question of whether the attorney/client privilege applies is a mixed question of law and fact, subject to de novo review. See *In re Grand Jury Proceedings October 12, 1995*, 78 F.3d 251, 253-54 (6th Cir.1996). Questions of privilege are to be determined by federal common law in federal question cases. Fed.R.Evid. 501. The elements of the attorney/client privilege are as follows: (1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) unless the protection is waived. *Fausek v. White*, 965 F.2d 126, 129 (6th Cir.1992) (citing *United States v. Goldfarb*, 328 F.2d 280, 281 (6th Cir.1964)).

The privilege is based on two related principles. The first is that loyalty forms an intrinsic part of the relationship between a lawyer and client in our adversary system. This loyalty is offended if the lawyer is subject to routine examination regarding the client's confidential disclosures. Kenneth S. Brown, et al., *McCormick on Evidence* § 87, at 205-06 (3rd ed.1984). The second principle is that the privilege encourages clients to make full disclosure to their lawyers. A fully informed lawyer can more effectively serve his client and promote the administration of justice. *Id.* § 87, at 205; *id.* § 89, at 212.

²⁸ 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]).

The privilege serves these purposes, but it comes with substantial costs. The privilege excludes relevant evidence and stands “in derogation of the search for the truth.” United States v. Nixon, 418 U.S. 683, 710, 94 S.Ct. 3090, 3108, 41 L.Ed.2d 1039 (1974). When an organization, such as a corporation, is the client the costs imposed by application of the privilege increase. Given the number of employees who may have information relevant to litigation by or against a corporation, administration of the privilege by the courts proves difficult. More significantly, “[w]here corporations are involved, with their large number of agents, masses of documents, and frequent dealings with lawyers, the zone of silence grows large.” David Simon, The Attorney/Client Privilege as Applied to Corporations, 65 Yale L.J. 953, 955 (1956); see also 24 Charles Alan Wright & Kenneth W. Graham, Jr., Federal Practice and Procedure: Evidence § 5476, at 189 (1986); id. § 5476, at 29 (1997 Suppl) (noting that corporations may use the privilege to prevent the disclosure of information useful to adversaries simply by funneling it through lawyers).

Assuming that a valid joint defense agreement exists between Law firm X’s clients (Subsidiary and Individual A) and Lawfirm Y’s clients, (Individuals A, B, Subsidiary and Parent Company) and that all privileged discussions were made between the law firm and each client and no other clients were present at the discussions between the law firm and the client.

A dual or joint representation, absent an agreement to establish a “joint defense” between clients, may render any attorney/client privilege inapplicable because non-clients were parties to the privileged communications. See Matter of Bevill Breslder & Schulman Asset Management Corporation, 865 F.2d 120, 124-126 (3rd Cir. 1986); In re Indiantown Realty Partners, Lmt. Partnership, 270 B.R. 532 (Bankr. S.D. Fla. 532, 539-540) (Bankr. S.D. Fla. 2001). See also In re Miracle Enterprises, Inc., 40 B.R. 503 (Bankr. D. R.I. 1984) (no attorney/client privilege with respect to communications between Defendant bank and attorney, where attorney served as secretary of Debtor and counsel to bank); U.S. v. Moss, 9 F.3d 543 (6th Cir. 1993). (“Generally, the attorney/client privilege extends to “(c)onfidential disclosures by a client to an attorney made in order to obtain legal assistance.”); Haines v. Liggett Group, Inc., 975 F.2d 81, 94 (3rd Cir. 1992) (quoting, Fisher v. United States, 425 U.S. 391, 403, 96 S.Ct. 1569, 1577, 48 L.Ed.2d 39 (1976)). A joint defense extension of the attorney/client privilege has been applied to confidential communications shared between co-defendants which are “part of an ongoing and joint effort to set up a common defense strategy.” Haines, 975 F.2d at 94 (quoting Eisenberg v. Gagnon, 766 F.2d 770, 787 (3rd Cir.), cert. denied, 474 U.S. 946, 106 S.Ct. 342, 88 L.Ed.2d 290 (1985)). The burden to establish the applicability of the privilege is upon the defendants. Haines, 975 F.2d at 94.

Even assuming that a joint defense privilege exists, however, it has been universally held that communications that are otherwise privileged under the common interest or joint defense doctrine are not privileged in subsequent litigation between the parties to the joint defense agreement. See Simpson v. Motorists Mutual Insurance Company, 494 F.2d 850 (7th Cir. 1974) (recognizing the existence of the doctrine in a diversity case governed by Ohio law); Duncan v. Duncan, 2001 WL 1837384 (Va. Cir. Ct. July 16, 2001) (Not reported in S.E.2d) (“The clear majority of reviewing courts has held that the attorney/client privilege does not preclude an attorney who originally represented both

parties in a prior matter from disclosing information in a subsequent action between the parties.”). See also Abbott Laboratories v. Alpha Therapeutic Corp., 200 F.R.D. 401 (N.D. Ill. 2001); Securities Investor Protection Corporation v. Stratton Oakmont, Inc., 213 B.R. 433 (Bankr. S.D. N.Y. 1997); In re Megan-Racine Associates, Inc., 189 B.R. 562 (Bankr. N.D. N.Y. 1995). Therefore, Parent Company may be able to obtain all otherwise privileged communications of all other parties under a joint defense agreement.

