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Does the Absolute Priority Rule Apply to Individuals in Chapter 11?

ANDREW G. BALBUS

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I. Introduction

Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA),[1] an individual debtor in Chapter 11 generally could not retain valuable, nonexempt, prepetition property by means of a plan of reorganization confirmed over the objection of a class of unsecured creditors. To be confirmed under §1129(b), among other requirements, a "cramdown" plan must have been "fair and equitable," the primary component of which was satisfying §1129(b)(2)(B)(ii), the statutory codification of the absolute priority rule. Under the absolute priority rule, equity owners cannot retain any property unless senior classes of creditors have been paid in full.[2] As a result of the absolute priority rule, unless their Chapter 11 plan provided for the payment of their creditors in full, individual debtors could not retain ownership of valuable business assets.

As part of BAPCPA, Congress amended §1129(b)(2)(B)(ii) by adding the following exception: "except that in the case in which the debtor is an individual,[3] the debtor may retain property *included* in the estate under §1115" (emphasis added).

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Under §1115(a), "in a case in which the debtor is an individual, property of the estate *includes*, *in addition to the property specified in §541*—(1) all property of the kind specified in §541 that the debtor acquires after the commencement of the case…; and (2) earnings from services performed by the debtor after the commencement of the case" (emphasis added).

Section 541[4] specifies that property of the estate includes "all legal and equitable interests of the debtor in property as of the commencement of the case."

What does the new exception language in §1129(b)(2)(B)(ii) mean by allowing an individual debtor to retain property *included* in the debtor's estate under §1115, when §1115 includes in an individual debtor's estate two kinds of property that were not already property of the individual debtor's estate under §541?

The new exception language in §1129(b)(2)(B)(ii) is susceptible to two different interpretations. The first interpretation is that an individual debtor in Chapter 11 may retain all of the property that is defined as being included in the individual debtor's estate under §1115. The first interpretation thus reads the words "included in the estate under §1115" in §1129(b)(2)(B)(ii) broadly to mean all the individual's property of the estate under §541 plus all of the property that is added to the individual's estate under §1115. Under this interpretation, referred to herein as the "broad interpretation," an individual debtor in Chapter 11 may retain prepetition assets (which are property of the estate under §541) as well as postpetition assets and earnings, all of which are "included" within the individual debtor's estate pursuant to §1115.

The second interpretation of the new exception language in §1129(b)(2)(B)(ii) is that an individual debtor in Chapter 11 may retain only that property which is incorporated into the individual debtor's estate by §1115 which has not already been incorporated into the individual debtor's estate by §541. The second interpretation thus reads the words "included in the estate under §1115" in §1129(b)(2)(B)(ii) narrowly to mean only that property which is included in the estate under §1115 which would not otherwise be included in the estate under §541. Under this interpretation, referred to herein as the "narrow interpretation," the maximum amount of property that an individual debtor in Chapter 11 may retain is postpetition assets and earnings. An individual debtor in Chapter 11 may not retain prepetition assets, because those assets are already included within the individual debtor's property of the estate under §541 and are, therefore, not "included" within the individual debtor's estate pursuant to §1115.

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This article will argue that the broad interpretation is stronger than the narrow interpretation. The rule of construction in §102(3) provides a "plain meaning" reading to §§1129(b)(2)(B)(ii) and 1115 whereby postpetition assets and earnings as well as prepetition property are included within the property of the estate of an individual debtor in Chapter 11.

As a result of that interpretation along with the limited legislative history of BAPCPA and the interrelation of several other Code provisions discussed below, this article will argue that Congress intended to place an individual debtor in Chapter 11 in a similar position to an individual debtor in Chapter 13, i.e., able to retain prepetition property, property acquired by the debtor postpetition and postpetition service income earned by the debtor, subject to paying creditors projected disposable income.

The adoption of the broad interpretation effectively ends the application of the absolute priority rule to individual debtors in Chapter 11 and makes the confirmation requirements more like those in Chapters 12 and 13, where there is no absolute priority rule. This interpretation is significant because many individuals have no alternative to filing in Chapter 11. Individuals with household incomes over the median income for similar sized households in their state may not qualify for Chapter 7 under §707(b). Individuals with large amounts of debt or without regular income may not qualify for Chapter 13 under §109(e).[5]

The broad interpretation should allow individual debtors in Chapter 11 to keep valuable prepetition property, including their prepetition business assets, over the objection of unsecured creditors.[6] Although individuals without business assets would derive some benefit from being able to retain valuable, nonexempt, nonbusiness, prepetition property, the main beneficiary of this interpretation, and the focus of this article, will be individuals with valuable, nonexempt, prepetition business assets. The inapplicability of the absolute priority rule to such individual debtors will also provide them with leverage in any prefiling negotiations with creditors.

This interpretation does not represent a radical windfall for individual debtors in Chapter 11. Confirmation of their plans is still subject to the satisfaction of the "best interest of creditors" test under §1129(a)(7). Each holder of an impaired claim must receive or retain under the plan at least as much as the claim holder would receive if the debtor were liquidated under Chapter 7. Nevertheless, the broad interpretation should generally produce a better result for both debtors and creditors, which, this article will suggest, furthers bankruptcy policy.

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II. Interrelationship of Relevant Bankruptcy Code Provisions

The interplay of several BAPCPA amendments to the Code with other Code sections fundamentally changed the way individuals are treated in Chapter 11.[7] This section examines the interplay of five Code sections.

