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ISSUES IN INDIVIDUAL CHAPTER 11 CASES

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I. Introduction

In recent years a growing number of entrepreneurs, professionals and high net-worth individuals have sought Chapter 11 relief to restructure their personal finances and maintain control of their businesses and investments. An individual Chapter 11 case is not merely a large Chapter 13. To the contrary, individual Chapter 11 cases present complex challenges for both bankruptcy courts and practitioners.[1]

Section I of these materials summarizes certain of the differences between Chapter 11 and Chapter 13 of the Bankruptcy Code. Sections II through VII address selected legal issues that can arise in individual Chapter 11 cases, and Section VIII presents a hypothetical designed to illustrate those issues.[2]

II. Differences Between Chapter 11 and Chapter 13

Unlike Chapter 13 with its debt limits,[3] Chapter 11 is available to any individual who is eligible for Chapter 7. *See Toibb v. Radloff*, 501 U.S. 157, 160 (1991) ("[Section] 109(d) makes stockbrokers and commodities brokers ineligible for Chapter 11 relief, but otherwise leaves that Chapter available to any other entity

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[1]Harley E. Riedel, Susan H. Sharp & Daniel R. Fogarty, *Individual Chapter 11 Cases*, *available at* www.sbli-inc.org/archive/2011/documents/DD%20-%20Riedel.pdf. ("Many lawyers that practice in chapter 11 cases are very familiar with the 'ins and outs' of the most complex corporate loan documents and the intricacies of corporate chapter 11 cases but would frankly admit to only a passing knowledge of dischargeability and exemption laws that are implicated in individual chapter 11 filings. And as emotionally draining as corporate chapter 11 cases may be, the experience of representing individual debtors who may have marital problems and who are unused to creditors rummaging through their personal checking account and challenging their country club membership may be a new and harrowing experience for any corporate lawyer. On the other hand, for the lawyer practicing consumer law, there are significant consequences to filing an individual chapter 11 petition and critical differences between chapter 11 and chapter 13 for individuals.").

[2]The author thanks his law clerks, Brian L. Gifford and Laura F. Atack, for their assistance and substantial contributions to these materials.

[3]*See* 11 U.S.C. § 109(e) ("Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $394,725 and noncontingent, liquidated, secured debts of less than $1,184,200, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $394,725 and noncontingent, liquidated, secured debts of less than $1,184,200 may be a debtor under chapter 13 of this title.").

eligible for the protection of Chapter 7."). There are several other significant differences between Chapter 11 and Chapter 13, and in order for an individual Chapter 11 case to succeed, the debtor and his or her counsel must be aware of those differences and plan for them before filing the case. In fact, failure to observe the requirements of Chapter 11 and to prepare the case in accordance with those requirements likely will result in an unsuccessful attempt to reorganize the debtor's financial affairs and also will pose other risks for both the debtor and counsel.

A. The Chapter 11 Case Before Confirmation

Certain of the differences between Chapter 11 and 13 become relevant early in the case:

Expense. Chapter 11 is more expensive than Chapter 13 in every way possible, starting with the fee required to commence the case. The Chapter 13 filing fee currently is $235, while the Chapter 11 filing fee (including for individuals) is $1,167. 28 U.S.C. § 1930(a)(1) & (a)(3).

Codebtors. Chapter 11 does not automatically protect nondebtors who are liable with the debtor on consumer obligations (i.e., "codebtors"). Chapter 13 of the Bankruptcy Code provides for a codebtor stay against acts to "collect all or any part of a consumer debt[4] of the debtor from any individual that is liable on such debt with the debtor, or that secured such debt, unless[:] (1) such individual became liable on or secured such debt in the ordinary course of such individual's business; or (2) the case is closed, dismissed, or converted to a case under chapter 7 or 11[.]" 11 U.S.C. § 1301(a). Unlike Chapter 13, Chapter 11 does not provide for a codebtor stay.[5] Under certain limited circumstances, however, a Chapter 11 debtor in possession may obtain a court order extending the automatic stay to nondebtor parties under § 105(a) of the Bankruptcy Code. *See, e.g.*, *A.H. Robins Co. v. Piccinin*, 788 F.2d 994 (2d Cir. 1986).

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[4]The Bankruptcy Code defines "consumer debt" to mean "debt incurred by an individual primarily for a personal, family, or household purpose." 11 U.S.C. § 101(8).

[5]On the plus side for Chapter 11 debtors, the so-called hanging paragraph of § 1325 of the Bankruptcy Code, which makes § 506 inapplicable to the valuation of certain purchase-money security interests (including liens on motor vehicles acquired for the personal use of the debtor within the 910-day period before the petition date), does not apply in Chapter 11. On the other hand, Chapter 11 is no different from Chapter 13 in one important respect. Like Chapter 13 plans, Chapter 11 plans may not "modify the rights of [a] holder[] of . . . a claim secured only by a security interest in real property that is the debtor's principal residence[.]" 11 U.S.C. § 1123(b)(5).

20 Largest Creditors. Unlike Chapter 13 debtors, Chapter 11 debtors must file a list of their 20 largest creditors. Fed. R. Bankr. P. 1007(d). Unless a creditors' committee is appointed (which would be unusual in an individual Chapter 11 case), creditors on this "Top 20 List" must be served with certain motions, including motions for relief from the automatic stay, motions for use of cash collateral and motions to obtain credit. Fed. R. Bankr. P. 4001.

Debtor in Possession. On the petition date, an individual Chapter 11 debtor becomes a "debtor in possession." 11 U.S.C. § 1101(1). As a debtor in possession, the Chapter 11 debtor owes many of the same fiduciary duties to the bankruptcy estate that would be owed by the Chapter 11 trustee if one were appointed. 11 U.S.C. § 1107(a); *see also In re Johnson*, 546 B.R. 83, 122, 125, 162–64 (Bankr. S.D. Ohio 2017) (discussing the fiduciary duties of Chapter 11 debtors in possession). By contrast, a Chapter 13 debtor does not owe the estate the fiduciary duties of a trustee.

Retention of Counsel. Because an individual Chapter 11 debtor is a debtor in possession who owes fiduciary duties to the estate, counsel for the debtor must be retained through an application filed under § 327(a). The application must be accompanied by a verified statement of the attorney to be employed setting forth the attorney's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States Trustee, or any person employed in the Office of the United States Trustee. Fed. R. Bankr. P. 2014(a). Failure to make the required disclosures could result in the denial of compensation, or its disgorgement if it has already been paid. *See, e.g.*, *Law Offices of Ivan W. Halperin v. Occidental Fin. Grp., Inc. v. Occidental Fin. Grp., Inc.*, 40 F.3d 1059, 1063 (9th Cir. 1994); *Pierce v. Aetna Life Ins. Co. (In re Pierce)*, 809 F.2d 1356, 1363 (8th Cir. 1987).

In order to be employed under § 327(a), the debtor in possession's attorney must "not hold or represent an interest adverse to the estate" and must be "disinterested." 11 U.S.C. § 327(a). Disinterestedness means that the attorney: (1) is not a creditor, an equity security holder, or an insider of the debtor; (2) is not and was not, within two years before the petition date, a director, officer, or employee of the debtor; and (3) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason. 11 U.S.C. § 101(14). Holding or representing an interest adverse to the estate or otherwise failing to be disinterested would result in disqualification as counsel. *See, e.g.*, *Michel v. Federated Dep't Stores, Inc. (In re Federated Dep't Stores, Inc.)*, 44 F.3d 1310, 1319 (6th Cir. 1995); *Pierce*, 809 F.2d at 1363.

Compensation of Counsel. Although local rules often provide for compensation of Chapter 13 debtors' attorneys without an application if the fees are below a specified dollar amount, those local rules do not apply to attorneys for Chapter 11 debtors in possession, who therefore must file an application with a detailed statement of the services rendered and the time expended regardless of the amount requested. Fed. R. Bank. P. 2016(a). Of course, fees in an individual Chapter 11 case almost certainly will exceed the "no-look" fee in Chapter 13 cases.

Counsel for a Chapter 13 debtor may be compensated "for representing the interests of the debtor in connection with the bankruptcy case," 11 U.S.C. § 330(a)(4)(B), but counsel for a Chapter 11 debtor in possession cannot be compensated for services that were not (1) "reasonably likely to benefit the debtor's estate" or (2) "necessary to the administration of the case," 11 U.S.C. § 330(a)(4)(A).

Chapter 11 Guidelines. Chapter 11 debtors (including individuals) are subject to the United States Trustee's "Chapter 11 Guidelines for Debtors-in-Possession (the "Guidelines").[6] The Guidelines impose certain obligations on Chapter 11 debtors that Chapter 13 debtors do not have. For example, Chapter 11 debtors must immediately close all existing bank accounts and open one or more accounts designated as "Debtor-in-Possession" bank accounts (commonly referred to as "DIP" Accounts) maintained with an authorized depository institution. The Chapter 11 debtor must provide the United States Trustee with a sample of a voided check from the DIP Account(s) imprinted with the debtor's name, bankruptcy case number and the term "Debtor-In-Possession." The debtor also is required to deposit all receipts and make all disbursements through the DIP Account(s), unless otherwise approved by order of the court or the United States Trustee. In addition, the debtor should maintain funds in separate household and business DIP Accounts.

Monthly Operating Reports. Under the Guidelines, the debtor must file monthly operating reports. The monthly operating reports required to be completed and submitted by debtors include income and expense statements, balance sheets and a summary of significant items such as the debtor's insurance coverage.

Small Business Cases. Section 1116 of the Bankruptcy Code imposes additional filing requirements in small business cases.[7]

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[6]For cases in the Western District of Missouri, see www.justice.gov/sites/default/files/ust-regions/legacy/2011/09/07/Ch11_Debtor_Guidelines.pdf.

[7]A "small business case" is a Chapter 11 case in which the debtor is a "small business debtor," 11 U.S.C. § 101(51C)—that is, a debtor:

United States Trustee Fees. In Chapter 11, debtors must pay quarterly fees to the United States Trustee based upon disbursements as set forth in 28 U.S.C. §1930(a)(6).

Fiduciary Duties. The failure of a Chapter 11 debtor to comply with his or her fiduciary duties to the estate and to fulfill his or her other obligations may result in the conversion or dismissal of the Chapter 11 case under § 1112(b) of the Bankruptcy Code, or the appointment of a Chapter 11 trustee under § 1104(a). In addition, the Chapter 11 debtor who seeks to convert his or her case to Chapter 7 but who has failed to abide by the duties imposed on a Chapter 11 debtor in possession could be found to be operating in bad faith and on that basis have any request the debtor makes to convert the case to Chapter 7 denied. *See Johnson*, 546 B.R. at 171 ("[T]he Debtor's right to convert to Chapter 7 . . . is limited by his bad faith.").

B. Confirmation of the Plan

Other differences between Chapter 11 and 13 become relevant in connection with the plan:

Plan Deadlines. While Chapter 13 debtors are required to file their plans within 14 days after the petition date, Fed. R. Bankr. P. 3015(b), Chapter 11 debtors do not face such early plan-filing deadlines. In fact, Chapter 11 generally does not

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> (A) . . . engaged in commercial or business activities . . . that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than $2,566,050 (excluding debts owed to 1 or more affiliates or insiders) for a case in which the United States trustee has not appointed under section 1102(a)(1) a committee of unsecured creditors or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor; and
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> (B) does not include any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $2,566,050 (excluding debt owed to 1 or more affiliates or insiders).

11 U.S.C. § 101(51D).

impose a deadline for the debtor to file a plan.[8] *See* 11 U.S.C. § 1121(a) ("The debtor may file a plan with a petition commencing a voluntary case, or at any time in a voluntary case or an involuntary case."). Rather, the plan need be filed only "as soon as practicable." 11 U.S.C. § 1106(a)(5).[9] And unlike Chapter 13—which requires plan payments to begin within a month after the petition date, 11 U.S.C. § 1326(a)—payments under a Chapter 11 plan begin only after the plan is confirmed.

Who May File a Plan. In a Chapter 13 case, only the debtor may propose a repayment plan, 11 U.S.C. § 1321, while Chapter 11 affords the debtor an "exclusive period" to file a plan. In cases that are not small business cases, the debtor has an exclusive period of 120 days after the petition date to file a plan. 11 U.S.C. § 1121(b).[10] Once the plan is filed, the debtor has until 180 days after the petition date to obtain acceptances of the plan. 11 U.S.C. § 1121(c)(3). These time periods may be reduced or increased for cause up to 18 months after the petition date (for filing a plan) and 20 months after the petition date (for obtaining acceptances) if the request for an extension is made before the original exclusive period expires. 11 U.S.C. § 1121(d)(2). If the debtor fails to file a plan or obtain acceptances within the exclusive period (including extensions of the period), any party in interest may propose a plan. 11 U.S.C. § 1121(c). There is, however, one limitation on the plan that other parties in interest may propose for individual Chapter 11 debtors—the plan "may not provide for the use, sale, or lease of property exempted under section 522 of this title, unless the debtor consents to such use, sale, or lease." 11 U.S.C. § 1123(c).

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[8]Under the Local Rules of the Bankruptcy Court for the Western District of Missouri (the "Local Rule(s)"), Chapter 11 debtors are required to file a plan and disclosure statement in non-small business cases within 120 days after the petition date or seek an extension of time to do so. Local Rule 3016-1.

[9]Chapter 11 debtors typically "discuss proposed plan treatment with creditors and negotiate terms," and "[t]hose negotiations can be very helpful in formulating a plan and achieving confirmation." *In re Marshall*, No. 02-80496-RGM, 2010 WL 3959612, at *39 (Bankr. E.D. Va. Oct. 11, 2010). Indeed, the language of § 1106(a)(5), "as soon as practicable," provides time for those negotiations to occur. *Id*. Although the Bankruptcy Code sets a 300-day deadline for filing a plan in small businesses cases, the 300-day deadline may be extended, and the Bankruptcy Code does not set any limit on the number of days that the court may extend the deadline. 11 U.S.C. § 1121(e).

[10]In a small business case, only the debtor may propose a plan of reorganization during the first 180 days of the case, unless the court extends the 180-day period before it has expired. 11 U.S.C. § 1121(e).

Plan Length. Unlike Chapter 13 plans, Chapter 11 plans may exceed five years in length.

Disclosure Statement/Solicitation. In order to obtain confirmation of a Chapter 11 plan, a debtor first must prepare and obtain the bankruptcy court's approval of a disclosure statement containing "adequate information" to enable creditors to make an "informed judgment" about the plan. 11 U.S.C. § 1125(a) & (b).[11] Parties in interest must receive 28 days' notices of the hearing on approval of the disclosure statement and of the deadline to object to the disclosure statement. Fed. R. Bankr. P. 2002(b).

The disclosure statement is the document that Chapter 11 debtors use to initiate the process of soliciting votes in favor of the plan, a process that is not undertaken in Chapter 13. In addition to having the opportunity to object to confirmation, 11 U.S.C. § 1128(b), Chapter 11 creditors who are to receive a distribution under the plan but whose claims are "impaired" under § 1124 of the Bankruptcy Code may vote for or against the plan. 11 U.S.C. § 1126. A class of claims accepts the plan if, counting only those creditors that actually cast a ballot for or against the plan, creditors holding at least two-thirds in amount and more than one-half in number of the allowed claims of such class vote to accept the plan. 11 U.S.C. § 1126(c). Unlike Chapter 13, in which a creditor must file a proof of claim in order to have an allowed claim, Fed. R. Bankr. P. 3002(a), a creditor of a Chapter 11 debtor need not file a proof of claim and will have an allowed claim in the amount included on the debtor's schedules of assets and liabilities unless the claim is scheduled as disputed, contingent or unliquidated. 11 U.S.C. § 1111(a); Fed. R. Bankr. P. 3003(b)(1) & (c)(2). Any proof of claim filed by a creditor whose claim would have been allowed as scheduled will supersede the scheduled claim. Fed. R. Bankr. P. 3003(c)(4).[12]

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[11]In a small business case, the court may determine that the plan itself provides adequate information and that a separate disclosure statement is not necessary. 11 U.S.C. § 1125(f)(1); *see also* Fed. R. Bank. P. 3016(b); Local Rule 3016-3(D). The Bankruptcy Code and the Bankruptcy Rules contemplate the use of a standard form small business disclosure statement and plan. 11 U.S.C. § 1125(f)(2); Fed. R. Bankr. P. 3016(d). The Local Rules require the disclosure statement and plan in small business cases to "conform substantially to Official Forms 25A and 25B." Local Rule 3016-3(B).