II. Specific Questions

Question A: Can a Parent Company DIP or trustee waive Subsidiary’s or the Individual A’s privilege?

The Parent Company DIP or trustee cannot waive, under any circumstances, the attorney/client privilege between either Lawfirm X or Lawfirm Y and Individual A as the Parent Company bankruptcy estate has no interest in or control over Individual A’s attorney/client privilege. While some courts have allowed trustees to waive the attorney/client privilege of individual debtors, see, generally, In re Eddy, 304 B.R. 591 (Bkrcty. D. Mass. 2004); In re Williams, 152 B.R. 123 (Bkrcty. N.D. Tx. 1992), no court has ever permitted a corporation to waive its individual owner’s attorney/client privilege. See generally In re Bakalis, 199 B.R. 443, 449 (Bkrcty. E.D. N.Y. 1996) (trustee of Chapter 7 estate of majority owner of a corporation could not compel corporation to waive its attorney/client privilege).

If it is established that Individual A was given advice by either Lawfirm X or Lawfirm Y, as an officer or employee of Subsidiary, however, then Individual A’s ability to claim, as an individual, an attorney/client privilege will be greatly compromised. See In re National Trade Corporation, 76 B.R. 646 (N.D. Ill. 1985); In re Southern Air Transport, Inc., 225 B.R. 706 (Bkrcty. S.D. Ohio 2000); In re Fidelity Guarantee Mortgage Corp., 150 B.R. 854 (Bkrcty. D. Mass. 1993); In re Cumberland Inv. Corp., 120 B.R. 627 (Bkrcty. D. R.I. 1990).

As to the attorney/client privilege of Subsidiary, Parent Company as the owner of Subsidiary, may not directly waive the Subsidiary’s attorney/client privilege. As noted in Bakalis, the owner of the stock in a corporation may not waive the attorney/client privilege for that corporation absent certain specific showings of good cause, which will permit the owner of the corporation to obtain the privileged documents. Bakalis, 199 B.R. at 449; see also Fausek v. White, 965 F.2d 126, 130-131 (6th Cir. 1992).

A Parent Company DIP or trustee could indirectly cause Subsidiary to waive its own attorney/client privilege if they either gain control of the individuals who were actually running the Subsidiary bankruptcy or were able to use their corporation ownership to cause a change in control of the management of Subsidiary in its Chapter 11 case. See In re Lionel Corporation, 30 B.R. 327 (Bkrcty S.D. N.Y. 1983) (holding that “shareholders of Chapter 11 Debtors generally retain their state controlled rights to control a Chapter 11 Corporation within the requirements of the Bankruptcy Code”). However, the change of management of a Chapter 11 could be subject to Bankruptcy Court approval, see Matter of Gaslight Club, Inc., 782 F.2d 767 (7th Cir. 1986); Matter of

Lifeguard Industries, Inc., 37 B.R. 3 (Bkrcty. S.D. Ohio 1983). However, even with these limitations, a Parent Company DIP or trustee, by meeting the proper legal standards, could cause Subsidiary to waive its attorney/client privilege.

Question B: Can Subsidiary's waive the attorney/client privilege of Individual A?

As discussed above, Subsidiary may not waive the individual attorney/client privilege between Individual A and either Lawfirm X or Lawfirm Y because Subsidiary does not have any interest in or control over Individual A's attorney/client privilege. See, generally, In re Bevill, Bresler and Schulman, 805 F.2d 120, 123 (3rd Cir. 1986) (corporate officer may assert a personal attorney/client privilege for communications made to his or her own counsel concerning personal liability unrelated to the corporation or his role as a corporate officer).

Subsidiary can waive its own attorney/client privilege as to any communications Lawfirm X or Lawfirm Y had with Individual A, if those communications were made in the course of Lawfirm X's or Lawfirm Y's representation of Subsidiary, and not as part of their representation of Individual A. See In re National Trade Corporation, 76 B.R. at 647 (corporate officers barred from asserting privilege for communications made in their corporate capacity to corporate counsel); In re Southern Air Transport Inc., 255 B.R. at 710-712 (corporate officers cannot assert attorney/client privilege to prevent debtor corporation from obtaining testimony from its own attorney); In re Fidelity Guarantee Mortgage Corp., 150 B.R. at 867-869 (corporate waiver of corporate debtor's attorney/client privilege extends to words and actions of corporate debtor's officers and directors).

Question C: Can a third party force Subsidiary to waive its own attorney/client privilege or the attorney/client privilege of Individual A?