A. Section 1129(b)(2)(B)(ii)

Section 1129(b)(1) deals with the requirements for the confirmation of a plan of reorganization over the objection of an impaired class of creditors, also known as a "cramdown":

> Notwithstanding section 510(a) of this title,[8] if all of the applicable requirements of subsection (a) of this section[9] other than paragraph (8)[10] are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

With respect to a class of unsecured claims, the condition that a plan be "fair and equitable" may be satisfied under either of the following two alternative requirements set forth in §1129(b)(2)(B):

> (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>
> (ii) 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.

Subsection (i) essentially requires that unsecured creditors be paid in full in cash or other property. That requirement will almost never be satisfied. Subsection (ii) provides an alternative that more plans can satisfy.

The general principle of subsection (ii), up to the newly added exception, permits the court to confirm a plan over the objection of an impaired class of unsecured creditors if that class and all below it in priority are treated in accordance with the absolute priority rule. That is, the dissenting class must be paid in full before any class that is junior

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in priority to the dissenting class receives a distribution or retains any property under the plan. If the dissenting class is not paid in full, no junior class can receive or retain anything.

Under BAPCPA, Congress added to subsection (ii) the words: "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]

Subsection (a)(14) deals with the payment of postpetition domestic support obligations and does not bear on the meaning of §1129(b)(2)(B)(ii) or 1115.[12]

B. Section 1115

Section 1115 was enacted as part of BAPCPA in 2005[13] along with §1129(b)(2)(B)(ii). Section 1115 is captioned "Property of the estate." There already was a "Property of the estate" provision in the Code—§541. New §1115, however, specifically defines property of the estate for an individual debtor in Chapter 11.

Section 1115(a) provides in full text:

> 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. (emphasis added)

Section 1115 refers to two types of property in numbered parentheticals: (1) property the debtor acquires postcommencement and (2) personal service income the debtor earns postcommencement. Both of these types of property would not be included within the definition of property of the estate under §541 because they arise after the commencement of the case, which is the express temporal limit of §541(a)(1).[14]

Section 1115(b) provides: "Except as provided in section 1104[15] or a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate."[16] Whatever property is considered property of the estate under §1115(a), §1115(b) gives the debtor the right to remain in possession of that property until a trustee is appointed to replace the debtor as debtor in possession under §1104 (in which case the trustee takes possession), the property is distributed un-

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der a confirmed plan (in which case creditors take possession) or the plan confirmation vests all undistributed property of the estate in the debtor under §1141 (in which case the debtor takes possession).[17]

Section 1115(a) thus widens the definition of property of the estate for an individual debtor in Chapter 11 and §1115(b) instructs that the debtor is to remain in possession of all of that widely defined property.

C. Section 541(a)

Section 541(a) provides in relevant part:

> The commencement of a case… creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held: (1)… all legal or equitable interests of the debtor in property as of the commencement of the case… (6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case. (7) Any interest in property that the estate acquires after the commencement of the case.

Property of the estate under §541(a) includes all legal or equitable interests of the debtor in property as of the commencement of the case. That would include all of the debtor's legal or equitable interests in the debtor's prepetition business assets.

D. Section 1129(a)(15)

Section 1129(a)(15) states:

> (a) The court shall confirm a plan only if all of the following requirements are met:
>
> (15) In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan—
>
> (A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in §1325 (b)(2)) to be received during the five-year

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> 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.[18]

Section 1129(a)(15) thus permits the confirmation of an individual debtor's plan notwithstanding the objection of a holder of an allowed unsecured claim,[19] provided the debtor either pays the unsecured claim in full, or distributes under the plan property of a value that is not less than the "projected disposable income"[20] to be received during the five-year period beginning on the date the first payment is due or during the plan payment period, whichever is longer.

Section 1129(a)(15)(B) adopts the definition of "disposable income" in §1325(b)(2), which provides a "debtor engaged in business" with a deduction from "current monthly income" for "the payment of expenditures necessary for the continuation, preservation, and operation of such business."

E. Section 1123(a)(8)

Section 1123(a)(8) states:

> (a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall—-
>
> > (8) in a case in which the debtor is an individual, provide for the payment to creditors under the plan of all or such portion of earnings from personal services performed by the debtor after the commencement of the case or other future income of the debtor as is necessary for the execution of the plan.

Section 1123(a)(8), also enacted as part of BAPCPA,[21] introduced a new plan requirement for an individual debtor in Chapter 11. The plan must provide for the payment of creditors through postpetition service income or other future income of the debtor to the extent necessary for the execution of the plan.

To summarize the operation of these provisions, the new exception in §1129(b)(2)(B)(ii) allows an individual debtor in Chapter 11 to retain postpetition service income and property acquired postpetition, because those two types of property are included within the definition of property of the estate in §1115. That new section refers to the inclusion of those two types of property as being "in addition to" property of the estate specified in §541. All of the debtor's interest in prepetition property is included within the definition of property of the estate in §541.

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What does the new exception language in §1129(b)(2)(B)(ii) mean by allowing an individual debtor to retain property *included* in the debtor's estate under §1115, which includes in an individual debtor's estate two kinds of property that were not already property of the individual debtor's estate under §541?

The new exception language in §1129(b)(2)(B)(ii) is susceptible to two different interpretations, a broad interpretation and a narrow interpretation, each of which will be described in detail in separate sections below.