[12]Under the Local Rules, "[i]n all Chapter 11 cases, on motion without hearing, the Court shall fix a claims bar date." Local Rule 3002-1(B)(1). In addition, unless the bankruptcy court orders otherwise, the debtor must serve notice of the claims bar date with a blank proof of claim form and instructions on all creditors and parties in interest. Local

The Effects of Voting. The voting results affect confirmation in several ways. A plan can be confirmed only if all impaired classes either accept the plan or the plan is "crammed down" under § 1129(b) (discussed below) over the dissent of the impaired classes that have not accepted the plan. 11 U.S.C. §§ 1129(a)(8) & 1129(b). Further, if there is an impaired class—and there almost always is—then at least one impaired class must have accepted the plan (determined without including any acceptances of the plan by any insider) in order for the plan to be confirmed. 11 U.S.C. § 1129(a)(10). Because the Bankruptcy Code provides that the determination of whether or not a plan has been accepted by creditors holding the requisite number and amount of allowed claims is made by counting only those creditors that have "accepted or rejected such plan," 11 U.S.C. § 1126(c), if a single vote is cast in a plan class and that vote is to accept the plan, then the class has accepted the plan. But it would not be unusual for apathy among creditors to set in, leading to a lack of voting in one or more classes. And the general rule is that a class cannot be deemed to have accepted a plan if no creditor in the class has voted. *See, e.g.*, *In re Castaneda*, No. 09-50101, 2009 WL 3756569, at *1 & n.1 (Bankr. S.D. Tex. Nov. 2, 2009); *In re Friese*, 103 B.R. 90, 91–92 (Bankr. S.D.N.Y. 1989). In light of the need for acceptance by at least one impaired class and the ramifications of having an impaired class that does not accept the plan (i.e., cramdown is required), Chapter 11 debtors in possession or their counsel sometimes contact creditors (after the disclosure statement has been transmitted to them) in an effort to spur them to vote in favor of the plan.

And More . . . Additional differences between Chapter 11 and Chapter 13—including the treatment of personal expenses, the projected disposable income requirement, and the absolute priority rule—will be discussed in Sections III through V below.

III. Security Interests in Salary

One issue that individual Chapter 11 debtors can face arises when a creditor asserts a security interest in the debtor's salary. Individual Chapter 11 debtors often are highly compensated,[13] and they sometimes borrow large sums of money. In

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Rule 3002-1(B)(2).

[13]There are, of course, exceptions. Some individuals are forced to file Chapter 11 due to, for example, personal guarantees on a business loan, despite the fact that they themselves are not particularly highly compensated. *See In re Rausch*, Case No. 16-55719 (Bankr. S.D. Ohio) (monthly take-home of $9,500 and assets—not including pension and retirement accounts—of approximately $109,000, but over $1.5 million in liabilities, with

exchange for a large loan, a creditor might seek to obtain a security interest in much, if not all, of the debtor's existing and after-acquired property, including his or her income.[14]

Section 552 of the Bankruptcy Code provides, with certain exceptions, that "property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case." 11 U.S.C. § 552(a). The exception relevant here provides that:

> if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, products, offspring, or profits of such property, then such security interest extends to such proceeds, products, offspring, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

11 U.S.C. § 552(b)(1).

Thus, if a creditor has a prepetition security agreement with the debtor that provides for a lien on after-acquired property, § 552(a) "provides the general rule that postpetition property of the debtor or estate is not subject to any lien resulting from [that] security agreement." *Rumker*, 184 B.R. at 624 (quoting *Fin. Sec. Assur., Inc.*

$1.15 million the result of an unsecured personal guarantee).

[14]*See Johnson v. RFF Family P'ship, LP (In re Johnson)*, 554 B.R. 448 (Bankr. S.D. Ohio 2016) (lender sought "'security interest in and lien upon' substantially all of the [d]ebtor's property then existing or to be acquired, including 'the payment, proceeds, and rights under and related to'" the debtor's professional hockey employment contract), *appeal docketed*, No. 16-8035 (B.A.P. 6th Cir. Sept. 7, 2016); *In re Rumker*, 184 B.R. 621 (Bankr. S.D. Ga. 1995) (lender with blanket lien on Chapter 13 debtor's property asserted security interest in monies earned from debtor's employment contract with county to provide legal representation to indigent defendants); *Smoker v. Hill & Assocs., Inc.*, 204 B.R. 966 (N.D. Ind. 1997) (lender sought security interest in Chapter 13 debtor's insurance commissions).

v. Tollman-Hundley Dalton, L.P., 165 B.R. 698, 701 (N.D. Ga. 1994), *rev'd on other grounds*, 74 F.3d 1120 (11th Cir. 1996)). But a creditor's lien on after-acquired property may still attach to postpetition property if that property is "proceeds, products, offspring, or profits" of the prepetition collateral and the security agreement covers such property. 11 U.S.C. § 552(b)(1); *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 374 (1988) ("Section 552(b) sets forth an exception, allowing postpetition 'proceeds, product, offspring, rents, or profits' of the collateral to be covered only if the security agreement expressly provides for an interest in such property, and the interest has been perfected under 'applicable nonbankruptcy law.'").

It is well established that an assignment of or lien on a debtor's future income cannot survive bankruptcy. *See Rumker*, 184 B.R. at 628 ("[T]he well accepted notion that a lien cannot attach to future wages in bankruptcy was first enunciated by the United States Supreme Court in *Local Loan Co. v. Hunt*, [292 U.S. 234 (1934)]."). "According to the Supreme Court [in *Local Loan*], decisions holding that an 'assignment of future earned wages' survived bankruptcy were 'destructive of [one of the primary] purpose[s] . . . of the Bankruptcy Act,' which is to permit debtors to 'start afresh.'" *Johnson*, 554 B.R. at 462 (internal citations omitted). As Justice Sutherland explained:

> The earning power of an individual is the power to create property; but it is not translated into property within the meaning of the Bankruptcy Act until it has brought earnings into existence. An adjudication of bankruptcy, followed by a discharge, releases a debtor from all previously incurred debts, with certain exceptions not pertinent here; and it logically cannot be supposed that the act nevertheless intended to keep such debts alive for the purpose of permitting the creation of an enforceable lien upon a subject not existent when the bankruptcy became effective or even arising from, or connected with, preexisting property, but brought into being solely as the fruit of the subsequent labor of the bankrupt.
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> When a person assigns future wages, he, in effect, pledges his future earning power. The power of the individual to earn a living for himself and those

> dependent upon him is in the nature of a personal liberty quite as much if not more than it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern. From the viewpoint of the wage-earner there is little difference between not earning at all and earning wholly for a creditor. Pauperism may be the necessary result of either. The amount of the indebtedness, or the proportion of wages assigned, may here be small, but the principle, once established, will equally apply where both are very great. The new opportunity in life and the clear field for future effort, which it is the purpose of the Bankruptcy Act to afford the emancipated debtor, would be of little value to the wage-earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy.

Local Loan Co., 292 U.S. at 243, 245.

Nothing has changed with the enactment of the Bankruptcy Code. Indeed, not only is there "nothing in the [Bankruptcy Code] that suggests, even faintly, that assignments of future earnings may create a lien that will withstand bankruptcy," *In re Miranda Soto*, 667 F.2d 235, 237 (1st Cir.1981), but rather § 552(a) specifically provides that property acquired postpetition "is not subject to any lien resulting from any [prepetition] security agreement." 11 U.S.C. § 552(a).

Numerous courts accordingly have held that § 552(a) "invalidates both assignments of, and security interests in, individual debtors' postpetition earnings from employment." *Johnson*, 554 B.R. at 463; *see, e.g.*, *Miranda Soto*, 667 F.2d at 237; *Rumker*, 184 B.R. at 629; *In re Scott*, 142 B.R. 126, 132 (Bankr. E.D. Va. 1992); *Ortiz Vega v. Asociación de Empleados del Estado Libre Asociado de Puerto Rico (In re Ortiz Vega)*, 75 B.R. 858, 861 (Bankr. D.P.R. 1987); *Tr. Co. Bank v. Walker (In re Walker)*, 35 B.R. 237, 242 (Bankr. N.D. Ga. 1983). But while this is the general rule, two issues may arise when dealing with a debtor who earns his or her salary under an employment contract.

The first is that a creditor may argue that payments owed under an employment contract have already been earned and therefore are not property acquired postpetition. This was the case in *Johnson*, in which the debtor had a seven-year, $30.5 million contract to play professional hockey for the Columbus Blue Jackets NHL team. *Johnson*, 554 B.R. at 451. The creditor maintained that "'the Debtor . . . earned his payments merely by virtue of being employed by the Blue Jackets, whether he played or not,' and that the Debtor therefore had already acquired, even if he had not received, his salary payments by the time he entered into the [prepetition security agreement]." *Id.* at 458. The creditor relied in part on a provision in the contract providing that the debtor would still receive payments even if he was "unfit for play by reason of an injury sustained during the course of his employment as a hockey [p]layer." *Id.*

The bankruptcy court rejected this argument, noting that "barring such injury, the Debtor must play hockey [and perform other obligations] in order to receive the full salary provided for in the Player Contract." *Id.* The court found that:

> [t]he Debtor therefore did not earn the Postpetition Salary Payments before the Petition Date; instead, his bankruptcy estate has acquired and is acquiring the Postpetition Salary Payments as a result of the Debtor's performance of services under the Player Contract after the Petition Date. Because the Postpetition Salary Payments are earnings from services the Debtor performed after the Petition Date, the Debtor's bankruptcy estate 'acquired' (or is acquiring) the Postpetition Salary Payments after the commencement of his case, and § 552(a) therefore applies.

Id. at 461–62.[15]

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[15]*See also In re Clark*, 891 F.2d 111, 114 (5th Cir. 1989) (noting that football player's employment contract required him to, among other things, continue to play football, so "[a] holding that [the debtor] had satisfied his contractual obligations and was entitled to [his annual salary] the moment after passing his medical exam would certainly be unreasonable and possibly absurd"); *Rumker*, 184 B.R. at 629 (holding that bank's lien could only attach to income earned by prepetition performance, even though it was not received until postpetition).

The other issue that can arise is whether the payments to be received under the contract are "proceeds," such that they fall within the § 552(b)(1) exception. The creditor in *Johnson* argued that its security interest was in the debtor's NHL employment contract itself and that the salary the debtor received under that contract constituted the "proceeds" of the contract. *Johnson*, 554 B.R. at 464.

The bankruptcy court—looking to UCC and state law definitions of "proceeds," as the Bankruptcy Code leaves it undefined—noted that "proceeds" require some sort of *disposition* of the collateral. *Id.* at 465–66.[16] The debtor was not receiving his salary payments by means of selling, exchanging, or otherwise "disposing" of the NHL contract; rather, he received payments in exchange for his performance of services under the contract. *Id.* at 466. The mere existence of a written employment contract would not allow the creditor to bypass the protections

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[16]*See also 1st Source Bank v. Wilson Bank & Tr.*, 735 F.3d 500, 504 (6th Cir. 2013) (noting that under the UCC, proceeds are "obtained as a result of some loss or dispossession of the party's interest in that collateral, not simply by its use"); *Bank of N. Ga. v. Strick Chex Columbus Two, LLC (In re Strick Chex Columbus Two, LLC)*, 542 B.R. 914, 919 (Bankr. N.D. Ga. 2015) ("Black's Law Dictionary defines the term 'proceeds' as '[t]he value of land, goods, or investments when converted into money; the amount of money received from a sale' [or] '[s]omething received upon selling exchanging, collecting, or otherwise disposing of collateral.' The use of the words 'converted' and 'disposing' in these definitions indicates that proceeds, even in a broad sense, can only come about as the result of the replacement or substitution of the collateral, and the case law supports this conclusion."); *Rumker*, 184 B.R. at 626 (applying Georgia law to hold that "[p]roceeds are generated by the 'sale, exchange, collection, or other disposition' of prepetition collateral [so a] prepetition contract for employment only generates 'proceeds' when the contract itself is exchanged based on its intrinsic value"); *Great-W. Life & Annuity Assur. Co. v. Parke Imperial Canton, Ltd.*, 177 B.R. 843, 851 (N.D. Ohio 1994) ("The legislative history to section 552 indicates that '[t]he term "proceeds" is not limited to the technical definition of that term in the UCC, but covers any property into which property is converted.' Although broader than the definition in [the UCC], the federal approach still maintains 'conversion' as the essential aspect of 'proceeds.'"); *Walker*, 35 B.R. at 242 ("[P]ayment under contract of earned real estate commissions is property acquired by the debtor's estate which is not within the exceptions of § 552(b)."). *But see Smoker*, 204 B.R. at 972 (noting that debtor's insurance commissions qualified as proceeds of the debtor's contract under Indiana law).

of § 552 and the Thirteenth Amendment[17] by characterizing the debtor's wages as "proceeds."[18]

For all these reasons, a creditor's assertion of a security interest in an individual Chapter 11 debtor's salary or wages should not present an obstacle to a successful reorganization of the debtor.

IV. Preconfirmation Personal Expenses

A. The Issue of Whether Individual Chapter 11 Debtors Are Required to Obtain Court Authority Before Paying for Ordinary Course Personal Expenses

Just as companies need to operate their businesses while they are in Chapter 11 if they are to have any chance of reorganizing, individuals attempting to reorganize their debts in Chapter 11 must continue go about the everyday business of living. Under § 363(b) of the Bankruptcy Code, all Chapter 11 debtors in possession (companies and individuals alike) must obtain court approval to use property of the estate outside "the ordinary course of business" and must provide notice to parties in interest of their request for permission to do so. 11 U.S.C. § 363(b)(1). The Bankruptcy Code, however, does not require debtors to give notice before they use property of the estate to pay for expenses they incur "in the ordinary course of business." 11 U.S.C. § 363(c)(1) ("If the business of the debtor is authorized to be operated . . . the [debtor in possession] may . . . use property of the estate in the ordinary course of business without notice or a hearing."). But are individual Chapter 11 debtors in possession permitted to use property of the estate to pay for their ordinary course *personal expenses* without obtaining court authority to do so? The question is important because cash on hand as of the petition date is property of the estate under § 541(a)(1), individual Chapter 11 debtors' postpetition

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[17] "Neither slavery nor involuntary servitude . . . shall exist within the United States, or any place subject to their jurisdiction." U.S. Const. amend. XIII. "The Thirteenth Amendment is triggered when a 'law or force compels performance or a continuation of service.'" *In re Clemente*, 409 B.R. 288, 291 (Bankr. D.N.J. 2009) (quoting *Clyatt v. United States*, 197 U.S. 207, 215–16 (1905)).

[18] *Johnson*, 554 B.R. at 465 ("Given § 552(a)'s role in effectuating the fresh start principle . . . , it seems unlikely that Congress intended to legislatively overrule that principle in § 552(b) with respect to postpetition salary earned under an employment contract. And it would seem strange indeed for Congress to leave the protections of § 552(a) in place for at-will wage earners who file bankruptcy, but allow creditors to take away those protections from debtors merely because they are parties to employment contracts.").

earnings from services constitute property of the estate under § 1115(a)(2),[19] and most individual debtors will need to use postpetition earnings to pay for their personal expenses.

In light of § 363(c)(1)'s reference to the "ordinary course of business" and its lack of any mention of debtors' personal affairs, the argument has been made that the section provides no authority for individual Chapter 11 debtors to use property of the estate to pay for their living expenses. For example, the individual Chapter 11 debtors in a case from the Central District of California used property of the estate to pay for their living expenses without obtaining an order from the bankruptcy court authorizing them to do so, and after the case was converted to Chapter 7, the Chapter 7 trustee argued that the debtors should be required to repay the estate the funds they had used for living expenses while they were in Chapter 11. *See In re Seely*, 492 B.R. 284, 288–90 (Bankr. C.D. Cal. 2013).

Noting that Chapter 13 debtors are allowed to use property of the estate (including postpetition income) to cover their ordinary living expenses without obtaining a court order,[20] the bankruptcy court in *Seely* concluded that individual

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[19]Before the adoption of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), most courts held that postpetition earnings of individual Chapter 11 debtors should be treated like postpetition earnings of Chapter 7 debtors. Thus, the earnings were not considered property of the estate, because § 541(a)(6) provides that property of the estate does not include "earnings from services performed by an individual debtor after the commencement of the case." 11 U.S.C. § 541(a)(6). As a result, "[p]rior to BAPCPA, individual chapter 11 debtors were generally permitted to pay expenses from their postpetition income, which was not property of the estate." *United States v. Villalobos (In re Villalobos)*, No. NV-11-1061, 2011 WL 4485793, at *8 (B.A.P. 9th Cir. Aug. 19, 2011). But § 1115(a)(2), which entered the Bankruptcy Code with BAPCPA, provides that "[i]n a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541 . . . earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first." 11 U.S.C. § 1115(a)(2).