Initially, it is clear that a creditor or other third party cannot force Subsidiary to waive Individual A's attorney client privilege, as Subsidiary itself may not waive the attorney/client privilege between Lawfirm X, Lawfirm Y and Individual A because Subsidiary has no interest in or control over Individual A's attorney/client privilege.

A creditor or other party in interest could ultimately require Subsidiary to waive its own attorney/client privilege, however, either by obtaining the appointment of a trustee in the Subsidiary bankruptcy case, see Commodity Futures Trading Commission v. Weintraub, 471 U.S. 343 (1985), or by filing a motion to force the Debtor to waive the attorney/client privilege. See, generally, In re Gibson Group Inc., 66 F.3d 1436 (6th Cir. 1995) (creditor granted standing to pursue preference suit where debtor unjustifiably refused to bring preference action). While there is no established case law permitting a third party to force a debtor to waive its attorney/client privilege, under the authority of the Gibson Group case, such a motion would have merit in the circuits which have adopted this position.

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Ordinary Course Expenses in Individual Chapter 11 Cases

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[O]ftentimes the “meaning—or ambiguity—of certain words or phrases may only become evident when placed in context.” *Brown & Williamson*, 529 U. S., at 132.

King v. Burwell 576 U.S. ____ (slip op. at 9) (2015)

Debtors in chapter 11 cases can and do use property in the ordinary course of business. Section 363(c)(1)¹ of the Bankruptcy Code provides:

If the business of the debtor is authorized to be operated under section . . . 1108 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 a notice or a hearing.

Debtors in chapter 11 cases can and do exercise the powers and rights of trustees. Section 1107² of the Code states that a debtor in possession in chapter 11, even in individual cases, has all of the powers and in general, is required to perform all of the functions and duties of a trustee in chapter 11. Section 1108³ of the Code allows the debtor in possession to operate his or her own business in a chapter 11 case.

¹ 11 U.S.C. § 362(c)(1) (2012).

² 11 U.S.C. § 1107 (2012).

³ 11 U.S.C. § 1108 (2012).

While debtors can use, buy or sell property of the bankruptcy estate in the ordinary course of business, an individual debtor faces a peculiar conundrum. The property of the bankruptcy estate is expansive including:

- Property of the type included in a bankruptcy estate under section 541 of the Code
- Property of the type included in Section 541 of the Code acquired after the commencement date of the case⁴; and
- Post-petition earnings for services performed after commencement of the case.⁵
- Initially, Section 1115 of the Code provides that property of a chapter 11 bankruptcy estate includes property as of the commencement of the case as well as after acquired property together with earnings from services performed after commencement of the case.

The intersection of these seemingly innocuous provisions requires a fair degree of thought and planning in the context of a chapter 11 case for an individual. All of the debtor's property and post-petition earnings are property of the estate. The debtor has the uncontestable right to use, buy, sell or dispose of property of the estate in the ordinary course of business. But "ordinary course of business" is not a defined term and there are no particular standards to determine what is "ordinary" and what is not "ordinary" in the context of an individual chapter 11 case.

Ordinary Course of Business

This term is not defined in the Code. Prior to the Bankruptcy Abuse Prevention Consumer Protection Act ("BAPCPA") courts considered both creditor's expectations as well the debtor's conduct to determine whether an expenditure was in the ordinary

⁴ 11 U.S.C. § 1115(a)(1) (2012).

⁵ 11 U.S.C. § 1115(a)(2) (2012).

course. Creditors' expectations have been said to be a "vertical dimension" analysis⁶ whereas the legitimacy and fairness of debtor's actions are said to be the "horizontal dimension analysis."⁷ A post-petition transaction would be considered "ordinary course" if a similar business (or person) might engage in a similar transaction. This analysis would appear to be somewhat tautological.

As the Supreme Court instructs us in *King v. Burwell*, context informs our understanding of a phrase when it is undefined. While it is easy to suggest that ordinary course in an individual chapter 11 case requires a determination whether the expenses are reasonably necessary for the support of the debtor and the debtor's dependents⁸, One court has noted that "in calculating an individual Chapter 11 debtor's projected disposable income, § 1129(a)(15)(B) must be read to allow a judicial determination of the expenses that are reasonably necessary for the [maintenance or] support of the debtor and his or her dependents." However, what will be reasonable in the case of one debtor will not necessarily be reasonable in the case of another.

For example, a debtor who is involved in sales and marketing at an executive level may need a significant budget for entertainment, golf clubs, city clubs and the like. A debtor who is involved in a contentious divorce may have the need for considerable expenses for attorneys' fees. Debtors with medical conditions which are not covered by insurance may have a very high budget for medical and related expense.

Drawing lines is not easy. Does the debtor have the right to send his children to camp, to have orthodontia, to engage in dance or sports coaching? What if these are

⁶ *Burlington N. R.R. Co. v. Dant & Russell Inc. (In re Dant & Russell Inc.)*, 853 F.2d 700, 705 (9th Cir. 1988).