III. The Broad Interpretation and Analysis

The broad interpretation of the new exception language of §1129(b)(2)(B)(ii) is that an individual debtor in Chapter 11 may retain all of the property that is defined as being included in the individual debtor's estate under §1115: (1) property the debtor acquires after the commencement of the case, (2) earnings from services performed by the debtor after the commencement of the case, and (3) all of the property specified in §541.

The text of §1115 provides that property of the estate *includes*, in addition to the property specified in §541, (1) property the debtor acquires after the commencement of the case, and (2) earnings from services performed by the debtor after the commencement of the case. Section §1115 thus adds two kinds of property to the property of the estate of an individual debtor in Chapter 11. These two types of property are defined in §1115 as being "in addition to the property specified in section 541." The "in addition to" language means that there are more than those two types of property that are included in the estate of an individual debtor in Chapter 11.

Under the rule of construction in §102(3), the word "includes" before the words "in addition to the property specified in section 541" is not limiting. By its plain text, §1115 is not limited to the property described in (1) and (2). Section 1115 includes all §541 property, including prepetition assets, in addition to the property described in (1) and (2).

Section 1129(b)(2)(B)(ii) plainly states that an individual debtor in Chapter 11 can retain all of the property included in the estate under §1115, namely the two types of property in the numbered subparagraphs of §1115 in addition to whatever property is already considered property of the estate by virtue of §541.[22]

The default rule of statutory interpretation under contemporary Supreme Court jurisprudence is to apply the plain meaning of the words enacted by Congress.[23] In construing provisions of the Bankruptcy Code in particular, the Supreme Court has directed "time and time again that

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courts must presume that a legislature says in a statute what it means and means in a statute what it says there."[24] Under the plain meaning rule, if the meaning of the statute is clear, then no further inquiry is required.[25] If no ambiguity exists, then the plain meaning of the text is conclusive and the inquiry generally comes to an end.[26] If the language of the statute is unambiguous, courts do not need to resort to legislative history.[27] The plain meaning of legislation should be conclusive, except when a literal application produces a patently absurd result or contravenes any clear legislative history.[28]

In plain language, the new exception in §1129(b)(2)(B)(ii) provides that an individual debtor in Chapter 11 may retain property that is included within the definition of property of the estate in §1115. That new section, in turn, plainly includes all §541 property by stating that the two new types of property included in an individual debtor's Chapter 11 estate are "in addition to" property of the estate specified in §541. Because §541 includes all of the debtor's interest in prepetition property, that property plainly is included as property of an individual Chapter 11 debtor's estate by §1115. Thus, by virtue of §1129(b)(2)(B)(ii), an individual may confirm a Chapter 11 plan that provides for the retention of all prepetition and all postpetition property, despite rejection of the plan by unsecured creditors, subject to 100% distribution or distribution of the projected disposable income of the individual debtor as required by §1129(a)(15), and satisfaction of the requirement of §1123(a)(8) that the plan set forth the debtor's commitment of personal service earnings or other future income as necessary for the execution of the plan, and the requirement of §1129(a)(7) that each holder of an impaired claim receive under the plan at least as much as the holder would receive if the debtor were liquidated under Chapter 7.

As described more fully below, the effect of the BAPCPA amendments is to create for individuals in Chapter 11 a reorganization confirmation regime similar to that of Chapter 13, in which there is no absolute priority rule and debtors can retain, and remain in possession of, prepetition property subject to their devoting disposable income to their plan. The literal application of §§1129(b)(2)(B)(ii) and 1115 either alone, together or in the context of the other BAPCPA amendments does not produce a patently absurd result, nor does it contravene any clear legislative history or bankruptcy policy. Accordingly, the plain meaning of §§1129(b)(2)(B)(ii) and 1115 should be conclusive.

Bankruptcy Judge Markell has developed a two-part test derived from the jurisprudence of Justice Scalia which, if satisfied, would permit a judge to deviate from enforcing the plain language of a statute.[29] First, the plain meaning of the statute under consideration must lack any ra-

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tional purpose. If the language is capable of any plausible congressional purpose, it fails the test, even if the purpose is not what Congress may have intended. If there is no plausible congressional purpose in the text as written, the statute is a candidate for reformation. The second part of the test is that the intended meaning of the statute must be obvious. The court must be correcting an obvious scrivener's error.[30] Otherwise, the court might be rewriting the statute instead of correcting a technical mistake.[31]

Applying the *Kane* test to §§1129(b)(2)(B)(ii) and 1115 results in neither part of the test being satisfied.[32] First, the plain language of the provisions does not lack any rational purpose. Congress apparently did have a rational purpose in enacting these provisions along with the interrelated BAPCPA provisions—to make Chapter 11 for individuals operate like Chapter 13. Congress might have had another intent, also unarticulated, but the other intent certainly was not obvious. Thus, the second part of the *Kane* test is not satisfied. The inclusion of the words "in addition to the property specified in section 541" in §1115 is not an obvious scrivener's error. The language of §1115(a) is virtually identical to the language of §1306(a), which defines property of the estate in Chapter 13 cases.

IV. The Narrow Interpretation and Analysis

The narrow interpretation of the new exception language in §1129(b)(2)(B)(ii) is that an individual debtor in Chapter 11 may retain only that property which is incorporated into the individual debtor's estate by §1115 which has not already been incorporated into the individual debtor's estate by §541.

