

# FINDING A HOME IN CHAPTER 11

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What of the case of the unfortunate debtor who fails the means test for chapter 7 and is over the debt limits for chapter 13? Or another who cannot file chapter 7 for fear of charges of what the cases used to call substantial abuse but who has no regular income to fund a chapter 13? Imagine hundreds, no thousands, nay tens of thousands of individuals drowning in oceans of debt that they just cannot get on top of as their creditors race to the courthouse and debt relief agencies promise a debt-free life if only you pick up the phone and call now.

Conventional wisdom was that word would get out that BAPCPA did not abolish bankruptcy as the popular press seemed to say and the statistics of filings would return to “normal” levels. Despite some increased bureaucratic hurdles, people would realize that bankruptcy was still available and, in many cases, the best option. However, it’s not clear that word has gotten out and certainly not with respect to the potential for chapter 11 to provide a home in bankruptcy to some individuals.

## **Some Statistics**

As would be expected, calendar year 2006 filings were the lowest in nearly twenty years *See* ABI Press Release (April 17, 2007), at <http://www.abiworld.org>. Slowly, it appears bankruptcy filings are coming back (and expected to rise if Congress enacts legislation affecting home mortgage modification in chapter 13). That may not necessarily be true for Oregon. According to information from the Administrative Office of the U.S. Courts, chapter 11 filings in Oregon for fiscal years 2001 through 2004 (September 30 to September 30) usually numbered around 40. Fiscal years 2005 and 2006 had 29 and then 15 respectively. This past fiscal year, 2007, Oregon chapter 11 filings numbered 26. Thus, in a relatively small market for chapter 11s, Oregon is nonetheless feeling the effects of BAPCPA and it may be due in part to a lack of “common” knowledge about the potential use of chapter 11 for individuals.

## **Profile of a Chapter 11 Debtor**

Chapter 11 is usually the chapter you hear about for ENRON and Delta Airlines, even an archdiocese of the Roman Catholic Church. It is not generally conceived of as an option for the average person. Indeed, even post-BAPCPA where an individual may no longer have to propose a 100% plan to be able to stay in chapter 11, an individual considering chapter 11 would have more assets, indebtedness, and income than the average debtor, maybe even rising to the oxymoron of being a “rich” debtor.

For example, consider a dentist who buys a dental practice by way of a loan to his PC for \$350,000. The debt is secured by a blanket lien on the purchased asset. Every lender worth its salt today would also exact a personal guarantee from debtor. While the \$350,000 is secured debt as to debtor’s LLC, the \$350,000 guarantee is unsecured debt to the debtor that, by itself,

puts the debtor over the unsecured debt limits for a chapter 13. In places like California, debtors are knocking up against the secured debt limit where million-dollar home mortgages are not uncommon. These potential chapter 11 debtors are not Martha Stewart or OJ Simpson or CEOs. Some are people trying to start businesses. Others are professionals with high levels of personal debt. Still others are real estate investors or developers who have not been able to weather the recent market changes. They may not be the mass of consumer debtors, but neither are they multi-billion dollar corporations.

### **Why Individual Chapter 11s Are More Attractive Now**

Chapter 11s always have been and still are expensive. As of January 2008, the filing fee is \$1039. Attorney fees could run anywhere from \$20,000 to \$50,000 for an individual chapter 11 case. US Trustee fees add thousands per quarter on top of that. Using our dentist example once again, imagine the dentist has gross annual receipts of \$700,000, all of which is disbursed, including the dentist's salary. Using the new US Trustee rates effective January 1, 2008, the fees would add up to \$6500 per year.

Nonetheless, the fact is that BAPCPA has broadened the class of debtors that may have to be in chapter 11 or be nowhere. The implementation of the means test keeps more "rich" debtors out of chapter 7. The lack of a significant increase to debt limits keeps the same ones out of chapter 13. So, a costly chapter 11 seems the only option if there is to be a bankruptcy option. Anticipating this, Congress tinkered with chapter 11 dramatically as to individuals so that, for some debtors, it actually may not be a bad place to be.

The biggest change is the seeming abolition of the rule of absolute priority. The rule of absolute priority, which is still in place for corporate chapter 11s, resides in section 1129 of the Bankruptcy Code. In general, before BAPCPA, individuals that had an objecting creditor and could not propose a 100% plan could not do chapter 11. Now, section 1129(b)(2)(B)(ii) together with new section 1115 (expanding property of the estate to include post-petition income in chapter 11) and section 1129(a)(15) (allowing individuals to propose plans that pay projected disposable income for five years), may mean that individuals no longer have to propose a 100% plan if there is a dissenting creditor. Two bankruptcy courts have upheld that conclusion—one upholding a ten year 95% distribution plan and the other approving a plan proposing merely 3% distribution. *See In re Tegeder*, 369 BR 477 (Bankr D Neb 2007) and *In re Roedemeier*, 374 BR 264 (Bankr D Kansas 2007). There are many other unsettled issues as well as practical considerations regarding whether to file an individual chapter 11, all of which are beyond the scope of this article. *See, e.g.,* Bruce A. Markell, *The Sub Rosa Subchapter: Individual Debtors in Chapter 11 after BAPCPA*, 2007 U. Ill. L. Rev. 67 (2007). Suffice it to say, that BAPCPA has made chapter 11 a serious option for some "rich" debtors.

### **Restructuring Small Business**

One of the most interesting types of cases are what our firm has been dubbing "corporate collapse" cases though they usually involve other types of limited liability entities. The typical

situation involves a small, usually one owner business, in dire financial straits with creditors knocking on the individual's door waving personal guarantees. Before BAPCPA, that person would either be looking at two bankruptcies – one for the business entity and one for the individual – or the person might decide to walk away from the business and file individually. With the increased requirements BAPCPA places on debtor's counsel, individual chapter 7s and chapter 13s have gotten a whole lot more expensive. Dual bankruptcies seem insurmountably expensive.

However, the apparent “death” of the absolute priority rule in individual cases has opened up the possibility to do what was often done in chapter 13s with “mom-and-pop” businesses. Basically, the business entity is “collapsed” and the individual assumes the business' debt (which results in no greater debt if the individual already has guaranteed all of the business' debt) and then files one individual chapter 11. This theory stands limited liability practice on its head and raises a multitude of practical, legal, and potential ethical issues (ensuring both “corporate” and personal creditors would not be in a worse position after collapse is not the least of those issues) that are beyond the scope of this article. However, it is one of the most intriguing new possibilities out there and a way for at least some debtors to potentially find a home in chapter 11.

### **Conclusion**

Until changes are made to the chapter 13 debt limits, chapter 11 may be the only path available to many debtors. BAPCPA has made chapter 11 a better option for individuals but certainly not a cheap nor a simple one. As the law becomes better settled on various potential issues, however, it may be that more individual debtors seek refuge in chapter 11.