⁷ *In re Straightline Inv., Inc.*, 2008 WL 1970560, at *6

⁸ *In re Rodemeier*, 374 B.R. 264, 272-73 (Bankr. D. Kan. 2007).

expenditures which the debtor has had all along. What if the debtor lives in housing which might appear lavish? Must the debtor move? Can the debtor spend money in the ordinary course to maintain the home? How about mowing the lawn, or fixing the roof? How about paying a cleaning service to keep the place up? Should the debtor be required to do these services himself or herself rather than devoting his or her full time and attention to managing the affairs of the estate for the benefit of the creditors?⁹

Case Law is Sparse

While the text of Section 362(c) clearly allows a debtor to expend estate funds and to use and dispose of estate property in the ordinary course of business¹⁰, most individual chapter 11 debtors will want to obtain at least a degree of “safe harbor” defining a degree of permitted expenditures. The court in *Seely* correctly noted that BAPCPA did not create a procedure or establish a standard to determine whether an expenditure for living expense by an individual debtor in chapter 11 constituted ordinary course of business. So the court assumed that Congress did not intend a requirement that debtor make a request to file such requests. *Seely* also compared chapter 11 expenditures as similar to those in chapter 13 – not requiring court approval at least in respect to post-petition wages. So it held that “ordinary course living expenses should be treated as . . . within the debtor’s ordinary course of business for the purposes of interpreting section 363(c)(1).

⁹ See generally, Hon Paul G. Human, G. Frank Nelson, James Patrick Shea, *Best of ABI: The Year in Consumer Bankruptcy 2011 Lost in the Labyrinth of Chapter 11 Cases? How to Find Your Way Out* 120-122

¹⁰ *In re Seely*, 492 B.R. 294 (Bankr. C.D. Cal. 2013). *Seely* involved a Trustee’s motion to surcharge for purportedly improper expenditures of property of the estate subsequently declared to be exempt. *Cf. Law v. Siegel*, 571 U.S. ___ (2014).

The other case frequently cited on this point is *United States v. Villalobos*.¹¹ Here, the bankruptcy court retroactively approved debtor's expenses in accordance with a proposed budget. However, in doing so, the bankruptcy court did not issue sufficient findings of fact to support approval or disapproval. Ultimately, the bankruptcy court entered an order limiting debtor to \$10,000 per month for personal expenditures and \$10,000 per month for business expenditures in contrast to Debtor's initially proposed budget of \$128,052 per month.

Neither the *Seely* nor the *Villalobos* case provide any compelling standards or tests which might be utilized by other courts in considering what constitutes "ordinary course of business" for a chapter 11 debtor.

The Need for a Principled Analysis

It is relatively easy to determine the debtor's income. Form B22 B provides a template for determining income. Otherwise, income and expense for an individual debtor are reported in Schedule I and J. However, reported expenses on Schedule J do not necessarily render them Ordinary Course of Business expenses for purposes of Section 362 of the Code. In light of sparse authority, how does one go about making a principled determination? Or is it a situation where the judge is supposed to "know it when she sees it"¹²

At the time of this writing, the bankruptcy court in the Northern District of Texas is considering an extraordinary request for authority to expend funds in the ordinary course of business in *In re Wyle*.¹³ Here, Carolyn Wyle, 80 years of age, became a widow and highly illiquid when her husband died in an automobile accident. At the time of his

¹¹ 2011 WL 4485793 (B.A.P. 9th Cir. 2011).

¹² *Cf. Jacobellis v. Ohio*, 378 U.S.184 (1964).

¹³ *In re Carolyn D. Wyle* (Case No. 14-35074, Bankr. N.D. Texas, Dallas Division).

death Mr. Wyle and his son were the objects of litigation with the SEC. The Estate of Charles Wyly had been ordered to disgorge over \$63 million by the district court overseeing the SEC matter.

All parties agree that Debtor, Carolyn Wyly, was wholly innocent of any wrongdoing. She was to have received 90% of Mr. Wyly's estate while her son was to have received 10%. The probate estate continues to be tied up while the late Mr. Wyly's issues with the SEC are being litigated.

Prior to her chapter 11 case and prior to Mr. Wyly's death, Carolyn Wyly enjoyed a luxurious lifestyle. She and her husband had been philanthropists in Texas and Colorado. They own expensive homes in both Texas and Colorado.

Debtor has substantial assets. However she has very little income – less than \$10,000 per month. Her budget proposes to expend \$110,000 per month on her Dallas residence, including \$75,000 for at least 3 months for “Capital Renovation”. She proposes expenditures of \$96,000 per month, including almost \$80,000 per month for mortgage payments on her Colorado residence. Further, she proposes a \$25,000 per month contingency allowance, at least \$80,000 per month for bankruptcy legal fees and advisor fees as well a \$300,000 payment to the “Family Office” which had been running the Wyly family affairs prior to commencement of the case. These budgeted expenditures would reduce Controlled Cash” from \$3 million to about \$1 million over the budget period. This budget was prepared by an outside consulting firm which Debtor's “Family Office” had hired and for whose employment Debtor has sought court approval. Debtor also sought court approval to use the cash management system in place through her “Family Office” in lieu of new debtor-in-possession accounts.