The text of §1115 provides that property of the estate *includes*, in addition to the property specified in §541, (1) property the debtor acquires after the commencement of the case, and (2) earnings from services performed by the debtor after the commencement of the case. The structure of §1115 is to add two kinds of property to the property of the estate as determined under §541. The words "in addition to the property specified in §541" are not prescriptive. They do not define what is being added to property of the estate under §1115, because that property already is property of the estate. That construction would be redundant. The words "in addition to the property specified in §541" are merely descriptive, they describe what it is to which the property described in (1) and (2) is being added. The property actually being *included* in an individual's estate under §1115 is the property described in (1) and (2).

While property of the estate of an individual in Chapter 11 clearly consists of three types of property under §1115, the property of the

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estate being *included* in property of the estate pursuant to §1115 for purposes of §1129(b)(2)(B)(ii) is only that property which is added to property of the estate in §1115: (1) property the debtor acquires post-commencement and (2) earnings from services performed by the debtor postcommencement.

The rule of construction in §102(3) is that the words "includes" and "including" are not limiting. Courts have construed the words "includes" and "including" as being illustrative rather than exhaustive or exclusive.[33] The words "includes" and "including" should therefore be read as "includes, without limitation" or "including, without limitation."

The problem with applying the rule of construction in §102(3) to the word "includes" as used in §1115 or the word "included" as used in §1129(b)(2)(B)(ii), is that the rule of construction in §102(3) makes no sense as applied to those words.

The rule of construction in §102(3) cannot apply to §1115 because the words "includes, in addition to the property specified in §541—(1) property acquired post-petition and (2) post-petition earnings from services" cannot be read as "includes, *without limitation*, in addition to the property specified in §541—(1) property acquired post-petition and (2) post-petition earnings from services." The word "includes" as used in §1115 is limiting. The word "includes" as used in §1115 is specifically limited to the two types of property described in (1) and (2) of that provision. Property of the estate of an individual in §1115 cannot include anything else except the two types of property specified in (1) and (2) in addition to the property specified in §541.

The rule of construction in §102(3) also cannot apply to §1129(b)(2)(B)(ii) because that provision uses the word "included" not the words "includes" or "including," which are the words covered by the §102(3) rule of construction. Even if the word "included" were covered by the §102(3) rule of construction, the word "included" as used in §1129(b)(2)(B)(ii) cannot be read as "included, without limitation" because the provision would then be read as "the debtor may retain property included, without limitation, in the estate under section 1115." That reading makes no sense. The word "included" as used in §1129(b)(2)(B)(ii) is thus specifically limiting and can only be read as meaning the property that is included by §1115.

Since the rule of construction in §102(3) cannot apply to the word "included" as used in §1129(b)(2)(B)(ii), there must be another way to construe the word. Indeed there must be another way to construe the words "included in the estate" in that provision. Had Congress intended to allow an individual debtor in Chapter 11 to retain all of the property referred to within §1115, namely the type of property specified in (1)

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and (2) in addition to the property specified in §541, Congress would have worded §1129(b)(2)(B)(ii) to read, "the debtor may retain property of the estate under section 1115." Instead, Congress worded §1129(b)(2)(B)(ii) differently. Congress used the words "included in" in place of the word "of" so that that actual provision reads "the debtor may retain property included in the estate under section 1115." The only property that is included in the estate under §1115 that is not already property of the estate under §541 is the property that §1115 adds to the estate, namely the property specified in (1) and (2).

Accordingly, under the narrow interpretation, the proper way to construe §1129(b)(2)(B)(ii) is that an individual debtor in Chapter 11 may retain that property which is included in the estate solely due to the application of §1115. An individual debtor in Chapter 11 may thus retain only (1) property the debtor acquires after the commencement of the case, and (2) earnings from services performed by the debtor after the commencement of the case.

Under the narrow interpretation, the absolute priority rule would still apply. An individual debtor in Chapter 11 could not confirm a Chapter 11 plan that provides for the retention of prepetition property over the objection of unsecured creditors.

The narrow interpretation suffers principally from two types of weaknesses. The first is textual. The second is in its application.

The first textual weakness is that, as a general rule of statutory construction, a statute should be construed to give effect to all of its provisions, "so that no part will be inoperative or superfluous, void or insignificant, and so that one section will not destroy another unless the provision is the result of obvious mistake or error."[34] To argue that the new exception language in §1129(b)(2)(B)(ii) was never intended to include prepetition property of the estate already defined by §541 would be to read the words in §1115 "in addition to the property specified in section 541" out of §1115 and render them "mere surplusage," inoperative or superfluous.

The response to that criticism would be that while §1115 includes three types of property in defining property of the estate of an individual in Chapter 11, §1129(b)(2)(B)(ii) only allows the debtor to retain the two types of property in §1115(a) (1) and (2) that are added by §1115 to property of the estate. Accordingly, the words "in addition to the property specified in section 541" are not mere surplusage, inoperative or superfluous in §1115. The words have meaning in §1115. The words just are not operative by the way §1115 is applied in §1129(b)(2)(B)(ii).

The second textual weakness of the narrow interpretation is that §1129(b)(2)(B)(ii) uses the word "under" not "by." The narrow inter-

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pretation would have been stronger had §1129(b)(2)(B)(ii) read "the debtor may retain property included in the estate *by* section 1115," which is how the narrow interpretation construes it. Instead, §1129(b)(2)(B)(ii) actually reads "the debtor may retain property included in the estate *under* section 1115," which, arguably, is more inclusive and picks up the property specified in §541.