[20]*See, e.g.*, *Pisculli v. T.S. Haulers, Inc. (In re Pisculli)*, 426 B.R. 52, 65–66 (E.D.N.Y. 2010); *In re Manchanda,* No. 16-10222 (JLG), 2016 WL 3035946, at *7 (Bankr. S.D.N.Y. May 19, 2016); *In re Ashley*, No. 9:11-bk-08334, 2013 WL 315272, at *1 (Bankr. M.D. Fla. Jan. 28, 2013); *Bogdanov v. Laflamme (In re Laflamme)*, 397 B.R. 194, 205 (Bankr. D.N.H. 2008); *see also* 8 *Collier on Bankruptcy* ¶ 1303.02 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. rev. 2015) ("It seems extremely doubtful that Congress would have intended to require notice and a hearing as a prerequisite to the normal use of property of the estate, including postpetition earnings, household goods, vehicles and

Chapter 11 debtors should be allowed to use property of the estate to meet their living expenses because they, no less than Chapter 13 debtors, "need[] to pay [for] living expenses in order to continue generating revenues for the estate." *Id.* at 290; *see also, e.g.*, *In re Irwin*, 558 B.R. 743, 748–49 (Bankr. E.D. Pa. 2016) ("In a chapter 11 bankruptcy of an individual . . . the [Bankruptcy] Code contemplates that chapter 11 debtors will use property of the estate in the pre-confirmation process. *See* 11 U.S.C. § 363(c)."); *In re Bradley*, 185 B.R. 7, 8 (Bankr. W.D.N.Y. 1995) ("[W]hen a Chapter 11 Debtor-in-Possession is a natural person, his personal expenses and his obligations for incidents of his personal life are every bit as much a part of the ordinary course of his business and financial affairs as are expenses incident to the operation of the various shopping malls, nursing homes, and office buildings that he owned."). In short, individual Chapter 11 debtors generally do not need to seek court authority before using property of the estate to meet their ordinary living expenses.[21]

B. Reasons for Seeking Court Approval of Personal Expenses

That said, in many cases it will be prudent for individual Chapter 11 debtors to seek approval of their personal expenses. To understand why this is so in Chapter 11 but not Chapter 13, some background is in order. Again, in Chapter 13, the debtor is required to file a plan within 14 days after the petition date, Fed. R. Bankr. P. 3015(b), and the debtor must commence making payments under the plan within 30 days after the petition date, 11 U.S.C. § 1326(a). Furthermore, the provisions of the Bankruptcy Code and the Bankruptcy Rules governing Chapter 13 contemplate a relatively short time frame between the petition date and the hearing on confirmation. *See* 11 U.S.C. § 1324(b) (providing for confirmation hearings to be held "not later

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residential property, in a case commenced by a debtor not engaged in business. The administrative burdens and uncertainties attendant upon such a radical limitation would be a substantial deterrent to chapter 13 use by nonbusiness debtors.").

[21]There are at least two exceptions to the general rule. Debtors must seek authority if the property they intend to use is cash collateral, 11 U.S.C. §§ 363(a) & (c)(2), or if they intend to use proceeds from the sale of property that can be sold only after the debtor obtains authority to do so under § 363(b). *See In re May*, 169 B.R. 462, 472 (Bankr. S.D. Ga. 1994) (holding that the individual Chapter 11 debtors were prohibited from using cash collateral for personal expenses). In other words, for both corporate and individual debtors, the need to meet expenses never justifies taking actions—such as selling assets without court authority or using cash collateral without consent or court approval—that are inconsistent with the Bankruptcy Code. In addition, a debtor would be wise to request court authority before using significant amounts of funds existing as of the petition date that would have been administered by a panel trustee had a Chapter 7 case been filed.

than 45 days after the date of the meeting of creditors"); Fed. R. Bankr. P. 2003(a) (requiring the meeting of creditors in a Chapter 13 case to be held no more than 50 days after the petition date). The combined effect of these rules is that Chapter 13 plans typically are brought before the bankruptcy court for confirmation within a period as short as two to three months after the petition date. And when deciding whether the plan should be confirmed over an objection by the Chapter 13 trustee or a creditor if creditors are not being paid in full, the bankruptcy court must find "that all of the debtor's projected disposable income to be received in the applicable commitment period *beginning on the date that the first payment is due under the plan* will be applied to make payments to unsecured creditors under the plan." 11 U.S.C. § 1325(b)(1)(B) (emphasis added).

In other words, if there is an objection to confirmation, the debtor must pay creditors the projected disposable income to be received during the period beginning on the date that the first plan payment is due—again, typically 30 days after the petition date. Thus, if the bankruptcy court determines that the Chapter 13 debtor's expenses were too high between the petition date and confirmation, then the debtor will need to take steps to ensure that the Chapter 13 plan provides for creditors to receive the full amount they are due. *See In re Keenan*, 364 B.R. 786, 801 (Bankr. D.N.M. 2007) (holding that the debtor's expenditures prior to the confirmation hearing were excessive and that the court could not confirm the debtor's plan unless he amended it to increase the plan payments "retroactive to the date the first payment was due"). In order to make an increase in plan payments retroactive, a debtor could choose to either "pay a lump sum for back payments, increase future payments, or lengthen the term of the plan." *Id*.[22] In light of the typically short time frame between the petition date and the confirmation hearing, many Chapter 13 debtors who are able to reduce their expenditures to the required level also will be able to take one of the approaches suggested by the court in *Keenan.*

Individual Chapter 11 debtors who fail to develop a reasonable budget early in the case (i.e., well before a plan is proposed) could face problems as a result of a

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[22]*See also In re Nissly*, 266 B.R. 717, 720 (Bankr. N.D. Iowa 2001) ("If the disposable income figure of $500.00 is more accurate, it was more accurate at the beginning of the 36 month plan period, not merely six months into the plan. The failure to extend the plan period to cure the failure of the plan to provide disposable income during the first six months is fatal to the debtors' obtaining confirmation of this plan. Debtors may not offer less than disposable income, and when an objection is filed, provide the appropriate amount of disposable income only prospectively for any balance of the 36 months. Such a proposal fails to meet the requirement of 11 U.S.C. § 1325(b)(1)(B).").

Chapter 11 plan process that differs in significant ways from the process in Chapter 13. For the reasons already discussed, the process of negotiating and proposing a Chapter 11 plan typically takes much longer than the 14 days after the petition date that Chapter 13 debtors have to file their plans. Moreover, if an objection to confirmation is filed by the holder of an allowed unsecured claim that is not being paid in full, the bankruptcy court must find (before it can confirm the plan) that "the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period *beginning on the date that the first payment is due under the plan*, or during the period for which the plan provides payments, whichever is longer." 11 U.S.C. § 1129(a)(15)(B) (emphasis added). The phrase "beginning on the date that the first payment is due under the plan" in § 1129(a)(15)(B) is the same phrase used in § 1325(b)(1)(B). But unlike Chapter 13—which requires plan payments to begin within a month after the petition date—payments under a Chapter 11 plan begin only after the plan is confirmed. Thus, unless counsel advises the debtor of the need to think about budgeting early in the case, the debtor might put it off until later in the case, possibly only after a creditor makes the budget an issue.

Attorneys representing individual Chapter 11 debtors in possession accordingly should be careful to advise the debtors early on that it could be risky to spend whatever they want on living expenses prior to confirmation. In fact, counsel for individual Chapter 11 debtors might be well-advised to be proactive and put "parties in interest on notice as to the amounts the debtor intends to spend on living expenses each month." *Seely*, 492 B.R. at 289 n.5. If the debtor instead "wait[s] until estate assets have been dissipated . . . another party in interest [might] claim[] that the debtor's disbursements were unreasonable or excessive (and therefore constitute grounds to warrant the appointment of a chapter 11 trustee or [dismissal or] conversion of the case)." *Id.* The concern is not merely theoretical.[23]

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[23] *See, e.g.*, *In re Sann*, 549 B.R. 394, 396 (Bankr. D. Mont. 2016) ("The Court found that 'cause' was established under 11 U.S.C. § 1112(b)(4), and that conversion was in the best interests of creditors and the estate because of [among other things] Debtor's excessive monthly 'draws' for living expenses which were a substantial and continuing loss to and diminution of the estate[.]"); *In re Wallace*, No. 09-20496-TLM, 2010 WL 378351, at *3 (Bankr. D. Idaho Jan. 26, 2010) (holding that cause existed to dismiss Chapter 11 case of individual debtors because, among other things, they spent $48,000 on items that they identified only as "miscellaneous household expenses"); *In re Wahlie*, 417 B.R. 8, 11 (Bankr. N.D. Ohio 2009) (holding that cause existed to dismiss Chapter 11 case of individual debtors because, among other things, they "completely utilized all their monthly

Excessive personal expenses also may play a part in a court's finding that the debtor is conducting the case in bad faith, leading to a denial of a request by the debtor to convert the Chapter 11 case to Chapter 7. *See Johnson*, 546 B.R. at 165 (concluding that the individual Chapter 11 debtor had "not made a good-faith attempt to repay a portion of his debts by eliminating his excessive expenditures while in bankruptcy," because his "personal spending continued at an unreasonably high level under the circumstances of th[e] case" and he "continued—and even increased—his excessive spending" after filing the motion to convert his case to Chapter 7). In addition, some courts will use a bad-faith finding predicated on excessive expenditures as grounds to conclude that a plan of reorganization has not been "proposed in good faith" within the meaning of § 1129(a)(3) of the Bankruptcy Code. *See In re Osborne*, No. 12-00230-8-SWH, 2013 WL 2385136, at *7 (Bankr. E.D.N.C. May 30, 2013) ("[A] number of courts have denied confirmation either solely or significantly based on a finding that extravagant lifestyle choices constituted bad faith. . . . In light of the debtors' high cost lifestyle, the court cannot conclude that the plan will achieve a result consistent with the objectives and purposes of the Bankruptcy Code. Instead, the plan fails to meet the § 1129(a)(3) requirement of proposal in good faith. "); *In re Weber*, 209 B.R. 793, 798–99 (Bankr. D. Mass. 1997) (stating that in assessing an individual Chapter 11 debtor's good faith "it is certainly appropriate to examine . . . the use of the debtor's resources during the administration of a Chapter 11 case").

Those are the risks debtors face if they incur personal expenses that parties in interest could potentially challenge as excessive. And it would be unwise to assume that there are no issues with the level of a debtor's spending merely because the United States Trustee does not raise any. *See In re Keenan*, 195 B.R. 236, 242 (Bankr. W.D.N.Y. 1996) (noting that the "U.S. Trustee seemingly has not expressed

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disposable income to fund their day-to-day living expenses" and "consistently sought to allocate, during the two years th[eir] case [was] pending, only the bare minimum of their financial resources toward the payment of their debts"); *In re Bradley*, 185 B.R. 7, 11 (Bankr. W.D.N.Y. 1995) (declining to set a budget for an individual Chapter 11 debtor, but noting that parties in interest "are free under Chapter 11 of the Bankruptcy Code to seek the appointment of a Trustee if they are prepared to demonstrate that that is in the interests of the estate or that [the debtor] is mismanaging his assets" and that "[i]f they believe that he is throwing good money after bad, and that liquidation values are the best that creditors can hope for, they are free to move for conversion of the case"); *In re Wood*, 68 B.R. 613, 617 (Bankr. D. Haw. 1986) (converting case of individual Chapter 11 debtors to Chapter 7 after finding, among other things, that the debtors were "liv[ing] an affluent life while the creditors wait, wait, and wait").

an interest in the matter"). Likewise, counsel should not rely on the bankruptcy court to raise issues with a debtor's spending, as some courts may be reluctant to do so *sua sponte*. *See id.* ("The rights given to creditors by the [Bankruptcy] Code have meaning only if the Court is not needlessly chipping away at what might otherwise be a compelling set of circumstances in the creditor's favor. For example, a creditor may know that a given Chapter 11 debtor, left to his own devices, will soon leave a trail of wantonness and mismanagement that will justify the appointment of a trustee."). According to the *Keenan* court, bankruptcy courts "should let the threat or the pendency of a motion to appoint a trustee, or to convert or dismiss the case, temper the debtor's conduct and . . . should refrain from judicially micromanaging the debtor's conduct in ways designed to reduce the threat." *Id*. at 243. That is, some courts may decide to "let the practical consequences of the debtor's potential imprudence do their work within the statutory parameters." *Id*.

Of course, a hands-off approach sometimes works out for debtors even in cases in which they are expending significantly more than might be expected of someone in bankruptcy. In fact, bankruptcy courts have presided over individual Chapter 11 cases in which debtors in possession expended hundreds of thousands of dollars but still were able to provide creditors with a 100% recovery on their allowed claims. For example, during the more than four years from the petition date to confirmation of his plan, one individual Chapter 11 debtor expended hundreds of thousands of dollars to make payments on consumer debt (including mortgage payments and payments for taxes and condominium fees on two residences), yet the debtor's expenses never became an issue in the case, and he was able to obtain confirmation of a Chapter 11 plan that provided for a 100% dividend to creditors. *See Bavelis v. Doukas (In re Bavelis)*, — B.R. —, No. 10-2508, 2017 WL 737077, at *1 (Bankr. S.D. Ohio Feb. 22, 2017). But those cases are atypical. In most cases, creditors are not going to receive 100 cents on the dollar, and it therefore will make sense for counsel to address living expenses earlier rather than later.

One way to raise the issue is a motion for approval of a budget for the individual Chapter 11 debtor. Because forms can be helpful as a starting point, it bears noting that a form motion is available for approval of a budget, including living expenses, in individual Chapter 11 cases. The form motion, which was developed by the United States Bankruptcy Court for the Central District of California, is entitled Motion in Individual Chapter 11 Case for Order Approving a Budget for the

Use of the Debtor's Cash and Postpetition Income (the "Form Motion").[24] Debtors using the Form Motion make one of the following statements:

> a. The Debtor filed with the court Schedules I and J showing projected gross income, tax withholdings, other deductions and necessary living and business expenses. Copies are attached as Exhibit A and Exhibit B, respectively, to the declaration accompanying this Motion. The Debtor's gross income, tax withholdings and other deductions are set forth in Exhibit A and the Debtor's budget of approximate expenses by category is set forth in Exhibit B.
>
> or
>
> b. Attached as Exhibit A is the Debtor's monthly budget showing the Debtor's projected cash on hand and gross income and its source(s), and all anticipated expenses, deductions and withholding.

Form Motion at 3.[25]

Although they did not use a form motion, the attorneys for the debtor in possession took a proactive approach to the personal-expense issue in the high profile individual Chapter 11 case filed by Sam Wyly, the former billionaire businessman from Dallas. Early in the case, which is being presided over by Judge Barbara Houser, Wyly filed a motion requesting authority to fund "ordinary course business and living expenses." *See In re Wyly*, Case No. 14-35043 (Bankr. N.D. Tex. Oct. 19, 2014) (Doc. 6). The requested budget was high by almost any standard, and the Securities and Exchange Commission objected to it. Doc. 31 at 6–7 ("[Wyly's] monthly household expenses alone would boggle the average homeowner—over $13,500 including such extravagances as $2,200 in pool, home maintenance and landscaping; and $2,000 in groceries. . . . The budget is simply too fat to approve."). During a hearing on the motion for approval of the budget, counsel for the IRS also

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[24]The Form Motion is available at: www.cacb.uscourts.gov/sites/cacb/files/documents/forms/F2081-2.2MOTIONBUDGET.pdf.