Both the Internal Revenue Service and the Securities and Exchange Commission have objected to these expenditures. They contend that lavish spending is not acceptable for Chapter 11 debtors.¹⁴ This includes maintenance of luxury vehicles and tuition for grandchildren¹⁵, vacation home rentals, football brunches¹⁶, resort vacations or rainy day funds¹⁷. They assert that individual debtors can't maintain affluent lifestyles during Chapter 11 proceedings¹⁸. Extravagant expenditures should not be permitted even if they had been made previously. Only expenses for debts, to maintain assets or for legal obligations should be permitted.¹⁹

The SEC's papers assert that Mrs. Wyly should be able to live on a \$15,000 allowance.

Mrs. Wyly distinguishes the authorities cited by the SEC asserting that they deal with matters other than the question of what constitutes an ordinary course of business expense during the pendency of a chapter 11 case.²⁰

After a full evidentiary hearing, the bankruptcy court took the matter under advisement. It remains under advisement as of this writing. How is the Court to make a principled analysis given the sparsity of pertinent authority?

Principles for Analysis

There is a distinct difference between the use and expenditure of property of the estate and the use of cash collateral. Section 362(b) of the Code authorizes use, sale or

¹⁴ *In re Villalobos*, 2011 W.L. 4485793 at *8 (B.A.P. 9th Cir. 2011)

¹⁵ *Id.*

¹⁶ *In re Harp*, 166 B.R. 740, 755-56 (Bankr. N.D. Ala. 1993).

¹⁷ *In re Osborne*, 22013 WL 2385136 (Bankr. E.D. N.C. 2013).

¹⁸ *In re Wood*, 68 B.R. 613 (Bankr. D. Hawaii 1986).

¹⁹ *In re Baker*, 503 B.R. 751, 757 (Bankr. M.D. Fla. 2013).

²⁰ *In re Wyle*, (Case No. 15—35074 Bankr. N.D. Tex., Dallas Division) *Response to Objection* (filed November 6, 2014, Dkt. 54)

lease of property of the estate other than in the ordinary course of business after notice and a hearing.²¹ Otherwise, the debtor in possession may enter into transactions and use property of the estate in the ordinary course of business without notice or a hearing.²² In contrast, the debtor may not use cash collateral without consent of the secured creditor or court authority after notice and a hearing.²³

The default principle, then, is that ordinary course of business transactions do not require court approval. Extraordinary course of business transactions and use of cash collateral without permission is prohibited absent notice and hearing, and in the case of cash collateral, adequate protection.

There is a distinction to be drawn between ordinary course of commercial, mercantile, entrepreneurial or contractual business on one and the ordinary course of personal affairs on the other.

Ordinary Course of Business = Necessary and Ordinary Business Expense?

The term “ordinary course of business” should be interpreted in such a manner that it is consistently applied in both business chapter 11 case and individual chapter 11 cases. In absence of any definition of the term, it makes sense to see how the term or anything like it is used in other but related contexts. One context which comes immediately to mind is the Internal Revenue Code which allows for deduction of “necessary and ordinary business expenses.”²⁴ The law regarding deductibility of business expense is very well developed. An expense is deductible from income if:

- Ordinary

²¹ 11 U.S.C. § 362(b)(1) (2012).

²² 11 U.S.C. § 362(c)(1) (2012).

²³ 11 U.S.C. § 362(c)(2) (2012).

²⁴ 26 U.S.C. § 162.

- Necessary
- For carrying on a trade or business activity

For an expense to be deductible, it should be routine and directly related to business activity. It does not have to be a habitual or every day expense. However, it must be necessary for business.²⁵ To determine whether an expenditure is a business expense, one must consider the motivation of the expenditure.²⁶ The Internal Revenue Service states that a business expense is “ordinary” if common and accepted in one’s trade or business. Necessary means “helpful or appropriate” for one’s trade or business. An expense does not have to be indispensable to be considered necessary.²⁷ While the Bankruptcy Code does not incorporate the Internal Revenue Code, they can be intertwined.²⁸ A fair argument therefor can be made that if an expense is deductible for federal income tax purposes, it is an ordinary business expense.

Fiduciary Standards Apply for Personal and Family Expense

On the other hand, expenses which are not “business expenses” must still be made in connection with an individual’s chapter 11 case. Here a completely different set of standards apply. The individual debtor stands as a fiduciary for the estate with respect to bankruptcy estate property.²⁹ Estate property includes not only the assets of the estate as of the commencement of the case but also all after-acquired property.³⁰ With respect to

²⁵ *Welch v. Helvering*, 290 U.S. 111 (1933). An expenditure might be necessary but not ordinary of too personal, too bizarre to be ordinary. Justice Cardozo stated that in determining what is “necessary” “life in all its fullness must supply the answer to the riddle.”