The weakness of the narrow interpretation in application is that it does not accomplish very much. The narrow interpretation allows an individual debtor in Chapter 11 to retain postpetition income and property. Under §1123(a)(8), the debtor's plan must provide for the payment of creditors out of that postpetition income and property and under §1129(a)(15), if the holder of an allowed unsecured claim objects to the plan, the plan must distribute not less than the projected disposable income of the debtor for five years. What good does it do a debtor to be able to retain postpetition income and property if the postpetition income and property is going to be distributed to creditors?[35]

The only way the narrow interpretation might assist an individual debtor in Chapter 11 to reorganize is if the debtor managed to retain some property despite §§1123(a)(8) and 1129(a)(15) and was able to contribute that property to the plan as "new value" in return for retaining prepetition assets. For that slim possibility to work, there would have to be a new value exception to the absolute priority rule and the debtor would have to overcome the Supreme Court decision in *Norwest Bank Worthington v. Ahlers*,[36] which stated that the new value exception to the absolute priority rule, if it existed at all, could not be satisfied by the contribution of postpetition earnings from personal services ("sweat equity").

If the narrow interpretation means that a debtor is entitled to retain under §1129(b)(2)(B)(ii) property that does not go to creditors, but the promise of future labor would not qualify as money or money's worth and thus could not satisfy any new value exception to the absolute priority rule,[37] then the narrow interpretation would, at best, have a trivial meaning.[38]

Comparing the broad and narrow interpretations of the new exception language in §1129(b)(2)(B)(ii) yields a broad interpretation that is supported by a rule of construction and a plain language reading of the statute that gives effect to all of the words in the statute and that produces a result (allowing an individual debtor to retain prepetition assets, subject to satisfying all other confirmation requirements except the absolute priority rule) that is not patently absurd and that does not contravene any other Code section or legislative intent. In its application, the broad interpretation allows the debtor to retain valuable business assets which

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are the source of postpetition income and greater recovery for creditors. In contrast, while there is some statutory basis to argue for a narrow interpretation, that interpretation is not without textual problems and it produces a result that in its application is virtually meaningless.

V. Legislative History

A. Sections 1129(b)(2)(B)(ii) and 1115

Where statutory language is capable of multiple interpretations, a court may look to other interpretative tools, including the legislative history of the provision.[39] Ideally, there would be expressions of congressional intent in the legislative history explaining the BAPCPA provisions. Unfortunately, there aren't any.[40] One bankruptcy court has found that the "[l]egislative history is virtually useless as an aid to understanding the language and intent of BAPCPA."[41]

The origins of BAPCPA generally can be found in the Report of the National Bankruptcy Review Commission,[42] the Responsible Borrower Protection Bankruptcy Act,[43] the Consumer Bankruptcy Reform Act of 1997,[44] the Bankruptcy Reform Act of 1998,[45] the Consumer Lenders and Borrowers Bankruptcy Accountability Act of 1998,[46] the Bankruptcy Reform Act of 1999,[47] another Bankruptcy Reform Act of 1999,[48] the Bankruptcy Reform Act of 2000,[49] the Bankruptcy Abuse Prevention and Consumer Protection Act of 2001,[50] and the Bankruptcy Abuse Prevention and Consumer Protection Act of 2003.[51] For most of the eight-year gestation period, the legislative focus was primarily on means testing, homestead exemptions, and domestic support obligations.[52]

Proposed changes to the way an individual would be treated in Chapter 11 did not appear until 1999, when the Senate proposed to amend §541(a)(6) so that postpetition income would become property of the estate in an individual consumer case under Chapter 11.[53]

Legislative history regarding the relevant proposed amendments to the Code to what would become §§1129(b)(2)(B)(ii) and 1115 did not appear until 2001. The House Committee on the Judiciary Report to accompany H.R. 333 states that the proposed legislation "amends section 1129(b)(2)(B)(ii) of the Bankruptcy Code to provide that an individual chapter 11 debtor may retain property included in the estate under section 1115" and that the legislation:

> creates a new provision [§1115] specifying that property of the estate of an individual debtor[54] includes, in addition to that identified in section 541 of the Bankruptcy Code, all property of the kind described in section 541 that the debtor acquires after commencement

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> of the case, but before the case is closed, dismissed or converted to a case under chapter 7, 12 or 13 (whichever occurs first). In addition, it includes earnings from services performed by the debtor after commencement of the case, but before the case is closed, dismissed or converted to a case under chapter 7, 12 or 13.[55]

The changes proposed in H.R. 333 were essentially identical to changes enacted in §321 of BAPCPA in 2005.[56] The legislative history in the 2001 House Report on H.R. 333, although devoid of any further explanation of the purpose of the provisions, the problems or abuses the provisions were being enacted to solve or a judicial decision the provisions were intended to overrule, constitutes the most authoritative evidence of congressional intent with respect to §§1129(b)(2)(B)(ii) and 1115.