[25]Among other things, the Form Motion also states that "[t]o the extent that court approval is required, the Debtor requests that the court authorize the Debtor to use property of the estate as defined in 11 U.S.C. §§ 541(a) and 1115(a) to pay his/her projected expenses and to make the withholding and other deductions as described in the attached budget or in Schedule J[.]" *Id*. at 4.

objected to the budget, raising issues with, among other items, the "support for elderly family and friends of about $7,000 a month" and the "half a million dollars a year from what it looks like for writers to sit down with Mr. Wyly." Doc. 46 (hearing transcript) at 41. Addressing the budget, Judge Houser stated during a hearing:

> Not all debtors are created equal. And certainly Mr. Wyly is an unusual debtor in the sense of the magnitude of his assets, and conversely, the magnitude of his liabilities. [But] [t]he budget needs to be carefully scrubbed. This is a Chapter 11 case where Mr. Wyly is claiming to be insolvent and unable to pay his creditors in full. And therefore . . . support of family and friends, no matter how generous or humanitarian in the intent behind that, that's difficult for creditors to appreciate when they aren't theoretically going to be paid in full in this case. So the budget needs to be carefully considered in light of the current circumstances of what at least Debtor's counsel is suggesting is an insolvent debtor and creditors who are not going to get paid in full.
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> Now, I don't know if [the debtor] make[s] money off the book publications, but the SEC's concerns and the IRS's concerns of spending $500,000 or $600,000 a year for people to work with Mr. Wyly to publish books, unless that's a profit center, that may not be an appropriate use of funds during a Chapter 11 case. I'm not saying it is or it isn't today. I'm just urging that the parties look at the budget carefully and that we focus on what a Chapter 11 debtor needs to spend in order to maintain a reasonable lifestyle during a Chapter 11 case. I'm going to encourage that dialogue between the SEC, the IRS and the Debtor to continue.
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> [T]he budget is not detailed and I think most people looking at the budget would react in a similar way to some of the concerns that have been expressed

> by the IRS and the SEC. So, let's take a close look at that.

Doc. 46 at 51–52.

Judge Houser expressed a preference for a revised budget that was consensual. *See id*. at 52. Wyly filed a revised budget (Doc. 88), but it was not consensual, and the SEC filed an objection (Doc. 96), as did the IRS (Doc. 99), which contended that, "[a]lthough the Bankruptcy Court instructed Mr. Wyly to carefully scrub his budget, it does not appear he has followed the Court's admonition." Doc. 99 at 1. Wyly then filed and circulated to the SEC and the IRS a second amended budget in which he, among other things, eliminated the support payments to family members and friends and the expenses for writing assistants. Doc. 115. At the hearing on the second amended budget, counsel for the IRS acknowledged that the budget had been scrubbed. An agreement was reached on a two-month budget, Doc. 182 at 52–56 (transcript of hearing), and Judge Houser expressed appreciation for the work that the debtor and his professionals had done in taking a hard look at the budget. Judge Houser entered an order approving the budget, Doc. 129, and she has similarly approved further budgets throughout the case. In short, Wyly's Chapter 11 case provides a good example of how a motion requesting approval of a budget can initiate a process of objection and negotiation that may ultimately lead to an order by the bankruptcy court establishing a level of expenditures that, if the debtor stays within the budget, should avoid the risks of excessive spending discussed above.

C. The Amount of Preconfirmation Personal Expenses

Of course, bankruptcy judges generally prefer that budget issues be worked out consensually, as they were in the Wyly case. But negotiations with creditors about the budget take place against the backdrop of potential litigation over the issue. So if a bankruptcy court is asked to decide a motion for approval of a budget for an individual Chapter 11 debtor, what standard should it apply in deciding how much spending is too much to be considered "ordinary"?[26] As it turns out, the "difficult

[26]Some bankruptcy judges might be unwilling to decide such a motion on the grounds that the Bankruptcy Code does not contemplate a motion for approval of ordinary course living expenses. *See Keenan*, 195 B.R. at 243–44 ("The Court today must refuse to decide how much of this or other income these Debtors should have to apply to what purposes. . . . . If the [debtors] cannot reach accord with their objecting creditors about how the proceeds of these claims will be used, and about how personal service income will be used on an ongoing basis, then the creditors must decide whether to pursue a recognized

question" of "what expenses [should be considered] 'ordinary' living expenses [does not] have 'clear answers.'" William L. Norton III, *Post-petition Operations for Individual Chapter 11 Debtors* (2015) at 7–8 (hereinafter, "Norton"), *available at* http://apps.americanbar.org/dch/thedl.cfm?filename=/CL160090/otherlinks_files/post_petition_operations.pdf. Various answers have been proposed.

In *Villalobos*, the debtor filed a motion for approval of "ordinary course expenses," including college tuition for his grandchildren. The bankruptcy court approved the motion because the tuition "had been traditionally paid by the Debtor as his ordinary expenses." *Villalobos*, 2011 WL 4485793, at *8. Holding that such payments were not permissible merely because they had traditionally been made,[27] the bankruptcy appellate panel reversed. The BAP also rejected an argument, made by the IRS, that individual Chapter 11 debtors seeking approval of personal expenses must "articulate a 'business justification' for using property outside the ordinary course of business." As the BAP noted, the business-justification test applies to the "approval of expenses outside of the ordinary course of business under § 363(b)(1)," and "the Debtor sought approval of his expenses as ordinary course expenses under § 363(c)." Having established that the "traditionally paid" analysis of the bankruptcy court and the business-justification test proposed by the IRS both were incorrect, the BAP declined to establish a standard for determining whether personal expenses of individual Chapter 11 debtors are permissible. *Id*. at *9. The BAP, however, did

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right (to seek conversion, to seek a trustee, etc.) on that basis. . . . [I]f no such motion has been filed, the Debtors may use the net proceeds of the claims in the ordinary course of their business or financial affairs, personally or otherwise, without limitation by this Court. But the Court so rules without prejudice to 11 U.S.C. § 549 attack on any uses that occur outside the ordinary course of business or financial affairs, and without prejudice to a later motion by Norwest, or any other party, to make any recognized motion on the grounds of the irresponsible dissipation of such funds, or any other good cause. If any debtor is failing to take prudent steps toward an eventual plan, in good faith, such a motion is welcomed.").

[27]*See also Johnson*, 546 B.R. at 163–64 (holding that the debtor's use of "income to support persons other than himself or his dependents violated his fiduciary duties and constituted bad faith on his part."); *In re Garrett*, No. 14-04063-5-DMW, 2015 WL 1546149, at *7 (Bankr. E.D.N.C. Mar. 31, 2015) ("Although the court is sympathetic to the Debtor's desires to help those who are unwilling or unable to support themselves, the Debtor's bankruptcy filing exhibits bad faith. Debtors cannot choose to give unreasonable amounts of money to friends and loved ones instead of paying debts on which they are legally obligated."); *Wahlie*, 417 B.R. 8, 11 (Bankr. N.D. Ohio 2009) (granting creditor's motion to dismiss individual Chapter 11 case where debtor, among other things, "found it acceptable to pay the debts of third-party family members").

suggest a test when it noted that "[t]he bankruptcy court made no findings as to the reasonableness of any of the expenses contained in the [debtor's budget]." *Id*. at *4.

Indeed, reasonableness appears to be the touchstone of the analysis when assessing whether Chapter 11 debtors' living expenses are appropriate. *See Nelson v. Washburn (In re Washburn)*, No. 84-05282, 1987 WL 857551, at *3 (Bankr. D.N.D. Oct. 26, 1987); *Shaumut Boston Int'l Banking Corp. v. Rodriguez (In re Rodriguez)*, 41 B.R. 774, 775 (Bankr. S.D. Fla. 1984); *see also Johnson*, 546 B.R. at 164 ("Th[e] Court . . . assumes for purposes of its analysis [in the context of deciding the Chapter 11 debtor's motion to convert his case to Chapter 7] that the Debtor, despite not having requested approval of his expenses, was permitted to pay for his own reasonable, ordinary-course living expenses out of his postpetition income without requesting authority to do so.").

Reasonableness may vary from debtor to debtor—or, as Judge Houser stated in connection with the Chapter 11 debtor's expenses in *Wyly*: "Not all debtors are created equal." Expenses that might otherwise be considered excessive likely will be deemed reasonable if the debtor is paying for goods or services that place the debtor in a better position to repay his or her creditors. For example, as was stated in the bench decision confirming the Chapter 11 case of NHL hockey player Jack Johnson:

> [T]he Court grappled with the issue of whether the Debtor's budgeted expenses are reasonable. But the proffer of the Debtor's testimony supports finding by a preponderance of the evidence that the living expenses are necessary for him to generate the income that will be used to repay creditors. Now, the Court initially was concerned about what appeared to be his excessive expenditures on items such as food and training. But the proffer of the Debtor's testimony established that, in addition to incurring the expenses any other debtor with a family of three would have, the Debtor has certain other expenses that relate to his status as a professional hockey player. In order to perform well under the current Player Contract and to best position himself for obtaining a future contract, the Debtor incurs personal training expenses both during the hockey season and during the off-season, and he expends more on high-quality foods and

> nutritional supplements than someone who is not a professional athlete would need to spend. In addition, the Debtor has expenditures related to clothing, entertainment, charity and other professional obligations that are in line with the expectations imposed on an NHL player. No party in interest chose to cross-examine the Debtor in response to the proffer of his testimony. Moreover, the Settling Lenders all supported the Debtor's budget.
>
> [C]ounsel for [one of the lenders] stated: "[L]ooking at it as an investment in his future and the agreements that we've made for the percentage of payments on our claims, we are willing to support the budget which in other circumstances may be unreasonable. But here we do think it's reasonable."

Johnson, No. 14-57104, 2016 WL 8853601, at *14 (Bankr. S.D. Ohio Nov. 10, 2016); *see also Washburn*, 1987 WL 857551, at *3 ("In the current case the court finds that [the individual Chapter 11 debtor's] contributions of labor and expertise were essential to operating the business as allowed by section 1108. In light of [the debtor's] contribution, the court does not find that his personal living expenses were unreasonable.").

Requiring an individual Chapter 11 debtor's expenses to be reasonable does not impose as stringent a restriction as the debtor likely would have faced in Chapter 13. Chapter 13 delineates the expenses that are necessary for above-median income debtors facing an objection to confirmation. *See* 11 U.S.C. § 1325(b)(3). And as already noted, those expenses (along with the debtor's income) determine the monthly plan payment that Chapter 13 debtors must begin making even before the debtor's plan is confirmed. Although individual Chapter 11 debtors typically have above-median income, courts have not required them to abide by the budgetary restrictions imposed on Chapter 13 debtors.

Perhaps looking for something more specific than "be reasonable," one commentator has postulated that "[i]t may be that the . . . disposable income test for confirmation set forth in subsection (a)(15) of section 1129 . . . will serve as the guideline for pre-confirmation use of estate property for 'personal' expenses." Sally Neely, *How BAPCPA Changes Chapter 11 Cases for Individuals*, SS029 ALI–ABA 625, 647 (West 2011) (hereinafter, "Neely"). No court has held that § 1129(a)(15) should be applied prior to confirmation. But if it did, the expenses the court would

allow might not be any different than the expenses that a court would find to be appropriate under the reasonableness analysis.

V. Postconfirmation Personal Expenses

After confirmation of the plan, the amount an individual Chapter 11 debtor has available to meet personal expenses depends on the amount of the payments that the plan requires the debtor to make to creditors and administrative claimants. If the holder of an allowed unsecured claim objects to confirmation of an individual debtor's Chapter 11 plan, then one of the provisions of the Bankruptcy Code that will come into play in determining the required amount of plan payments is § 1129(a)(15), which provides:

> In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan—
>
> > (A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
> >
> > (B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.

11 U.S.C. § 1129(a)(15).

Creditors whose claims are not being paid in full under a proposed plan have sometimes argued that § 1129(a)(15)(B) prohibits an individual debtor's postconfirmation personal expenses from being any higher than the expenses that an above-median income Chapter 13 debtor would be permitted to incur under § 1325(b). *See, e.g.*, *Johnson*, 2016 WL 8853601, at *16. This is incorrect for two reasons.

A. The Wording of § 1129(a)(15)

Section 1129(a)(15)(B) provides that "the value of the property to be distributed under the plan" must not be less than the projected disposable income of the debtor for the requisite time frame. 11 U.S.C. § 1129(a)(15)(B). That is, § 1129(a)(15)(B) establishes the projected disposable income of the debtor as the

benchmark for determining the value of property to be distributed under the plan, but the section allows the debtor to distribute less than his or her entire projected disposable income so long as the debtor uses other property to make up for any shortfall. *See Johnson*, 2016 WL 8853601, at *16; *In re Pfeifer*, No. 12-13852 (ALG), 2013 WL 5687512, at *1 (Bankr. S.D.N.Y. Oct. 18, 2013). This is in contrast to § 1325(b), which provides for the payment of "*all of the debtor's projected disposable income to be received* in the applicable commitment period beginning on the date that the first payment is due under the plan." 11 U.S.C. § 1325(b)(1)(B) (emphasis added).

As the Sixth Circuit has stated: "In [§ 1129(a)(15)] Congress made clear that a Chapter 11 plan of any length may be confirmed as long as the value of the property to be distributed is not less than the projected disposable income of the debtor to be received over five years (or the length of the plan, whichever is longer)." *Baud v. Carroll*, 634 F.3d 327, 340 (6th Cir. 2011). Thus, a Chapter 11 plan of less than five years can be confirmed so long as the plan (in addition to meeting the other confirmation requirements) provides for the distribution of an amount that is not less than the amount that would be the debtor's projected disposable income over a five-year period. Of course, the only way a debtor could possibly distribute an amount that is at least equal to his or her five-year projected disposable income over a period of less than five years is for the debtor to contribute property other than his or her disposable income during the five-year period. *See* Neely at 674 ("[I]t is important to note that [under] section 1129(a)(15) . . . an individual chapter 11 debtor is required to distribute . . . property (*which need not be post-petition earnings*) under the plan of a value that is not less than his or her 'projected disposable income' calculated as set forth in section 1129(a)(15)(B)." (emphasis added)); *Johnson*, 2016 WL 8853601, at *16 (holding that the cash the debtor had accumulated as of the effective date of the plan and the proceeds of assets sales could be used as part of the property to be distributed under the plan for purposes of satisfying § 1129(a)(15)(B)); *Pfeifer*, 2013 WL 5687512, at *1 (concluding that § 1129(a)(15)(B) was satisfied even though distributions were to be made from a postconfirmation trust funded out of recoveries from avoidance actions and proceeds of asset sales).[28]

[28]The "value of the property to be distributed under the plan" includes all distributions—including distributions to secured and priority creditors and administrative claimants—not just distributions to unsecured creditors. *See Pfeifer*, 2013 WL 5687512, at *3 ("Not surprisingly, the courts that have considered this issue have uniformly held that § 1129(a)(15)(B) does not require an individual debtor to pay an amount at least equal to his or her projected disposable income to unsecured creditors.").

The first step in applying § 1129(a)(15) is to calculate the debtor's projected disposable income for the five years after confirmation (or the length of the plan if the length is longer than five years). In accordance with § 1129(a)(15), the debtor's projected disposable income is calculated in accordance with §1325(b)(2), which provides that the term "projected disposable income" means "current monthly income received by the debtor [with certain exceptions] less amounts reasonably necessary to be expended. . . ." 11 U.S.C. § 1325(b)(2).[29] The second step is to determine the value of the property to be distributed under the plan, including postconfirmation earnings (minus reasonable expenses) as well as any other property to be distributed, such as cash on hand as of the confirmation date and the proceeds of asset sales that the debtor proposes to use to pay creditors.

The third and final step in applying § 1129(a)(15) is compare the debtor's projected disposable income to the amount the debtor actually is distributing under the plan. In some cases, the amount that the debtor is contributing from sources other than earnings will be great enough that the plan will satisfy § 1129(a)(15) even if the creditor's objection to the debtor's postconfirmation expenses were sustained in its entirety. *See Johnson*, 2016 WL 8853601, at *15 ("[T]he Debtor would be providing more than § 1129(a)(15) requires even if RFF were correct that the Debtor's expenses could not exceed those of an above-median income Chapter 13 debtor."); *Pfeifer*, 2013 WL 5687512, at *4 ("The Objection is thus overruled because even assuming Objectant is correct in each of its assertions and the Debtors' projected disposable income must be increased accordingly, the Debtors' Plan still distributes property whose value is greater than their assumed projected disposable income, and it satisfies § 1129(a)(15)(B)."). This is one reason that individual Chapter 11 debtors' postconfirmation living expenses are permitted to be higher than those of above-median income Chapter 13 debtors.