²⁶ *Jenkins v. Commissioner*, T.C. Memo 1983-667 (U.S. Tax Court Memos 1983).

²⁷ Internal Revenue Service Website – Deducting Business Expenses found July 1, 2015 at <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Deducting-Business-Expenses>

²⁸ *Cf. Ransom v. FIA Card Services, N.A.* 562 U.S. 61 (2011).

²⁹ 11 U.S.C. §§ 704, 1106, 1107

³⁰ All wages are property of the chapter 11 estate irrespective of exemptions. *Smith v. Frazier*, 421 B.R. 513 (S.D. Ill. 2009); *In re Reindeau*, 293 B.R. 832 (D. Vt. 2002), *aff’d* 336 F.3d 78 (2d Cir. 2003).

personal expenditures, then, the debtor must ask herself whether the expenditure is in the best interest of the estate, taking into consideration her fiduciary obligations to the estate.

Mrs. Wyly must consider whether the monthly mortgage payment on the Colorado property is in the estate's best interest. Does she need the house? Must the house be maintained or otherwise protected and preserved? Can the house be sold immediately if it is not necessary for the estate? Should the house be sold through auction or a more orderly basis? Would the estate be harmed if she breached any of her existing contractual arrangements? Are the expenditures she proposes to make, even if large, benefit the estate and thus the creditors? Does it make a difference that the estate is solvent although highly illiquid? May she consider her personal interests if the estate is a solvent, but illiquid estate? May she use her business judgment in making these decisions? May she employ advisors to assist her in doing so?

The court should consider the constellation of expenses requested not only in terms of the debtor's historical expenditures, but also in terms of whether the expenditures proposed are in the interest of the estate, including her own personal interests if the estate, indeed is a solvent estate. The court should consider the particular context of the particular case and expense involved.

Debtors in chapter 11 should carefully consider when and to what extent that they seek the court's approval for ordinary business expenses. If the expense would be a legitimate tax deduction, it would be hard to argue that the expenses is improper. The "null hypothesis" is that no such approval is necessary. This is plain in the statute. A creditor or other party in interest who complains about such expenditures has remedies,

including a motion for the appointment of a trustee³¹, a motion to convert or dismiss³². Such a motion would require a showing of cause and the burden of proof would be on the movant.

On the other hand, individual debtors in chapter 11 cases should be very careful about expenditures. If the expense is for a previous contractual obligation, it would be hard to argue that it should not be made unless it is upon a burdensome executory contract. A debtor should determine whether to sell assets which are burdensome to maintain.

A debtor may need to maintain a seemingly lavish lifestyle if so doing enhances the estate for the benefit of creditors. On the other hand, a debtor might need to downsize in an orderly fashion in order to fulfill her fiduciary obligations to creditors. As Justice Cardozo put it in *Welch*, “life in its fullness must supply the answer to the riddle.”

³¹ 11 U.S.C. § 1104(a)(1) (2012) (cause including . . . gross mismanagement).

³² 11 U.S.C. § 1112(b) (2012).

**CHAPTER 11 CRAMDOWN FOR AN INDIVIDUAL
AND THE ABSOLUTE PRIORITY RULE
(as of 2015)**

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CHAPTER 11 CRAMDOWN FOR AN INDIVIDUAL AND THE ABSOLUTE PRIORITY RULE

The 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) provided a number of amendments to the Bankruptcy Code with respect to individuals. Many of the changes have been refined by judicial interpretation over the past ten years. One of the changes that has become more clear as court decisions have developed is whether the absolute priority rule applies to individuals in a chapter 11 case. The early case law analyzing this issue gave rise to a clear split among bankruptcy courts as to whether the absolute priority rule no longer applied with respect to individuals. This analysis was due to the changes made to Bankruptcy Code §§ 1115 and 1129(b)(2)(B)(ii). These sections permit an individual in a cram down situation, with respect to unsecured creditors, to retain property included in the bankruptcy estate under §1115. The question became, how much property could be retained in a cram down? This provision differs from the cram down test under the absolute priority rule with respect to unsecured creditors in a non-individual case where the debtor is not allowed to retain or receive any property on account of the plan. The fair and equitable test with respect to gaining confirmation of a plan over the dissent of a class of unsecured creditors was modified with respect to individuals to account for the fact that the then newly added §1115 included within the estate the debtor’s post-petition personal service income. The cram-down provisions had to adjust to allow the debtor to retain the use of personal income in order to survive and allow for a plan confirmation despite the rejecting vote of unsecured creditors. While the model is based on chapter 13, the application of the absolute priority rule causes unique problems for a practitioner who cannot develop a consensual plan.