H.R. 333 ultimately went to a House and Senate conference in 2002. The conference report is almost identical to the earlier House Report.[57] In connection with the final version of BAPCPA, there is no Senate Report, there is a House Report that repeats most of the text of prior House Report which is itself often just a recitation of the text of the Code provisions, there is no joint conference committee report, and there are no joint floor manager statements which might carry the weight of a conference report.[58]

The House Report on H.R. 333 is not conclusive as to the meaning of the phrase "the debtor may retain property included in the estate under section 1115" in §1129(b)(2)(B)(ii) as enacted by BAPCPA. Nevertheless, there is no suggestion whatsoever in the report that the word "included" was intended to cover only postpetition earnings and property. A plain reading of the report tends to support the broad interpretation that the word "included" in §1129(b)(2)(B)(ii) was intended to cover all of the property the report states was included in the property of the estate of an individual in Chapter 11 under §1115, including prepetition property.

B. Congressional Intent to Make Chapter 11 Function Like Chapter 13

In BAPCPA Congress enacted many changes to Chapter 11 that apply only to individual debtors and are clearly modeled upon Chapter 13.[59] Six specific changes to the Code that make Chapter 11 function for individuals the way Chapter 13 functions are as follows:

> Section 1115 brings property the debtor acquires post-petition into the estate just as in Chapter 13 under §1306(a);

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Section 1123(a)(8) requires the debtor's plan to provide for payment to creditors from post-petition earnings from services or other future income just as Chapter 13 under §1322(a)(1) calls for the debtor's plan to "provide for the submission of all or such portion of future earnings or other future income of the debtor... as is necessary for the execution of the plan"***;***

The exception in §1129(b)(2)(B)(ii) allowing the debtor to retain property included in the estate under §1115 without paying in full senior objecting creditors effectively repeals the absolute priority rule just as it is not present in Chapter 13;

Section 1129(a)(15) authorizes the debtor to overcome an objection to the plan made by a single unsecured creditor by proposing to distribute under the plan property worth at least as much as the debtor's projected disposable income for a five-year period. Chapter 13 authorizes the debtor to overcome an objection to the plan made by a single unsecured creditor by proposing to distribute under the plan all of the debtor's projected disposable income for the three to five year period of the plan under §1325(b)(1)(B);

Section 1141(d)(5) ordinarily delays the entry of the debtor's discharge until completion of all payments under the plan just as in Chapter 13 under §1328; and

Section 1127(e) permits modification of a confirmed plan even after substantial consummation for certain purposes just as in Chapter 13 under §1329.

Viewed in context, these changes indicate that Congress intended to place an individual debtor in Chapter 11 in a similar position to an individual debtor in Chapter 13. Since there is no absolute priority rule in Chapter 13, it is reasonable to conclude that Congress intended to extend the exemption from the application of the absolute priority rule in Chapter 13 to individual debtors in Chapter 11 as well.

Indeed it would be difficult to consider the above-cited BAPCPA amendments, all of which incorporate an element of the Chapter 13 confirmation process into Chapter 11, and some of which use identical language, as evidencing anything other than deliberate congressional design to reproduce the Chapter 13 model in Chapter 11 for individuals.

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C. Section 1306, the Chapter 13 Analog to §1115

The definition of property of the estate in §1115 is virtually identical to the definition of property of the estate in §1306.[60] Although no legislative history explains the scope of §1115, there is legislative history explaining the scope of §1306. The legislative history is unambiguous:

> Section 541 is expressly made applicable to Chapter 13 cases... Section 1306 broadens the definition of property of the estate for Chapter 13 purposes to include all property acquired and all earnings from services performed by the debtor after the commencement of the case. Subsection (b)… provid[es] that a Chapter 13 debtor need not surrender possession of property of the estate, unless required by the plan or order of confirmation.[61]

Since Congress enacted the virtually identical language in §1115 that it had in §1306, it is reasonable to conclude that Congress intended the same result, i.e., that §1115 includes prepetition property in the definition of property of the estate for an individual in Chapter 11 just as §1306 includes prepetition property in the definition of property of the estate for an individual in Chapter 13. Thus, it is possible to discern congressional intent to create a regime for individual debtors in Chapter 11 similar to that of Chapter 13 by incorporating virtually identical provisions from Chapter 13 into Chapter 11.

Accordingly, the House Report, the pattern of adopting Chapter 13 provisions into Chapter 11 for individual debtors, and the legislative history to §1306 all support the broad interpretation that individuals in Chapter 11 may retain prepetition property, subject to satisfying all confirmation requirements except the absolute priority rule.

D. Congressional Intent to Restrict the Ability of Individual Debtors to Obtain Debt Relief

An intent can also be discerned from the pattern of statutory provisions enacted in BAPCPA by Congress to restrict the ability of individuals to obtain debt relief by filing bankruptcy. The means test is one such provision.[62] Arguably, it would be incongruous to restrict the ability of individuals to get out of debt on the one hand, while enhancing their ability to confirm a plan of reorganization in Chapter 11 over the objections of unsecured creditors by abolishing the absolute priority rule on the other hand.

That argument supports the narrow interpretation. The weakness in the argument is that it fails to explain why the new exception language in §1129(b)(2)(B)(ii) was added at all. If the intent of Congress was to

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make bankruptcy relief more difficult for individual debtors generally, then why would Congress add any exception into §1129(b)(2)(B)(ii)?

E. The Rule of Continuity

The best argument from the legislative history that can be made in support of the narrow interpretation is the "rule of continuity": Congress does not create discontinuities in legal rights and obligations without some clear statement.[63] Under this canon of statutory construction, Congress would not have ended the application of the absolute priority rule without specifically mentioning it in the BAPCPA legislative history.