B. The Nonapplicabilty of the Expense Limitations Imposed on Chapter 13 Debtors

The second reason that individual Chapter 11 debtors' postconfirmation personal expenses can exceed those of above-median income Chapter 13 debtors is that—under the prevailing view—the expense limitations imposed in Chapter 13 do not apply in Chapter 11. Again, the plan of an individual Chapter 11 debtor who is

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[29]The term "current monthly income" means the average gross monthly income that the debtor receives, derived during a six-month lookback period, excluding "benefits received under the Social Security Act" and certain other payments. *See* 11 U.S.C. § 101(10A)(B).

not proposing to pay unsecured claims in full can be confirmed over the objection of the holder of an allowed unsecured claim only if the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor "as defined in section 1325(b)(2)," 11 U.S.C. § 1129(a)(15)(B), and § 1325(b)(2) in turn provides that the term "projected disposable income" means "current monthly income received by the debtor [with certain exceptions] *less amounts reasonably necessary to be expended*," 11 U.S.C. § 1325(b)(2) (emphasis added). Most Chapter 11 debtors have above-median income, and the "amounts reasonably necessary to be expended" for those debtors if they were above-median income Chapter 13 debtors would be the expenses provided for in § 1325(b)(3). Those expenses will be less than the expenses of a typical high-earning Chapter 13 debtor, let alone a high-earning Chapter 11 debtor.

As the *Baud* court explained:

> For debtors with current monthly income exceeding the applicable median family income, however, § 1325(b)(3) requires courts to determine the amounts reasonably necessary to be expended in accordance with the means test, i.e., the statutory formula for determining whether a presumption of abuse arises in Chapter 7 cases. The result of determining these expenditures in accordance with the means test is that above-median-income debtors must use several standardized expenditure figures in lieu of their own actual monthly living expenses. . . . *Because standardized expense figures are used in portions of the calculation, however, the amounts reasonably necessary to be expended by above median-income debtors are unlikely to reflect these debtors' actual expenses*.

Baud, 634 F.3d at 333–34 (citations and internal quotation marks omitted) (emphasis added).

Section § 1129(a)(15)(B) refers only to § 1325(b)(2), not § 1325(b)(3). Despite this, at least one court has held that the expenses limitations of § 1325(b)(3) apply to Chapter 11 debtors who have above-median income. *See In re Bennett*, No. 07-10864-SSM, 2008 WL 1869308, at *2 n.6 (Bankr. E.D. Va. Apr. 23, 2008). The court likely relied on § 1129(a)(15)(B)'s reference to § 1325(b)(2) and that section's

acknowledgment that projected disposable income must take into account the amounts reasonably necessary to be expended by the debtor.

But because § 1129(a)(15)(B) references only § 1325(b)(2), not § 1325(b)(3), most courts have held that the plain meaning of the Bankruptcy Code leads to the conclusion that § 1325(b)(3) does not apply when the "amounts reasonably necessary to be expended" are being determined under § 1129(a)(15)(B).[30]

This conclusion also finds support in comments by the Advisory Committee on Bankruptcy Rules. As one bankruptcy court has explained:

> The Advisory Committee on Bankruptcy Rules that drafted the Interim Bankruptcy Rules and Forms to implement the BAPCPA . . . omitted the Chapter 7 means-test expenses from Official Form 22B, the one that individual Chapter 11 debtors are supposed to complete. The Committee explained: "The Chapter 11 form is the simplest of the three [22A, 22B, and 22C], since the means-test deductions of § 707(b)(2) are not employed in determining the extent of an individual Chapter 11 debtor's disposable income. Section 1129(a)(15) requires payments of disposable income

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[30]*See Johnson*, 2016 WL 8853601, at *16–17; *In re Woodward*, No. BK11-40936, 2014 WL 1682847, at *4–5 (Bankr. D. Neb. Apr. 29, 2014) ("Section 1129(a)(15) specifically incorporates Chapter 13's disposable income definition found in § 1325(b)(2), but it is silent as to the determination of reasonable expenses for purposes of calculating disposable income. That is, while § 1325(b)(3) can be read as an instructional section of permissible expenses for § 1325(b)(2)—and, therefore, presumably incorporated into § 1325(b)(2)—§ 1129(a)(15) does not include it. The omission seems intentional, as noted in a leading bankruptcy treatise: '[T]he reference in section 1129(a)(15) is explicitly to, and only to, paragraph (2) of section 1325(b). Congress had it within its power to draft the cross-reference more broadly, but did not." (quoting 7 *Collier on Bankruptcy* ¶ 1129.02[15][a] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. rev. 2014)); *In re Bacardi*, No. 09 B 25757, 2010 WL 54760, at *5 n.2 (Bankr. N.D. Ill. Jan. 6, 2010) ("[T]he means test does not in fact apply in chapter 11. Section 1129(a)(15) mentions section 1325(b)(2) but not section 1325(b)(3)."); *In re Roedemeier*, 374 B.R. 264, 272–73 (Bankr. D. Kan. 2007) ("[Section] 1129(a)(15) must be read to allow a judicial determination of the expenses that are reasonably necessary for the support of the debtor and his or her dependents."); *In re Gray*, No. 06-927, 2009 WL 2475017, at *3 (Bankr. N.D. W.Va. Aug. 11, 2009) (same).

> 'as defined in section 1325(b)(2), and that paragraph allows calculation of disposable income under judicially-determined standards, rather than pursuant to the means test deductions, specified for higher income Chapter 13 debtors by § 1325(b)(3)."

Roedemeier, 374 B.R. at 272.

In short, adherence to the plain-meaning rule of statutory construction should lead to the conclusion that the Chapter 7 means test applicable to above-median income debtors in Chapter 13 cases does not apply in Chapter 11.

VI. The Absolute Priority Rule In Individual Chapter 11 Cases

A. Origins of the Absolute Priority Rule

The origins of the absolute priority rule can be traced to the latter half of the nineteenth century. The earliest version of the rule was announced by the Supreme Court in response to widespread collusion between stakeholders in railroad reorganizations, immediately following the Civil War. *In re Maharaj*, 681 F.3d 558, 560 (4th Cir. 2012). In *Chicago, Rock Island & Pacific Railroad v. Howard*, 74 U.S. 392, 409–10 (1868), the Court held that "stockholders are not entitled to any share of the capital stock nor to any dividend of the profits until all the debts of the corporation are paid." As the Supreme Court later pointed out, "[t]he rule had its genesis in judicial construction of the undefined requirement of the early bankruptcy statute that reorganization plans be 'fair and equitable.'" *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988); *see also* Pub. L. No. 73–296, 48 Stat. 911, 919 (1934) (amending the Bankruptcy Act to add confirmation requirement that a plan is "fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders"). Applying this confirmation requirement in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 117 (1939), the Court for the first time used the term "absolute priority" to describe the rule.

Although the absolute priority rule was based on the "fair and equitable" requirement contained in § 77B of the Bankruptcy Act (the "Act"), the rule itself was never codified in the Act. *Maharaj*, 681 F.3d at 560–61. Indeed, Congress expressly prohibited its further judicial application by passing the 1952 amendments to the Act. *See* Pub. L. 456, 66 Stat. 420, 433 (1952). In modifying the plan confirmation standards under what was then Chapter XI of the Act, Congress amended the Act so that "[c]onfirmation of an arrangement [would] not be refused solely because the interests of a debtor, or if the debtor is a corporation, the interest of its stockholders or members [would be] preserved under the arrangement." *Id.* Instead, under the

1952 amendment to the Act, a Chapter XI plan could be confirmed if the plan "[was] for the best interest of the creditors and [was] feasible." *Id.*

The legislative history to the 1952 amendments to the Act makes it clear that Congress intended an express repeal of the judicially created absolute priority rule in Chapter XI, which was a remedy designed for small, privately held businesses. *Maharaj*, 681 F.3d at 561. "[T]he fair and equitable rule . . . cannot realistically be applied. . . . Were it so applied, no individual debtor, [and] no corporate debtor where the stock ownership is substantially identical with management could effectuate an arrangement except by payment of the claims of all creditors in full." H.R. Rep. No. 82–2320 (1952), *reprinted in* 1952 U.S.C.C.A.N. 1960, 1982. The absolute priority rule remained in place for proceedings under Chapter X of the Act, which was designed for the reorganization of public companies. *Maharaj*, 681 F.3d at 561 n.3 (citing Ralph A. Peeples, *Staying In: Chapter 11, Close Corporations and the Absolute Priority Rule*, 63 Am. Bankr. L.J. 65, 66 (1989)).

B. Codification of the Absolute Priority Rule in the Bankruptcy Code

In 1978, Congress enacted the Bankruptcy Reform Act of 1978, thereby replacing the Act with the Bankruptcy Code. The newly created Chapter 11 included many of the features of Chapters X and XI (as well as the infrequently used Chapter XII, which governed real property arrangements). *See* H.R. Rep. No. 95–595 at 223 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6183 ("This bill adopts a consolidated chapter for all business reorganizations."). With the enactment of the Code, Congress expressly codified the absolute priority rule. 11 U.S.C. § 1129(b)(2)(B)(ii); *Ahlers*, 485 U.S. at 202. The absolute priority rule, as provided in § 1129, remained unchanged until the passage of BAPCPA in 2005.

To confirm a proposed plan of reorganization, a plan proponent must show that the plan meets the confirmation standards set forth in § 1129(a) of the Code, including § 1129(a)(8)(A)'s requirement that each impaired class of creditors accept the plan. But as noted earlier, the Bankruptcy Code offers a plan proponent another path to confirmation when not all impaired classes of claims and interests vote to accept the plan. Under § 1129(b), a plan of reorganization may be confirmed over the dissent of an impaired class of creditors—a process commonly known as a "cram down." A plan proponent need not comply with the requirements of § 1129(a)(8) in a cram-down scenario "if the plan does not discriminate unfairly, and is fair and equitable" to the dissenting creditors. 11 U.S.C. § 1129(b)(1).

Section 1129(b)(2) of the Bankruptcy Code specifies certain requirements that a plan must meet in order to be found "fair and equitable." Among those requirements is the absolute priority rule. 11 U.S.C. § 1129(b)(2)(B)(ii). Prior to the enactment of BAPCPA, the absolute priority rule was simply that, in order to be deemed fair and equitable, a proposed Chapter 11 plan must provide that "the holder of any claim or interest that is junior to the claims of such [dissenting] class will not receive or retain under the plan on account of such junior claim or interest any property." *Id.* Put differently, if the proposed plan called for the debtor to retain property, any dissenting creditors had to be paid in full in order for the plan to be "crammed down." *See Ahlers*, 485 U.S. at 202.

Before BAPCPA, there was no exception to § 1129(b)(2)(B)(ii)'s absolute priority rule for individual debtors. And as the Supreme Court's unanimous decision in the *Ahlers* case made clear, the rule was uniformly applied in that context pre-BAPCPA. *Id.* ("There is little doubt that a reorganization plan in which [the individual debtors] retain an equity interest in the[ir] farm is contrary to the absolute priority rule."). While prior to BAPCPA's passage there was no question about the absolute priority rule's applicability in individual Chapter 11 cases, courts were divided on whether an individual debtor could retain exempt property without running afoul of the rule. One line of cases reads § 1129(b)(2)(B)(ii) to mean that an individual debtor could not satisfy the absolute priority rule while retaining exempt property. *See, e.g.*, *In re Gosman*, 282 B.R. 45, 49 (Bankr. S.D. Fla. 2002) ("Had Congress intended to exclude exempt property from the effect of the 'absolute priority rule,' then the term 'property' would not have been used under Section 1129(b)(2)(B)(ii), rather Congress would have used 'non-exempt property' or 'property of the estate.' . . . Section 1129(b)(2)(B)(ii) uses the term 'property' and such term is modified by the word 'any,' a word which, by any definition, sets no boundaries. 'Any' does not refer to certain things and not others. 'Any' means 'every' and 'all.' It is unlimited."). Other courts found that an individual Chapter 11 debtor's retention of exempt property did not violate the absolute priority rule because retention was "not on account of . . . [the debtor's] junior interest" in property. *See In re Henderson*, 321 B.R. 550, 559–60 (Bankr. M.D. Fla. 2005) ("The ordinary meaning of the term 'junior' means a claim or interest that is subordinate to other claims or interests which enjoy a higher rank. . . . It is clear that the Debtor's interest in exempt property can never be junior to the interest of creditor[s] including the claim of dissenting unsecured creditors. This is so because unsecured creditors could never reach exempt property outside of bankruptcy, and such properties are immune and not subject to liquidation under any of the operating chapters of the Code."), *aff'd*, 341 B.R. 783 (M.D. Fla. 2006).

C. The Absolute Priority Rule After BAPCPA

The BAPCPA amendments added an exception to the absolute priority rule requirements imposed by § 1129(b)(2)(B)(ii) for individual debtors. As amended by BAPCPA, § 1129(b)(2)(B)(ii) now states that to be fair and equitable, a proposed plan must provide that:

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

11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added to show statutory language added by the 2005 amendment).

Following this amendment to § 1129(b)(2)(B)(ii), courts have divided on the issue of whether the absolute priority rule continues to apply in individual Chapter 11 cases. Two new provisions added to the Bankruptcy Code by the BAPCPA amendments also have a bearing on this issue. The first is § 1115, which provides:

> (a) In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541—
>
> > (1) all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first; and
> >
> > (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first.
>
> (b) Except as provided in section 1104 or a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.

11 U.S.C. § 1115.[31] Section 1129(a)(15)—which was quoted and discussed above and which also was added to the Bankruptcy Code in 2005—is the second provision that courts consider in analyzing whether, in enacting the BAPCPA amendments, Congress intended to abrogate the absolute priority rule in individual Chapter 11 cases.

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[31]Prior to the addition of § 1115 to the Bankruptcy Code with the enactment of the BAPCPA amendments, there was some uncertainty about what constituted "property of the estate" in an individual Chapter 11 case. Courts considering this issue looked to 11 U.S.C. § 541(a) (creating a bankruptcy estate composed of property of the debtor as of the commencement of the case and of certain property or rights the debtor acquires after the commencement of the case) and § 541(a)(6) (providing that "[e]arnings performed by an individual debtor after the commencement of the case" are not property of the estate under §541(a)(6)). Virtually every pre-BAPCPA case held that earnings of debtors from post-petition services rendered to third parties were not property of the estate. *See Toibb*, 501 U.S. at 166 (stating that "there is no . . . provision in Chapter 11 requiring a debtor to pay future wages to a creditor"); *see also Roland v. Unum Life Ins. Co. of Am.*, 223 B.R. 499, 502 (E.D. Va. 1998) ("In accord with the great majority of courts to consider this question, the Court finds that the post-petition wages of an individual in chapter 11 are not property of the estate." (footnotes omitted)); *id*. at 502 n.5 (collecting cases). But while the § 541(a)(6) personal-earnings exception clearly carved out an individual Chapter 11 debtor's post-filing earnings from the estate, there was a considerable amount of pre-BAPCPA litigation centered on the question of whether the revenues of an individual debtor's professional association were "earnings of the individual" debtor or were earnings of the debtor's entire professional enterprise. *See, e.g.*, *FitzSimmons v. Walsh (In re FitzSimmons)*, 725 F. 2d 1208, 1210–11 (9th Cir. 1984) ("[T]he earnings exception applies only to services performed personally by the individual debtor . . . [He] is thus entitled to monies generated by his law practice only to the extent that they are attributable only to personal services that he himself performs. To the extent that the law practice's earnings are attributable not to [the debtor's] personal services but to the business' invested capital, accounts receivable, good will, employment contracts with the firm's staff, client relationships, fee agreements, or the like, the earnings of the law practice accrue to the estate); *In re Cooley*, 87 B.R. 432, 436–45 (Bankr. S.D. Tex. 1988) (holding that income from services performed by debtor surgeon and income based on calculated goodwill of his medical practice, a sole proprietorship, were not property of estate for purposes of determining portion of postpetition income accruing to estate); Stacy L. Daly, *Post-Petition Earnings and Individual Chapter 11 Debtors: Avoiding a Head Start*, 68 Fordham L. Rev. 1745, 1765 (2000) (recognizing that majority of courts "have held that post-petition income derived from personal services rendered by the individual debtor [is] excluded from the estate, while post-petition income derived from the sole proprietor's business assets [is] included within the debtor's estate.").

D. Does the Absolute Priority Rule Continue to Apply in Individual Chapter 11 Cases After BAPCPA?

As previously stated, courts are divided on whether the absolute priority rule retains its vitality in individual Chapter 11 cases following the BAPCPA amendments. A number of courts have adopted the "broad view" that, by including in § 1129(b)(2)(B)(ii) a cross-reference to § 1115 (which in turn references § 541, the provision that defines the property of a bankruptcy estate), Congress intended to include the entirety of the bankruptcy estate as property that an individual debtor may retain. Courts adopting this view hold that, by enacting the BAPCPA amendments, Congress effectively abrogated the absolute priority rule in Chapter 11 for individual debtors. By contrast, courts adhering to the "narrow view" have concluded that Congress did not intend such a sweeping change to Chapter 11, and that the BAPCPA amendments merely have the effect of allowing individual Chapter 11 debtors to retain property and earnings acquired after the commencement of the case that would otherwise be excluded under § 541(a)(6) & (7).