11 U.S.C. §1115

The 2005 amendments added §1115 to the Bankruptcy Code. Prior to 2005, § 541(a)(7) provided that post-petition income derived from personal services of an individual was not property of the estate. The individual could include all or a portion of their income to fund a plan or pay creditors but they were not required to do so. §1115 was added to the Code to include within the bankruptcy estate all income derived by the

debtor from personal services as well as all of the property described in §541 that the debtor acquires after commencement of the case and before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13. This amendment had tremendous ramifications for the individual debtor. Once all assets including income were included in the estate, creditors could arguably have a say as to how the income was spent. In order to allow the debtor to confirm a plan over the dissenting vote of unsecured creditors, Congress amended §1129(b) to allow the Debtor to retain certain assets included in the estate under §1115.

11 U.S.C. §1129(b)(2)(B)(ii)

The rules for a cram down of a plan on unsecured creditors are generally contained in §1129(b). A chapter 11 plan could generally be confirmed over the rejection of the plan by unsecured creditors if either the plan paid the unsecured creditors in full or the plan provided that there was no class junior to the unsecured creditor class that would “receive or retain under the plan on account of such junior claim or interest any property”. Payment in full was never a very popular option in chapter 11 so the latter portion of this provision received all of the attention. The latter portion became known as the absolute priority rule. It required payment in full to senior classes before a junior class received or retained anything. In short, if the unsecured creditors were not paid in full and they rejected the plan, the plan could not be confirmed over the rejection if the existing shareholders, members or equity received or retained any property. This provision did not work well with an individual who now found their income included in the estate. As a result, §1129(b)(2)(B)(ii) was amended to include the following:

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.

The drafting of this provision created the issue of whether the absolute priority rule had been abrogated for individuals. Did the provision mean that the debtor could retain all property included in the estate under §1115 including the property that had traditionally been part of the estate under §541 or did it mean the debtor could only retain the property that was newly added to the estate under §1115, such as personal service income.

The Bankruptcy Court Decisions

Several courts have interpreted §1129(b)(2)(B)(ii) and §1115 together to indicate that Congress intended to exempt individual chapter 11 debtors from the absolute priority rule. See *In re Roedemeier*, 374 B.R. 264 (Bankr. D. Kan. 2007) and *In re Tegeder*, 369 B.R. 477, 480-81 (Bankr. D. Neb. 2007). The *Tegeder* and *Roedemeier* cases were two of the first cases to examine the issue as to the elimination of the absolute priority rule for individuals. In *Tegeder* the court concluded the absolute priority rule was eliminated because §541 was referenced within §1115. In *Roedemeier* the court believed Congress intended to make chapter 11 more like chapter 13 and therefore repealed the absolute priority rule. In the case of *In re Shat*, 424 B.R. 854 (Bankr. D. Nev. 2010) the court analyzed the language of the property of the estate under new §1115 and the apparent ties between chapter 11 and 13 and concluded that the absolute priority rule had been eliminated in order to further the rehabilitative goals of chapter 11. Therefore, according to these courts, a chapter 11 debtor may retain prepetition and post-petition property and still cram-down a plan of reorganization over the objection of unsecured creditors. These courts adopted the so-called “broad view” reading of the statute.

Following these decisions were a series of “narrow view” cases that held that the exception to the absolute priority rule only applied to the property added by §1115 to the definition of property of the estate under §541. The narrow view cases included *In re Gbadebo*, 431 B.R. 222 (Bankr. N.D. Cal. 2010), *In re Mullins*, 435 B.R. 352 (Bankr. W.D. Va. 2010), *In re Karlovich*, 456 B.R. 677 (Bankr. S.D. Cal. 2010), *In re Stephens*, 445 B.R. 816 (Bankr. S.D. Tex. 2011), *In re Walsh*, 447 B.R. 45 (Bankr. D. Mass 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 Maharaj*, 449 B.R. 484 (Bankr. E.D. Va. 2011), *In re Lindsey*, 453 B.R. 886 (Bankr. E.D. Tenn 2011), and *In re Tucker*, 2011 WL 5926757 (Bankr. D.Or. 2011). The cases from 2010 and 2011 were overwhelmingly sided on the narrow view approach. In 2012 through 2014 the cases were similarly overwhelmingly sided with the narrow view reading of the statute.