The rule of continuity argument suffers from two weaknesses. First, there have been significant periods of time in the past when the absolute priority rule did not apply to individuals.[64] The inapplicability of the absolute priority rule to individuals starting in 2005 is therefore not discontinuous. Second, as described above, if the narrow interpretation is to have any applicability, it must allow an individual debtor in Chapter 11 who managed to retain some income despite §§1123(a)(8) and 1129(a)(15) to contribute income to the plan and thereby retain prepetition assets pursuant to a new value exception to the absolute priority rule. However, by allowing the debtor to retain valuable prepetition business assets by paying creditors through postpetition earnings from personal services performed by the debtor, the narrow interpretation would overrule the Supreme Court decision in *Norwest Bank Worthington v. Ahlers*,[65] which stated that the new value exception to the absolute priority rule, if it existed at all, could not be satisfied by the contribution of postpetition earnings from personal services. The narrow interpretation cannot be supported by an argument on the one hand that Congress would not have abolished the absolute priority rule without mentioning it in the BAPCPA legislative history, but, on the other hand, that Congress would have overruled the Supreme Court decision in *Ahlers* without mentioning it in the BAPCPA legislative history.

On balance, the legislative history weighs more heavily in favor of the broad interpretation over the narrow interpretation.

VI. Policy Considerations Favor a Broad Interpretation

There are a number of reasons why it makes sense from a bankruptcy policy perspective to adopt the broad interpretation and view §§1115(a) and 1129(a)(15) and (b)(2)(B)(ii) as replacing the absolute priority rule with a disposable income test for individuals in Chapter 11.

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A. Fresh Start

Perhaps the most important policy objective in Chapter 11 is to provide a debtor with a fresh start.[66] When the debtor is a large, public corporation, the estate can eliminate all the former equity owners and the debtor can still have a successful reorganization and a fresh start. When a large, public corporation reorganizes, management can remain intact or be replaced and the corporation gets a fresh start. The absence of old equity ownership or old management makes no difference to the operation of the reorganized entity postbankruptcy. When the debtor is a large, public corporation, the "bargain" offered by bankruptcy is worth pursuing: the debtor reveals information about itself, puts itself under the jurisdiction of the bankruptcy court and subjects itself to the court's supervision in return for the ability to reject contracts and leases, restructure the balance sheet and otherwise reshape the business.

The same is not true for small businesses in bankruptcy. When the principal manager is also the principal owner, the business often cannot get a fresh start without continued involvement of the former manager-owner. The former manager-owner may be too critical to the business for the business to survive without. The reorganization of a small business may not be feasible without the manager-owner being able to retain a continuing interest as the equity owner. There is thus a tension between the policy objective of promoting a fresh start and the policy objective of maximizing creditor returns in small business reorganizations that does not exist in large corporate reorganizations.

B. Maximize Value of the Estate and Returns to Creditors

The policy goal should be to maximize the value of the estate and distribute the maximum value to creditors under the plan. The value in large, asset rich corporate reorganizations exists to a large extent in the corporation's assets and how they are deployed. The value in small businesses generally is derived to a much greater degree through intangibles: customer relationships, know-how and goodwill.[67] Much of that intangible value may be attributable to the manager-owner. If the manager-owner disappears, so may the intangible value.

In large corporate reorganizations, the absolute priority rule captures for creditors more than they would receive in a liquidation and facilitates the process of distributing going concern value to creditors under the plan.[68] In small business reorganizations, the absolute priority rule produces the opposite result. Assuming the business is balance sheet insolvent, equity will be eliminated. Without an equity interest, the manager is unlikely to remain. Without the manager, the business cannot succeed, and liquidation will produce less for creditors than if the man-

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ager were retained through continued ownership. Without the intangible value created by the manager, the value of the business approximates its liquidation value. If the manager has no possibility of retaining the business, he will likely liquidate it. There is no reason or incentive for a manager who is going to lose the business to creditors to reorganize it for their benefit.[69]

Thus, instead of delivering the going concern value to creditors, the absolute priority rule destroys the going concern value.[70] A rule that permits the former manager-owner to retain ownership and remain in possession is preferable to an absolute priority rule that bars further equity participation, because a "retain and remain" rule that permits the debtor to retain and remain in possession of the assets which are the source of its ability to produce income enhances the value of the estate, which in turn enhances the return to creditors.

Allowing debtors to retain their assets and pay creditors over time is thus better for creditors. Section 1115 can be seen as protecting the source of postpetition income as well as the income itself.

C. Rehabilitation and Job Preservation

"Retain and remain" promotes the rehabilitation of financially distressed entities. Small businesses have very limited access to capital. They cannot access the capital markets. Banks generally will not lend without collateral and personal guarantees from an experienced manager-owner. Insolvent small businesses have even less access to capital. The former manager-owner may be the only source of financing.[71]

VII. The Cases[72]

A. *In re Tegeder*

The first judicial opinion to consider what constitutes property of the estate under §1115(a) and the effect of the new exception language in §1129(b)(2)(B)(ii) on the application of the absolute priority rule to individuals in Chapter 11 was *In re Tegeder*.[73]

The facts of *Tegeder* were fairly straight forward. The Tegeders owned and operated two businesses.[74] The Tegeders' Chapter 11 plan proposed to pay unsecured creditors less than the full amount (but more than 95%) of their claims starting in year eight of a 10-year plan, while allowing the debtors to retain ownership of their business assets.[75] There were eight classes of creditors in the debtors' plan, of which four were impaired. Only one of the impaired classes, a class of general unsecured creditors, voted against the plan. Apparently, only the U.S. Trustee filed

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an objection to confirmation of the plan, although counsel for four other creditors were listed in the opinion. The U.S. Trustee argued that the plan could not be confirmed because allowing the debtors to retain property without paying creditors in full violated the absolute priority rule.