The terms "broad view" and "narrow view" appear to have been used first in *In re Roedemeier*, 374 B.R. 264 (Bankr. D. Kan. 2007). There, the court stated that § 1115 and the exception to the absolute priority rule set forth in § 1129(b)(2)(B)(ii) "are worded in such a way that the exception could be construed narrowly to cover only the additional, postpetition property brought into the Chapter 11 bankruptcy estate by § 1115(a), or broadly to cover not only that property but also all the property brought into the estate by § 541, most of which is property the debtor had before filing for bankruptcy." *Id.* at 274.

1. The Broad View

The following courts adhere to the broad view:

- *Friedman v. P+P, LLC (In re Friedman)*, 466 B.R. 471 (B.A.P. 9th Cir. 2012);
- *SPCP Group, LLC v. Biggins*, 465 B.R. 316 (M.D. Fla. 2011);
- *In re O'Neal*, 490 B.R. 837 (Bankr. W.D. Ark. 2013);
- *In re Tucker*, 479 B.R. 873 (Bankr. D. Or. 2012);
- *In re Shat*, 424 B.R. 854 (Bankr. D. Nev. 2010);
- *In re Johnson*, 402 B.R. 851 (Bankr. N.D. Ind. 2009);
- *In re Tegeder*, 369 B.R. 477 (Bankr. D. Neb. 2007);
- *In re Roedemeier*, 374 B.R. 264 (Bankr. D. Kan. 2007); and

- *In re Bullard*, 358 B.R. 541 (Bankr. D. Conn. 2007).[32]

Some of these broad view courts have concluded that Congress intended abrogation on the basis of the "plain" language of § 1129(b)(2)(B)(ii). For instance, in *Biggins*, the district court reasoned that:

> [s]ection 1115 says that "property of the estate includes, in addition to the property specified in section 541–(1) all property of the kind specified in section 541 that the debtor acquires after the commencement of the case," as well as "(2) earnings from services performed by the debtor after the commencement of the case." The *plain reading* of this statute is that "property of the estate," for purposes of Section 1115, includes property acquired and earnings earned after the debtor files his or her Chapter 11 petition, in addition to property specified in section 541. . . .
>
> Reading these statutes together, "property of the estate" for purposes of Section 1115 includes property and earnings acquired both before and after the commencement of the bankruptcy case.

465 B.R. at 322 (emphasis added); *see also Tegeder*, 369 B.R. at 480 ("Since § 1115 broadly defines property of the estate to include property specified in § 541, as well as property acquired post-petition and earnings from services performed post-petition, the [absolute priority] rule no longer applies to individual debtors who retain property of the estate under § 1115.").

Based on what it took to be the "plain meaning" of §§ 1115 and 1129(b)(2)(B)(ii), a divided Ninth Circuit Bankruptcy Panel in *Friedman* reached a similar conclusion:

> "Included" is not a word of limitation. To limit the scope of estate property in §§ 1129 and 1115 would require the statute to read "included, except for the property set out in Section 541" (in the case of

[32]Several of these decisions have been overruled or abrogated by a federal circuit decision cited below in the list of cases adopting the narrow view.

> § 1129(b)(2)(B)(ii)), and "in addition to, but not inclusive of the property described in Section 541" (in the case of § 1115).
>
> 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.

Friedman, 466 B.R. at 482 (emphasis added) (footnote omitted).

Several other courts have adopted the broad view of the BAPCPA amendments but in doing so have not relied on the plain-meaning approach. For example, in *Shat* the bankruptcy court found the phrase "property included in the estate under section 1115" to be "ambiguous" but nevertheless concluded that Congress intended to abrogate the absolute priority rule for individual debtors. *Shat*, 424 B.R. at 863–68. Relying on *Roedemeier*, the *Shat* court reasoned that several other BAPCPA amendments to Chapter 11 demonstrated Congress's intent that Chapter 11 procedures for individual debtors function more like those found in Chapter 13. *Id.* at 867 (citing *Roedemeier*, 374 B.R. at 276).[33]

In addition to the amendment to § 1129(b)(2)(B)(ii)'s statutory language, the court in *Shat* also cited the following changes to Chapter 11 made by BAPCPA as support for its broad view that Congress intended to fully abrogate the absolute priority rule for individual debtors:

- the inclusion of § 1123(a)(8)—specifying the mandatory contents of a Chapter 11 plan—which resembles § 1322(a)(1);
- the addition of the disposable income test in § 1129(a)(15), which parallels that imposed by § 1325(b);
- the addition of § 1141(d)(5)(A), which delays an individual debtor's discharge until the completion of all plan payments as in § 1328(a);
- the addition of § 1141(d)(5)(B), which permits a discharge before all payments are completed under § 1141(d)(5), similar to the hardship discharge provision contained in § 1328(b); and

[33]According to the *Roedemeier* court, the Chapter 11 amendments "are clearly drawn from the Chapter 13 model." 374 B.R. at 275.

- the inclusion of § 1127(e), which allows for modification of a plan even after substantial consummation for purposes similar to § 1329(a).

Shat, 424 B.R. at 862. According to the *Shat* court, these amendments reflected Congress's "overall design of adapting various chapter 13 provisions to fit in chapter 11." *Id.* at 868. In its view, then, interpreting the amendments to § 1129(b)(2)(B)(ii) as eliminating the absolute priority rule for individual debtors would be consistent with the perceived congressional intent to harmonize the treatment of the individual debtor under Chapter 11 with those under Chapter 13, which has no absolute priority rule.

To further bolster their view that Congress intended to have Chapter 11 operate for individual debtors as Chapter 13 does, the *Shat* and *Friedman* courts noted that Congress drafted the new § 1115 to mirror § 1306(a) of the Code, which, in a Chapter 13 case, augments the bankruptcy estate created by § 541 with certain additional property. *See Friedman*, 466 B.R. at 482; *Shat*, 424 B.R. at 862. Both §§ 1115 and 1306 contain prefatory language stating that "property of the estate includes, in addition to the property specified in section 541," and both also list, in similar terms, post-petition acquired property and earnings. *See* 11 U.S.C. §§ 1115 & 1306.

In *Shat*, the court also pointed out that "[t]he broader view . . . saves Section 1129(b)(2)(B)(ii) from an almost trivial reading." *Shat*, 424 B.R. at 868. The *Roedemeier* court made a similar observation when it noted that "the narrow reading of the new exception in § 1129(b)(2)(B)(ii) would have little impact on . . . probably most . . . individual debtors'[] ability to reorganize in Chapter 11." *Roedemeier*, 374 B.R. at 275; *see Tegeder*, 369 B.R. at 480 ("A more narrow interpretation [of § 1129(b)(2)(B)(ii)] would cause this amendment to have little effect." (quoting Hon. William L. Norton, Jr., 4 *Norton Bankruptcy Law & Practice 2d* § 84A:1)).

2. The Narrow View

The following courts adhere to the narrow view:

- *Zachary v. Cal. Bank & Tr.*, 811 F.3d 1191 (9th Cir. 2016);
- *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., LLC v. Stephens (In re Stephens)*, 704 F.3d 1279 (10th Cir. 2013);
- *In re Maharaj*, 681 F.3d 558 (4th Cir. 2012);
- *Brown v. Ferroni (In re Brown)*, 505 B.R. 638 (E.D. Pa. 2014);

- *Heritage Bank v. Woodward (In re Woodward)*, 537 B.R. 894 (B.A.P. 8th Cir. 2015);[34]
- *In re Rogers*, No. 14-40219-EJC, 2016 WL 3583299 (Bankr. S.D. Ga. June 24, 2016);
- *In re Akinpelu*, 530 B.R. 822 (Bankr. N.D. Ga. 2015);
- *In re Lucarelli*, 517 B.R. 42 (Bankr. D. Conn. 2014);
- *In re Batista-Sanechez*, 505 B.R. 222 (Bankr. N.D. Ill. 2014);
- *In re Brown*, 498 B.R. 486 (Bankr. E.D. Pa. 2013);
- *In re Grasso*, 497 B.R. 448 (Bankr. E.D. Pa. 2013);
- *In re Martin*, 497 B.R. 349 (Bankr. M.D. Fla. 2013);
- *In re Gerard*, 495 B.R. 850 (Bankr. E.D. Wis. 2013);
- *In re Tex. Star Refreshments, LLC*, 494 B.R. 684 (Bankr. N.D. Tex. 2013);
- *In re Lee Min Ho Chen*, 482 B.R. 473 (Bankr. D.P.R. 2012);
- *In re Ferguson*, 474 B.R. 466 (Bankr. D.S.C. 2012);
- *In re Arnold*, 471 B.R. 578 (Bankr. C.D. Cal. 2012);
- *In re Lindsey*, 453 B.R. 886 (Bankr. E.D. Tenn. 2011);
- *In re Kamell*, 451 B.R. 505 (Bankr. C.D. Cal. 2011);
- *In re Draiman*, 450 B.R. 777 (Bankr. N.D. Ill. 2011);
- *In re Maharaj*, 449 B.R. 484 (Bankr. E.D. Va.2011);
- *In re Walsh*, 447 B.R. 45 (Bankr. D. Mass. 2011);
- *In re Stephens*, 445 B.R. 816 (Bankr. S.D. Tex. 2011);
- *In re Tucker*, No. 10-67281-fra11, 2011 WL 5926757 (Bankr. D. Or. Nov. 28, 2011);
- *In re Borton*, No. 09-00196-TLM, 2011 WL 5439285 (Bankr. D. Idaho Nov. 9, 2011);
- *In re Karlovich*, 456 B.R. 677 (Bankr. S.D. Cal. 2010);
- *In re Gelin*, 437 B.R. 435 (Bankr. M.D. Fla. 2010);
- *In re Mullins*, 435 B.R. 352 (Bankr. W.D. Va. 2010);
- *In re Gbadebo*, 431 B.R. 222 (Bankr. N.D. Cal. 2010); and
- *In re Steedley*, No. 09-50654, 2010 WL 3528599 (Bankr. S.D. Ga. Aug. 27, 2010).

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[34]In a decision rendered earlier this year, Judge Norton, citing *Woodward*, recognized the applicability of the absolute priority rule in individual Chapter 11 cases. *See James v. West (In re West)*, No. 16-04083-can, 2017 WL 746250, at *14 (Bankr. W.D. Mo. Feb. 24, 2017) (holding, among other things, that there was no evidence "that converting th[e] [Chapter 7] case to a Chapter 11 would be in the best interests of the estate and other parties in interest, or that the Debtor could even propound a confirmable Chapter 11 plan").

Every circuit court that has considered the issue, and nearly two dozen separate bankruptcy courts, have adopted the narrow view and held that BAPCPA did not abrogate the absolute priority rule in its entirety for individual Chapter 11 debtors.[35] Like the courts adhering to the broad view, in reaching this conclusion, these courts have offered differing rationales as to why the absolute priority rule remains valid in individual Chapter 11 cases.

Beginning with *Gbadebo*, several of the courts in this camp found that the language of § 1129(b)(2)(B)(ii) preserved the absolute priority rule in unambiguous terms. *See, e.g.*, *Tucker*, 2011 WL 5926757, at *2; *Draiman*, 450 B.R. at 821 (relying on the "plain meaning" of § 1129(b)(2)(B)(ii)); *Walsh*, 447 B.R. at 48–49 (quoting *Gbadebo*, 431 B.R. at 229); *Steedley*, 2010 WL 3528599, at *2; *Mullins*, 435 B.R. at 360; *Karlovich*, 456 B.R. at 681; *Borton*, 2011 WL 5439285, at *4.

After discussing the contrary holding in *Shat*, the *Gbadebo* court, in frequently quoted language, stated that

> [n]otwithstanding the thorough and thoughtful analysis by the *Shat* court, the Court is unable to agree with its conclusion. If the Court were writing on a clean slate, it would view the language of § 1129(b)(2)(B)(ii) as *unambiguous*. The Court would read the phrase "included in the estate under section 1115" to be reasonably susceptible to only one meaning: i.e., added to the bankruptcy estate by § 1115.

431 B.R. at 229 (emphasis added).

While it did not find the language of § 1129(b)(2)(B)(ii) to be unambiguous, the Sixth Circuit in *Ice House* undertook a detailed textual analysis of this provision:

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[35]In the Chapter 11 case of an individual, the Eleventh Circuit, noting the bankruptcy court's independent duty to ensure compliance with the absolute priority rule if there is an impaired non-accepting class, held that a creditor in an impaired non-accepting class could argue on appeal that the plan violated the absolute priority rule even though the creditor had not filed an objection to the plan in the bankruptcy court. *See Ala. Dep't of Econ. & Cmty. Affairs v. Ball-Healthcare-Dallas, LLC (In re Lett)*, 632 F.3d 1216 (11th Cir. 20110). In so holding, the Eleventh Circuit discussed the absolute priority rule in the context of an individual Chapter 11 case, but did not directly address its continued applicability in such cases post-BAPCPA.

The parties agree that the [language added to § 1129(b)(2)(B)(ii) by BAPCPA] creates an exception to the absolute-priority rule, and moreover that the exception applies only in Chapter 11 cases where the debtor is an individual. But the parties otherwise disagree upon the exception's scope. Ice House argues that the [new] language excepts from the absolute-priority rule only property that is added to the estate by § 1115, i.e., post-petition property. In contrast, Cardin and the bankruptcy court believe that the [new] language excepts not only post-petition property added by § 1115, but also pre-petition property that was already part of the estate under § 541(a). Thus, under Cardin's reading, the 2005 amendment to § 1129(b)(2)(B)(ii) excepts *all* of an individual debtor's property from the absolute-priority rule—which is to say that the rule does not apply to individual debtors at all.

The critical language in § 1129(b)(2)(B)(ii) is that "the debtor may retain property included in the estate under section 1115[.]" And the key word within that language is "included." "Include" is a transitive verb, which means it "show[s] action, either upon someone or something." Shertzer, *Elements of Grammar* 26 (1986). The action described by "include" is either "to take in as a part, an element, or a member" (first definition) or "to contain as a subsidiary or subordinate element" (second definition). The *American Heritage Dictionary* 913 (3d ed. 1992). The first definition ("to take in") describes genuine action—grabbing something and making a part of a larger whole—whereas the second definition ("to contain") lends itself, more dryly, to a description of things that are already there—"the duties of a fiduciary include. . . ." The first definition is plainly the better fit in § 1129(b)(2)(B)(ii): converted into the active voice, § 1129(b)(2)(B)(ii) refers to property that § 1115 includes in the estate,

> which naturally reads as "property that § 1115 takes into the estate," rather than as "property that § 1115 contains in the estate." Thus—employing this definition and converted into the active voice—§ 1129(b)(2)(B)(ii) provides that "the debtor may retain property that § 1115 takes into the estate."
>
> Section 1115 cannot take into the estate property that was already there. And long before Congress enacted the 2005 amendments, § 541 had already brought into the estate "all legal or equitable interests of the debtor in property as of the commencement of the case." What § 1115 adds to that pile of legal and equitable interests—and thus what § 1115 takes into the estate—is property "that the debtor acquires *after* the commencement of the case[.]" 11 U.S.C. § 1115(a) (emphasis added). (We recently read parallel language in Chapter 13 precisely the same way. *See In re Seafort*, 669 F.3d 662, 667 (6th Cir. 2012) ("§ 541 fixes property of the estate as of the date of filing, while § 1306 adds to the 'property of the estate' property interests which arise post-petition.")). Thus, it is only that property—property acquired after the commencement of the case, rather than property acquired before then—that "the debtor may retain" when his unsecured creditors are not fully paid. 11 U.S.C. § 1129(b)(2)(B)(ii).

Ice House, 751 F.3d 738–39; *see also Zachary*, 811 F.3d at 1197 (quoting and adopting the Sixth Circuit's statutory analysis in *Ice House*); *Lively*, 717 F.3d at 410 ("Reading the phrase in § 1129(b)(2)(B)(ii) to evince ambiguity seems a grammatical stretch, because § 1115 expressly states that property is being 'added' to that comprised by § 541; the section does not supersede § 541 property, any more than '2' supersedes '3' when added to it."); *Woodward*, 537 B.R. 899–900 (embracing the Sixth Circuit's textual analysis in *Ice House*).