The Circuit Courts Weigh In

Beginning in 2013, we had Circuit Court decisions that all adopted the narrow view. The rulings by the Circuit Courts have been consistent and their answer is, there is no change in the law for individual debtors with respect to the absolute priority rule. While the debtor may retain post-petition income notwithstanding the fact that it is now included in the estate, the debtor could always retain such income since it was never included in the estate prior to 2005. *In re Lively*, 717 F. 3d 406 (5th Cir. 2013); *In re Stephens*, 704 F. 3d 1279 (10th Cir. 2013); *In re Maharaj*, 681 F. 3d 558 (4th Cir. 2012), and *In re Cardin*, 2014 WL 1887583 (6th Cir. 2014). The absolute priority rule clearly applies in these Circuits. The remaining Circuits still contain a mix of Bankruptcy and District Court opinions, however it does seem as though courts are siding more with the narrow view rulings. The Circuit Court decisions contrast with the BAP decision of *In re Friedman*, 466 B.R. 471 (9th Cir. B.A.P. 2012) which adopted the broad view, has been widely criticized, and is not viewed as binding precedent. A court in the Central District of California has eroded the view that held that the absolute priority rule was eliminated by holding that the Ninth Circuit B.A.P. opinion in *Friedman* is not binding on bankruptcy courts in the circuit. *In re Arnold*, 471 B.R. 578 (Bankr. C.D. Cal. 2012).

Many of the narrow view decisions rely on the notion that there was no legislative history to support a change from the past application of the absolute priority rule and even though the statute is ambiguous Congress would have been more explicit if they were changing prior law. The individual debtor in a Chapter 11 is not permitted to retain any non-exempt property in a cram-down on unsecured creditors, with the exception of the new assets added to the estate under §1115, unless the dissenting unsecured creditor class is paid in full.

Do Creditors Really Control the Debtor's Earnings Prior to Confirmation

While §1115 does include the debtor's post-petition earnings in the estate, the question arises as to what degree such assets are subject to the control of creditors. Are the earnings to be treated as if they are cash collateral in which unsecured creditors have an interest or does the debtor have control over their use. Prior to plan confirmation there could be an extended period of estate administration. During this time the debtor should have the right to any applicable state earnings exemption. Under many of these

exemptions the debtor may be able to exempt up to 75% of their earnings from creditor claims, depending upon the state. While 100% of the earnings are property of the estate, there is no limit on the application of exemptions. In fact, §1123(c) provides that in a plan proposed by a creditor in an individual case, the plan may not provide for the use, sale, or lease of exempt property unless the debtor consents. While the debtor may provide under their plan that exempt assets will be used to pay creditors, that provision will not be effective until the plan is confirmed and a debtor should not give up the right to exempt assets prior to plan confirmation. The right to choose to use exempt assets under a plan may be a key bargaining point. The use of exempt assets may constitute “new value” to allow the debtor to retain assets in a cram-down situation.

Is the “new value exception” working?

Several recent cases focus on individual debtors who have attempted to address the absolute priority rule, generally through the new value exception. In *In re Batista-Sanchez*, 505 B.R. 222 (Bankr. N.D. Ill. 2014), the debtor proposed bidding on equity interests to allow unsecured creditors to credit bid on the debtor’s equity interests in a sole-proprietorship as a means of satisfying the absolute priority rule. In *In re Gerard*, 495 B.R. 850 (Bankr. E.D. Wis. 2013), the debtor proposed to contribute \$27,000 in new value to the plan to retain non-exempt interests. This was ultimately denied because the debtor had a cash account and other assets that exceeded the new value contribution. In *In re Lee Min Ho Chen*, 482 B.R. 473 (Bankr. D.P.R. 2012) the debtor was similarly denied the use of the new value exception because the funds did not come from an external source. While the reported cases on debtors’ attempts to utilize the new value exception have largely been found to be unsuccessful primarily because not enough money was being contributed, at least one court has recognized that an individual debtor may use the new value exception to retain non-exempt property in a cram-down and allowed the debtor to retain exempt property. See *Van Buren Indus. Investors v. Henderson (In re Henderson)*, 341 B.R. 783 (M.D. Fla. 2006). In the *Van Buren* case, the new value exception was met through new cash in the amount of \$525,000 contributed by the debtor’s former wife.

What Else Might Work

In certain cases, the debtor may be able to propose a full payment plan over an extended period of time. The debtor may allow the estate to continue to exist for the duration of the plan and utilize the estate assets as they are used in turn by the debtor to generate the income necessary to fund the plan. At some point in time the debtor will have: a) accomplished the goal of paying off the creditors; b) worked hard enough to allow for a plan amendment to provide for less than full payment and an accepting vote; or c) converted the case to chapter 7 after selling off assets over time and not realizing enough to pay the creditors in full. In many cases, the debtor just needs time to try to sell an asset and pay creditors. Such a strategy may or may not work but at least the debtor will have had a chance to make it work.

The debtor may be able to create a liquidating trust under the plan and transfer all assets to the trust. The trust may then be able to resell the assets to the debtor over time or to the debtor's family members in order to retain continuity and allow the income or profit from sale to be paid to creditors. In the interim the assets could be leased to the debtor by the trust.

In each of these situations, the debtor will have to find a source of "new value" whether it's an outside investor, partner, relative or a wealthy ex-spouse as in the *Van Buren* case. The alternatives include selling the assets over time while retaining them in the estate or an entity created under the plan or placing the assets in a newly created entity to be used to generate value for creditors over time. In such a case an earn back or creditor pay off situation may allow the debtor to reacquire the assets over time.