Most of the courts adopting the narrow view find that the language of § 1129(b)(2)(B)(ii) is ambiguous. *Lindsey* in particular noted that, if the statute were not ambiguous, "there would be no split of authority and the arguments in favor of each position [would not be] so diverse." 453 B.R. at 903; *see also Maharaj*, 681

F.3d at 569 ("[W]e conclude that the language of § 1129(b)(2)(B)(ii) and § 1115 lends itself to more than one reasonable interpretation, and thus does not have a 'plain' meaning. Perhaps the only thing that is clear and plain is that the courts that have considered this issue have arrived at plausible, competing arguments as to why their respective approaches are consistent with Congressional purpose in enacting BAPCPA. In short, the meaning of the BAPCPA amendments is anything but 'plain.' It is ambiguous."); *Friedman*, 466 B.R. at 485 (Jury, J., dissenting) ("Taken in . . . context the meaning of the words [contained in §§ 1115 and 1129(b)(2)(B)(ii)] is not plain. There can be more than one cogent interpretation of their meaning and intent and I believe they do not write the absolute priority rule out of individual chapter 11's.").

Cases following the narrow view—which is now the overwhelming weight of authority—also make the following points:

- It would be very odd for Congress to make a fundamental change to bankruptcy law—by abrogating the absolute priority rule in individual Chapter 11 cases—without making any mention of it in BAPCPA's legislative history. *See Zachary*, 811 F.3d at 1199 ("It seems unlikely that Congress would address a cornerstone rule of bankruptcy practice 'and yet omit any mention of this remedy from the legislative history.'" (quoting *Maharaj*, 681 F.3d at 575)); *Gelin*, 437 B.R. at 441 ("[T]he legislative history is entirely silent as to whether the drafters of the amendment to § 1129(b)(2)(B)(ii) intended to wholly except individual Chapter 11 debtors from the absolute priority rule."); *Kamell*, 451 B.R. at 509–10 ("[T]he legislative history is . . . scarce, equivocal and altogether unhelpful. . . . Such a momentous change should have at least merited a mention in the legislative history.").

- Congress expressly repealed the absolute priority rule in Chapter XI cases under the Act in 1952 and presumably would have done so directly in BAPCPA if that had been its intent. *Zachary*, 811 F.3d at 1198 ("The history of the absolute priority rule also strongly supports the narrow view. Congress repealed the absolute priority rule in 1952, only to reinstate it in 1978, demonstrating that when it intends to abrogate the rule, it knows how to do so explicitly."); *Maharaj*, 681 F.3d at 573 ("When Congress amended the Act in 1952 to eliminate the 'fair and equitable' requirement, it clearly explained its actions in the accompanying legislative history. . . . History shows that Congress knows how to abrogate the absolute priority rule, and it has not done so here.").

- Had Congress intended to abrogate the absolute priority rule in individual Chapter 11 cases, it would not have gone about it in such an indirect and convoluted way. *See Lively*, 717 F.3d 406 ("[T]he consequence of the 'broad view' is that the 'except' clause [in § 1129(b)(2)(B)(ii)] abrogates the absolute priority rule for individual debtors. This is a startling, and most indirect, way for Congress to have effected partial implicit repeal of the very provision that the section amended."); *Maharaj*, 681 F.3d at 571 ("[W]e are in agreement with those courts that have concluded that, if Congress intended to abrogate such a well-established rule of bankruptcy jurisprudence, it could have done so in a far less convoluted manner."); *Mullins*, 435 B.R. at 360–61 ("[I]f it had been the intent of Congress to eliminate entirely the operation of the [absolute priority rule] from individual chapter 11 cases, it would have been much clearer, easier and more direct for it to have said simply in § 1129(b)(2)(B)(ii) 'except that in a case in which the debtor is an individual, this provision shall not apply' in lieu of the language which it did use. . . .").

- If it was Congress's intent to harmonize Chapter 11's regime for individual debtors with Chapter 13, it would have revised or eliminated the eligibility requirements imposed in 11 U.S.C. § 109(e). *See Maharaj*, 681 F.3d at 566 ("[I]f Congress intended for Chapter 11 to operate the same as Chapter 13 in the case of an individual debtor, [it] would have simply amended the statutory debt ceilings for Chapter 13 cases set out in 11 U.S.C. § 109(e), and either eliminate them altogether or make them much higher." (internal quotation marks omitted)); *Karlovich*, 456 B.R. at 682 (same).

- Repeals by implication are disfavored and should not be presumed unless the legislature's intent is clear. This is particularly true in the area of bankruptcy law. *Zachary*, 811 F.3d at 1198 ("[T]he Supreme Court has expressly warned against finding implied repeal of provisions of the Bankruptcy Code." (citing *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 380 (1988)); *Stephens*, 704 F.3d at 1286–87 ("Because both the statutory language and Congress's intent are ambiguous, we heed the presumption against implied repeal. . . . These interpretive principles are particularly critical in bankruptcy cases, where parties rely on settled rules in conducting and structuring business."); *Maharaj*, 681 F.3d at 566 ("The canon against implied repeal is particularly strong in the field of bankruptcy law. In interpreting the Code, we are mindful that courts 'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.'" (quoting *Hamilton v. Lanning*, 560 U.S. 505, 506 (2010))).

- Although proponents of the broad view believe that abrogation of the absolute priority rule is "congruent with the Congressional goal of harmonizing Chapter 11 proceedings for individuals with those in Chapter 13," *Maharaj*, 681 F.3d at 573, "what the 2005 amendment to § 1129(b)(2)(B)(ii) [actually was intended to] accomplish[] is straightforward: the amendment maintains the pre-2005 scope of the absolute-priority rule, thus limiting the rule's scope to pre-petition property, even as the definition of 'property of the estate' expands to include post-petition property in § 1115." *Ice House*, 751 F.3d at 739.

- While some may view the difference in BAPCPA's treatment of individual Chapter 11 debtors and Chapter 13 debtors to be unfair, any relief from this perceived unfairness must come from Congress, not the courts. *Zachary*, 811 F.3d at 1199 ("We acknowledge that retaining the absolute priority rule in chapter 11 cases works a 'double whammy' on a debtor because, under the BAPCPA amendments to § 1129(a)(15), he 'must dedicate at least five years' disposable income to the payment of unsecured creditors, and—unlike a debtor in Chapter 13—is also subject to the absolute-priority rule (and thus cannot retain any pre-petition property) if he does not pay those creditors in full.' But the broad view could exact a heavy penalty on a 'crammed down' creditor, as this case illustrates. Our task is not to balance the equities, however, but to interpret the Bankruptcy Code." (quoting *Ice House*, 751 F.3d at 740)); *Ice House*, 751 F.3d at 739–40 ("[A]n individual debtor in Chapter 11 is hit by a double whammy: he must dedicate at least five years' disposable income to the payment of unsecured creditors, and—unlike a debtor in Chapter 13—is also subject to the absolute-priority rule (and thus cannot retain any pre-petition property) if he does not pay those creditors in full. We recognize that hardship; and, like the Supreme Court in *Ahlers*, we do not take lightly the concerns that drove the bankruptcy court to its result. But neither do we presume that Congress was without reasons to limit the exception to the absolute-priority rule the way it did. In any event, our task is to interpret the laws that Congress enacted, not to determine whether they are fair." (citation and internal quotation marks omitted)).

VII. Appointment of a Chapter 11 Trustee

A. The Statutory Basis

As previously discussed, one of the potential ramifications of a Chapter 11 debtor's failure to observe the fiduciary duties owed by a debtor in possession and/or failure to comply with his or her other obligations under the Bankruptcy Code is the

appointment of a Chapter 11 trustee. Section 1104(a) of the Bankruptcy Code, which provides the grounds for the appointment of a trustee, states:

> At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee—
>
> (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
>
> (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

11 U.S.C. § 1104(a).

"The examples of cause enumerated in § 1104(a)(1) are not exhaustive; the Court may find that cause exists for a reason not specifically set forth in the statute." *In re Cardinal Indus., Inc.*, 109 B.R. 755, 765 (Bankr. S.D. Ohio 1990). And "[u]nlike § 1104(a)(1), which provides for the mandatory appointment of a trustee upon a specific finding of 'cause,' § 1104(a)(2) envisions a flexible standard. . . . [W]hat the Court undertakes in a § 1104(a)(2) determination is a cost-benefit analysis to determine which, under general principles of equity, would be in the best interests of the creditors, equity security holders, and other interests of the estate: (1) leaving the debtor in possession; or (2) appointing a trustee." *In re Nat'l Staffing Servs., LLC*, 338 B.R. 31, 33–34 (Bankr. N.D. Ohio 2005) (internal citations omitted). "Factors which justify appointment of a trustee under this subsection are highly diverse and in essence reflect the practical reality that a trustee is needed to manage the debtor's affairs." *In re Nartron Corp.*, 330 B.R. 573, 592 (Bankr. W.D. Mich. 2005). "If appointment is ordered pursuant to the Court's general equitable powers under § 1104(a)(2), the cost of a trustee to the estate, when compared with the benefit

sought to be derived, will be a significant aspect of that determination." *Cardinal Indus.*, 109 B.R. at 766.

B. Evidence Required for the Appointment of a Chapter 11 Trustee

A majority of courts have adopted a clear and convincing evidence standard for the appointment of a Chapter 11 trustee.[36] The Eighth Circuit BAP has pointed out, however, that the courts applying a clear and convincing evidence standard "rely largely on a prior decision of the Third Circuit, *In re Sharon Steel Corp.*, and its progeny." *In re Keeley & Grabanski Land P'ship*, 455 B.R. 153, 162–63 (B.A.P. 8th Cir. 2011). *Sharon Steel* was decided before the Supreme Court decision of *Grogan v. Garner*, which held that the preponderance of the evidence standard "is applicable in civil actions between private litigants unless 'particularly important individual interests or rights are at stake.'" *Grogan v. Garner*, 498 U.S. 279, 286 (1991). The Eighth Circuit BAP held:

> If a preponderance of the evidence standard is a sufficient standard for the denial of discharge based on a debtor's fraud, it should likewise be sufficient for the appointment of a trustee based on allegations of the debtor's fraud or misconduct. Consequently, we conclude that the proper standard for a party seeking the appointment of a Chapter 11 trustee is preponderance of the evidence.

Keeley & Grabanski, 455 B.R. at 163.[37]

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[36] *See, e.g.*, *In re Bayou Grp., LLC*, 564 F.3d 541 (2d Cir. 2009); *In re G-I Holdings, Inc.*, 385 F.3d 313 (3d Cir. 2004); *In re Sharon Steel Corp.*, 871 F.2d 1217 (3d Cir. 1989); *In re LHC, LLC*, 497 B.R. 281 (Bankr. N.D. Ill. 2013); *In re Adelphia Commc'ns Corp.*, 336 B.R. 610, 656 (Bankr. S.D.N.Y. 2006); *Nat'l Staffing Servs.*, 338 B.R. at 31; *Cardinal Indus., Inc.*, 109 B.R. at 755; *In re Microwave Prods. of Am., Inc.*, 102 B.R. 666, 676 (Bankr. W.D. Tenn. 1989).

[37] *See also Tradex Corp. v. Morse*, 339 B.R. 823, 829 (D. Mass. 2006) ("Having canvassed this case law, I have come to conclude that [a bankruptcy] court need find the factual predicates—'cause' or the best interests of relevant parties—by only a preponderance of the evidence. Clear and convincing evidence is not required"); *In re Celeritas Techs., LLC*, 446 B.R. 514, 519 (Bankr. D. Kan. 2011) (noting that although a "majority of courts cite a clear and convincing burden . . . they have little support in the language of the Code or in legislative history.").

Regardless of which evidentiary standard the court applies, in a Chapter 11 reorganization case, "[t]here is a strong presumption that a debtor should remain in possession absent a showing of need for the appointment of a trustee." *In re 1031 Tax Grp., LLC*, 374 B.R. 78, 85 (Bankr. S.D.N.Y. 2007) (citing *In re Ionosphere Clubs, Inc*., 113 B.R. 164, 167 (Bankr. S.D.N.Y. 1990)).

C. Appointment of Chapter 11 Trustees in Individual Cases

Without a doubt, the appointment of a trustee in an individual Chapter 11 case would present challenges—possibly including difficulty in obtaining the cooperation of the Chapter 11 debtor. *See* Diana K. Carey, *The "Keeper": The Trustee's Role in Individual Chapter 11s*, 012711 ABI-CLE 279 (2011). But at least one court has held that the prospect that the debtor will refuse to cooperate with the Chapter 11 trustee is not a reason to decline to appoint one if the appointment is otherwise warranted. *See In re Grasso*, 490 B.R. 500, 526 n.29 (Bankr. E.D. Pa. 2013) ("This Court afforded no weight to the Debtor's threats to frustrate his estate's reorganization by refusing to provide assistance to a potential Chapter 11 Trustee."). And "although the appointment of a Chapter 11 trustee is an extraordinary measure" in Chapter 11 cases generally, the appointment of trustees in individual Chapter 11 cases has been found to be "merited" in numerous cases.[38]

"Courts have determined that 'bad faith' is . . . a basis for dismissal, conversion or appointment of a trustee." *Sydnor*, 431 B.R. at 590–91 (Bankr. D. Md. 2010); *Daniels*, 2014 WL 547176, at *2. In addition, "repeated failure to comply

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[38]*North v. Desert Hills Bank (In re North)*, 212 F. App'x 626, 627 (9th Cir. 2006) (affirming district court's order affirming bankruptcy court's order to appoint a Chapter 11 trustee); *Fraidin v. Weitzman (In re Fraidin)*, No. 94-1658, 1994 WL 687306 (4th Cir. Dec. 9, 1994) (same); *Daniels v. Gebhardt (In re Daniels)*, No. 1:12-CV-4181-WSD, 2014 WL 547176, at *2 (N.D. Ga. Feb. 10, 2014) (denying motion to reconsider order dismissing appeal of bankruptcy court's order appointing a Chapter 11 trustee); *Modanlo v. Ahan (In re Modanlo)*, 342 B.R. 238, 248 (D. Md. 2006) (affirming bankruptcy court's order appointing a Chapter 11 trustee); *Petit v. New England Mortg. Servs. Inc*., 182 B.R. 64, 72 (D. Me. 1995) (same); *Sims v. Sims (In re Sims)*, No. NM-97-022, 1997 WL 854793, at *6 (B.A.P. 10th Cir. 1997) (same); *In re Davis*, No. 09-10198-8-JRL, 2010 WL 2640587, at *3 (Bankr. E.D.N.C. June 29, 2010) (ordering the appointment of a Chapter 11 trustee); *In re Sydnor*, 431 B.R. 584, 597 (Bankr. D. Md. 2010) (same); *Taub v. Taub (In re Taub)*, 427 B.R. 208, 233 (Bankr. E.D.N.Y. 2010) (same); *In re Sanders*, No. 99 B 9876, 2000 WL 329574, at *6 (Bankr. N.D. Ill. Mar. 2, 2000) (same); *In re Lowenschuss*, 202 B.R. 305, 316–17 (Bankr. D. Nev. 1996) (same); *In re Russell*, 60 B.R. 42 (Bankr. W.D. Ark. 1985) (same); *In re Evans*, 48 B.R. 46, 49 (Bankr. W.D. Tex. 1985) (same).

with the [B]ankruptcy [C]ode" has been found to constitute cause for the appointment of a Chapter 11 trustee in an individual case. *North*, 212 F. App'x at 627; *Evans*, 48 B.R. at 49.

VIII. Property of the Estate After Conversion to Chapter 7

Unlike in a Chapter 7 case, in which wages earned after commencement of the case are specifically excluded from property of the estate, *see* 11 U.S.C. § 541(a)(6), an individual Chapter 11 debtor's postpetition earnings (and indeed, all property of a kind specified in § 541 acquired postpetition) become property of the Chapter 11 bankruptcy estate, 11 U.S.C. § 1115(a). But what happens to this property if the Chapter 11 debtor converts the case to one under Chapter 7? The answer is unclear.

The Bankruptcy Code is clear, however, that when a Chapter 13 debtor converts to a case under Chapter 7, unless the debtor does so in bad faith, property of the estate in the converted case includes only property that was property of the estate as of the petition date and that remains in the possession of or under the control of the debtor. 11 U.S.C. § 348(f)(1)(A), (2).[39] This means that—again, absent bad faith—the debtor may retain his or her postpetition wages after conversion to Chapter 7, even though those wages became part of the Chapter 13 estate under § 1306. *Meier v. Katz (In re Meier)*, 550 B.R. 384, 386 (N.D. Ill. 2016) ("[U]nder § 348(f), when a bankruptcy case is converted from Chapter 13 to Chapter 7, the Chapter 7 estate does not include earnings made by the debtor after the commencement of the

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[39]Section 348(f) in relevant part reads:

> (1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title—
>
> > (A) property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion. . . .
>
> (2) If the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion.

11 U.S.C. § 348(f)(1)(A), (2).

case."). But § 348(f) specifically applies to the conversion of a Chapter 13 case, and "[t]here is no provision, either in § 348 or elsewhere in the Bankruptcy Code, that specifically lays out what happens to post-petition earnings when a debtor first files a petition under Chapter 11 and later converts the case to Chapter 7." *Id.*

The difficulty of determining how the absence of an analogous provision for Chapter 11 should be interpreted has led to a split of authority. Some courts have held that a Chapter 11 debtor's postpetition property becomes property of the Chapter 7 estate upon conversion.[40] Others have disagreed, holding that, as in Chapter 13, postpetition income reverts to the debtor in possession upon conversion to Chapter 7.[41]

As one court put it:

> The cases all grapple with the same question of statutory construction, namely, did the enactment of § 348(f) create a new point of procedure (that is, that once a case is converted from Chapter 13 to Chapter 7, the estate would consist only of the debtor's property at the time of the original petition), or did it provide just one example of a broader right already created by § 348(a)[[42]] (that is, that once any bankruptcy case, whether Chapter 13, 11, or 12, is converted to another chapter, the matter would proceed as though it had been under the new chapter from the beginning).

Meier, 550 B.R. at 386–87.

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[40]*See Meier*, 550 B.R. at 390; *In re Vilaro Colón*, No. 13-05545 EAG, 2016 WL 5819783, at *4 (Bankr. D.P.R. Oct. 5, 2016); *Rogers v. Freeman (In re Freeman)*, 527 B.R. 780, 794 (Bankr. N.D. Ga. 2015); *In re Hoyle*, No. 10-01484-TLM, 2013 WL 3294273, at *7 (Bankr. D. Idaho June 28, 2013); *Pergament v. Pagano (In re Tolkin)*, No. 808-72583-REG, 2011 WL 1302191, at *10 (Bankr. E.D.N.Y. Apr. 5, 2011).

[41]*See Wu v. Markosian (In re Markosian)*, 506 B.R. 273, 276 (B.A.P. 9th Cir. 2014); *In re Evans*, 464 B.R. 429, 441 (Bankr. D. Colo. 2011).

[42]"Conversion of a case . . . constitutes an order for relief under the chapter to which the case is converted, but . . . does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief." 11 U.S.C. § 348(a).

"On the one hand, upon conversion, the date of the commencement of the case does not change [under § 348(a)] and Section 541(a)(6) prohibits income derived from services performed by a Chapter 7 debtor after commencement from becoming property of the estate." *Freeman*, 527 B.R. at 790. "On the other hand, while the case was in Chapter 11, post-petition services income became property of the estate by virtue of Section 1115(a)(2) and Section 541(a)(7), and, unlike in a case converted from Chapter 13, no statutory provision expressly states that such income cannot be included in the converted Chapter 7 estate." *Id.*

Cases such as *Markosian* and *Evans* represent the minority position. They reason: When a case is converted, § 348(a) provides that conversion does not affect the date of filing the initial petition. Property of the estate in a Chapter 7 case is determined by reference to property that existed as of the petition date, and postpetition earnings are in fact specifically excluded from property of the estate. 11 U.S.C. § 541(a)(6). "[B]y operation of § 348(a), personal service income that came into [a debtor's] chapter 11 estate is recharacterized as property of the debtor [not of the estate] under § 541(a)(6) when the case is converted to chapter 7." *Markosian*, 506 B.R. at 276.

According to the minority view, the fact that § 348(f)(1)(A) was drafted to apply exclusively to conversions from Chapter 13 in no way means that Congress did not intend the same principal to apply to conversions from Chapter 11. The *Evans* court noted that § 348(f)(1)(A) was enacted in 1994 following a split in authority as to the appropriate date to determine property of the estate in a case converted from Chapter 13. *Evans*, 464 B.R. at 439. At that time, "Chapter 11 did not have a counterpart to § 1306" and § 1115(a)(2) was enacted "as part of the sweeping changes to the Bankruptcy Code in BAPCPA in 2005." *Id.* at 440. The *Evans* and *Markosian* courts accordingly did not find the omission of an analogous provision for Chapter 11 conversions to be determinative, especially in light of the fact that "one of the Bankruptcy Code's goals is to encourage use of debtor repayment plans rather than liquidation" and "there is no reason to treat Chapter 11 . . . cases differently than Chapter 13 cases." *Id.* at 441.

A majority instead follows the approach that a Chapter 11 debtor's postpetition earnings remain property of the estate upon conversion—relying on the maxim of statutory construction *expressio unius est exclusio alterius* ("to express or include one thing implies the exclusion of the other"). *Meier*, 550 B.R. at 387. That is, the fact that Congress specifically carved out Chapter 13 indicates that postpetition earnings revest in the debtor *only* after conversions from Chapter 13. As to the *Evans* court's argument with respect to the 1994 amendment to § 348, comparing

Chapter 12 (under which individuals may reorganize if they are family farmers or family fishermen within the meaning of the Bankruptcy Code and have regular annual income) *Meier* noted: "When the 1994 amendments were proposed, post-petition funds earned by the debtor in Chapter 12 were part of the estate, just as they were in Chapter 13. And, just as in Chapter 13 cases, courts wrestled with the issue of whether post-petition earnings continued to be part of the estate when a Chapter 12 case is converted to Chapter 7." *Id.* at 389. Despite evidence that Congress was well aware of the issue also being present with respect to Chapter 12 conversions, Congress nonetheless limited § 348(f) to Chapter 13 cases. *Id.*

The diverging lines of authority that, according to the *Evans* court, led to the addition of § 348(f)(1)(A) persisted for close to a decade before the 1994 amendment. The split with respect to Chapter 11 conversions, on the other hand, appears to be a relatively recent development. It is possible that if the split remains unresolved, it will be up to Congress to clarify its intent in a future round of amendments to the Bankruptcy Code.

IX. Hypothetical

A. Part A

Dr. Norton Dow is an experienced neurosurgeon who practiced for many years in an area of the country where, in his view, neurosurgeons are not adequately compensated. A couple of years ago, he left his practice behind and moved to an area where neurosurgeons earn top dollar. For the last two years, Dr. Dow has been party to an employment contract with Primo Surgery Center, Inc. ("Primo"). Although he does not yet have an ownership interest in the company, Dr. Dow is well-compensated. His annual salary under his employment contract with Primo is $1 million, or $5 million over the contract's remaining five-year term.

After taking the position with Primo, Dr. Dow purchased an expensive new house and a pricey car. But in light of his annual salary, he foresees no problem servicing the debt on the $2 million principal he owes over the next 28 years on his mortgage loan from First Bank, N.A. or the $180,000 he owes to Auto Finance, Inc. over the next five years on his new model Porsche Panamera Turbo.

Dr. Dow has paid off the massive student-loan debt that he had when he graduated from medical school. But he has $120,000 of debt on multiple credit cards. Dr. Dow incurred the debt to finance the purchase of his private home theater and other high-end consumer goods. He has never been married and has no dependents, but is involved in a long-distance romance that involves expensive

dinner dates and frequent first-class air travel on the weekends. Dr. Dow also helps supports his down-on-his-luck younger adult brother.

While driving to work one day in his second car—a 2014 Audi A6 that he refers to as his "jalopy"—Dr. Dow had an idea for a new surgical device called "The Moneymaker." The device would make procedures somewhat more dangerous for patients—"but only slightly," Dr. Dow would later say—while drastically reducing the time and costs of certain neurosurgical procedures. Forgetting the maxim to "first do no harm," Dr. Dow decided to pursue development of The Moneymaker. He used his savings to cover the production of a prototype, but did not have the resources to fully develop the device. He sought financing from venture capital firms, but none of them was interested. Undeterred, Dr. Dow turned to his friend, Dr. Jerry V. Federman, a fellow Primo surgeon. Dr. Dow was able to persuade Dr. Federman to join him in his pursuit of The Moneymaker and to contribute $150,000 to the endeavor. But those funds were insufficient, so together they formed The Next Big Thing, LLC ("NBT"), a company that would own The Moneymaker and borrow the funds needed to bring the device to market. Dr. Dow and Dr. Federman each own 50% of the membership interests in NBT.

The doctors sought a loan from several banks, but were turned down. Still undeterred, they turned to an alternative financing source, a company known as Stream of Income Financing, Inc. ("Stream"), and applied for a $2.5 million loan. Stream was willing to make the loan, but only if the doctors personally guaranteed it, and only if they granted Stream security interests in their employment contracts with Primo. Brilliant doctors and true believers but no financial wizards, they caused NBT to borrow the $2.5 million from Stream while personally guaranteeing the debt and granting Stream security interests in their employment contracts.

Things did not go as planned. The Moneymaker had serious design flaws and did not receive the requisite regulatory approval. NBT defaulted on the loan, and Stream demanded immediate payment of the entire $2.5 million plus interest from Dr. Dow and Dr. Federman based on their guarantees. Stream is threatening to garnish Dr. Federman's salary payments. In the meantime, Dr. Federman sued Dr. Dow for fraud and won a $150,000 judgment.

Seeing a bankruptcy lawyer's ad on television, Dr. Dow decided that bankruptcy was the answer to his financial problems. But having had an aversion to lawyers ever since he was (unsuccessfully) sued for malpractice several years ago, Dr. Dow decided to file a bankruptcy case pro se.

Researching his options, Dr. Dow realized that Chapter 7 and Chapter 13 would not be available to him. He reviewed Official Form 122A-1 (Chapter 7 Statement of Your Current Monthly Income) and Official Form 122A-2 (Chapter 7 Means Test Calculation) and realized that a Chapter 7 case would not work because of something called a "presumption of abuse" and because his debts were primarily consumer debts (given that the amount of the mortgage loan, car loan and other consumer debts exceeded the amount of his business debt). He also realized that the amount of his debt exceeded the limits to be eligible for Chapter 13.

Before filing the Chapter 11 case, Dr. Dow was smart enough to take the prepetition credit counseling required of individual debtors. But ignoring the warnings on the instructions to one of the official forms that "[i]t is extremely difficult to succeed in a chapter 11, 12, or 13 case without an attorney," he filed the Voluntary Petition for Individuals Filing for Bankruptcy (Official Form 101), a list of creditors (as well as the List of Creditors Who Have the 20 Largest Unsecured Claims (Official Form 104)), the schedules of assets and liabilities, Schedule I and J, and the statement of financial affairs. Not having done quite enough research, Dr. Dow waited for his discharge.

In a move that surprised Dr. Dow, the bankruptcy judge presiding over his case, Judge Janice K. Reality, issued a notice setting a status conference to be held six weeks into the case. During the conference, the doctor became aware of a few things that his research had missed. Judge Reality informed him of his duties as a Chapter 11 debtor in possession. Judge Reality also advised Dr. Dow of the need to file a plan of reorganization and to solicit votes using something called a disclosure statement. An attorney for Stream appeared at the status conference. He made clear that Stream was abiding by the automatic stay that prevented his client from garnishing Dr. Dow's salary. But he took the position that Stream's claim was secured by Dr. Dow's salary under his employment contract with Primo and that no plan of reorganization could be successful over Stream's objection unless the plan provided for full payment of its secured claim with interest. The Stream attorney mentioned something he called the absolute priority rule and the projected disposable income requirement. Stream's attorney also took the position that Dr. Dow should be put on a stringent budget. The attorney for the Office of the United States Trustee stated that Dr. Dow had not filed the first or second required monthly operating reports. The attorney for the UST also stated that she was planning to file a motion to dismiss the case or appoint a Chapter 11 trustee based on, among other things, the failure to file the monthly operating reports and to pay the UST quarterly fees. Judge Reality advised Dr. Dow that he should seriously consider seeking the assistance of

a qualified Chapter 11 bankruptcy attorney. Swallowing his pride, Dr. Dow calls you for help.

B. Part B

The first question Dr. Dow asks is whether he could just convert his case to Chapter 7. He recognizes that there would have been a presumption of abuse if he had initially filed a Chapter 7. But given that things did not work out as planned, he wonders whether he could he just convert to Chapter 7 now. You point out that there is a split of authority on whether § 707(b) applies to cases converted from Chapter 11 and that, depending on which line of authority Judge Reality follows, his case might end up being dismissed. In addition, you note that real estate prices have skyrocketed in the area over the last couple of years and that Dr. Dow's house likely is worth a couple hundred thousands dollars more than the debt he owes. You advise Dr. Dow that, combined with the extremely low exemption in your state for residences, a Chapter 7 trustee almost certainly would seek to sell the house. Dr. Dow decides to try and make a go of it in Chapter 11. Recognizing that any retainer would have to be approved by Judge Reality and that there are stringent requirements for approval of such retainers, but believing that Dr. Dow's income will be sufficient to allow him to pay your fees, you decide to represent Dr. Dow.

You then turn to the delinquent monthly operating reports, obtaining an agreement from the UST—memorialized in an agreed order entered by Judge Reality—that the UST will not seek to dismiss the case as long as the UST quarterly fees are paid immediately and the delinquent monthly operating reports are filed within 10 days. Dr. Dow pays the UST fees, and you file the monthly operating reports on behalf of Dr. Dow by the deadline imposed by the agreed order. Among other things, the monthly operating report for the first full month of the case reveals the following income and expenses, all of which is consistent with Dr. Dow's income and expenses in the months leading up to the bankruptcy:

INCOME/EXPENSE STATEMENT FOR INDIVIDUALS (P&L)

Period Ending: April 2017

	Current Month	Total Since Filing
Gross Income from Salary/Wages	$83,333.33	$125,000.00
Less Payroll Deductions:		
a. Payroll Taxes & Social Security	$33,333.33	$50,000.00
b. Insurance Deducted	$0.00	$0.00
c. Other (specify)	$0.00	$0.00
d. Other (specify)	$0.00	$0.00
Subtotal of Payroll Deductions	$33,333.33	$50,000.00
Total Monthly Income	$50,000.00	$75,000.00
Rent or Home Mortgage Payment	$10,500.00	$15,750.00
Real Estate Taxes	$3,000.00	$4,500.00
Utilities	$500.00	$750.00
Home Security System	$100.00	$150.00
Home Maintenance	$500.00	$750.00
Housekeeping	$350.00	$525.00
Phones and Internet	$500.00	$750.00
Food	$2,500.00	$3,750.00
Clothing	$1,200.00	$1,800.00
Car payment (Porsche)	$3,500.00	$5,250.00
Gasoline, Vehicle Repairs and Maintenance	$1,000.00	$1,500.00
Entertainment	$1,100.00	$1,650.00
Gym Membership	$100.00	$150.00
Charitable Contributions	$0.00	$0.00
Insurance:		
Homeowner's	$400.00	$600.00
Auto	$450.00	$675.00
Support Payments for Brother	$3,000.00	$4,500.00
Business Expenses: Licensing	$100.00	$150.00
Business Expenses: Continuing Medical Education	$200.00	$300.00
Airline Tickets	$3,000.00	$4,500.00
Miscellaneous	$3,000.00	$4,500.00
Total Expenditures	$35,000.00	$52,500.00
Net Income/Loss	**$15,000.00**	**$22,500.00**

Balance Sheet

Assets		**Liabilities**	
Cash		Secured	
Savings Account	$22,500	First Bank, N.A. (Mortgage)	$2,000,000
Investments		Auto Finance, Inc. (Porsche)	$180,000
401(k)	$360,000	Unsecured	
50% interest in NBT	$0	Stream	$2,500,000
Real Property		Multiple Credit Cards	$120,000
Residence	$2,200,000	Nonpriority tax debt	$230,000
Personal Property		Dr. Federman	$150,000
2017 Porsche Panamera	$160,000	**Total**	**$5,180,000**
2014 Audi A6	$25,000	**Net Worth**	
Clothing, Furniture, Artwork, etc.	$232,500	Assets	$3,000,000
Total	**$3,000,000**	Liabilities	$5,180,000
		Assets - Liabilities	**($2,180,000)**