The court found the meaning of §1115 to be clear:

> Thus, §1115 *is clear* that property of the estate in a case in which the debtor is an individual includes the property described in §541 (which includes, but is not limited to, all legal or equitable interests of the debtor in property as of the commencement of the case), as well as post-petition property and earnings. 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. (emphasis added)

In the absence of any prior decisions dealing with this issue, the court relied upon three commentators to support its conclusion that the exception in §1129(b)(2)(B)(ii) should be read broadly to allow an individual debtor to retain prepetition property as well as postpetition service income and postpetition property.[76]

Only one of the three commentators cited in the opinion found any ambiguity in the wording of §1129(b)(2)(B)(ii), 1115 or 541. Hon. W. Homer Drake, Jr. in his *Bankruptcy Practice for the General Practitioner* §12:27 n.28 does not refer to any ambiguity.[77] Rosemary E. Williams in her 3 *Bankruptcy Practice Handbook* § 14:152 n.1 (database updated September 2006, available on Westlaw) which is cited in the *Tegeder* opinion as stating that "the amendment to §1129(a)(15) seems to remove individual debtors from compliance with the absolute priority rule" is only ambiguous for use of the word "seems."[78] The second edition updated June 2009 of the 3 *Bankruptcy Practice Handbook Database* no longer contains that statement.

The third commentator, Hon. William L. Norton, Jr., 4 Norton Bankruptcy Law & Practice 2d §84A:1,[79] is cited in the *Tegeder* opinion as stating:

> Although 1115 was added by the 2005 Amendments to include post-petition property and earnings, it also incorporates property of the estate under 541, and accordingly it is assumed that the debtor shall be entitled to retain property under 541 as well. *A more narrow interpretation* would cause this amendment to have little effect.[80] (emphasis added).

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B. *In re Roedemeier*

The idea that the new exception language is ambiguous and capable of more than one interpretation, a narrow and a broad one, was picked up in *In re Roedemeier*,[81] the second reported opinion to consider this issue.[82] Like the debtor in *Tegeder*, the debtor in *Roedemeier* was allowed to retain ownership of a prepetition business over the objection of a dissenting unsecured creditor class.

Roedemeier owned two business entities,[83] dental practices, the first of which essentially failed. Dr. Roedemeier had personally guaranteed debt incurred by the first practice. A creditor pursuing payment on that guarantee led to the Chapter 11 filing.[84] Neither practice filed a bankruptcy petition. There were five classes of creditors in the debtor's plan, two of which were impaired. One of the impaired classes was secured by equipment used in the second practice.[85] That class accepted the plan.[86] The other impaired class consisted of unsecured claims. The unsecured class was dominated by the creditor pursuing payment of the guarantee. That creditor objected to a number of aspects of the disclosure statement but did not technically object to the plan. Nevertheless, the court treated the unsecured class as if it had objected to confirmation of the plan.[87]

The *Roedemeier* court found that the debtor devoted sufficient projected disposable income to satisfy the requirement of §1129(a)(15),[88] and that the amount of the distribution exceeded the liquidation value of the practice,[89] thereby satisfying the "best interests of creditors" requirement of §1129(a)(7). With the rejection of the plan by the unsecured creditor class, the Roedemeier Chapter 11 plan could only be confirmed on a "cramdown" basis if the retention by Dr. Roedemeier of the equity ownership of his business, the dental practice, did not violate the absolute priority rule. Whether the absolute priority rule precluded the debtor from retaining the equity ownership of the dental practice, which was junior to the unsecured creditors' interest in it, according to the court, depended upon whether the new exception language in §1129(b)(2)(B)(ii) should be interpreted narrowly or broadly.[90]

The narrow interpretation would include in property of the estate of an individual debtor in Chapter 11 only earnings from postpetition services and property acquired postpetition. The broad interpretation would include in property of the estate of an individual debtor in Chapter 11 earnings from postpetition services and property acquired postpetition "in addition to the property specified in section 541," thereby also including the debtor's prepetition property.

The *Roedemeier* court rejected the narrow interpretation. Such an interpretation, the court found, would have had little impact on the ability

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of an individual debtor to reorganize in Chapter 11.[91] In particular, the court reasoned, although the debtor could retain earnings from postpetition services and property acquired postpetition without violating the absolute priority rule, the debtor could not retain a prepetition business under any new value corollary to the absolute priority rule that might exist, because of the Supreme Court's ruling in *Norwest Bank Worthington v. Ahlers*.[92] The *Ahlers* decision requires any new value to be in money or money's worth and the promise of future labor cannot satisfy that requirement. Thus, the $30,000 that the debtor's plan in *Roedemeier* proposed to pay creditors, which came primarily from future services, would not constitute money or money's worth.[93] Accordingly, if there were a new value exception to the absolute priority rule, Dr. Roedemeier could not take advantage of it even if he could retain postpetition earnings.

The *Roedemeier* court concluded that the broad interpretation, that property of the estate under §1115 encompassed prepetition property as well as postpetition earnings and property, would have an impact on the ability of an individual to reorganize in Chapter 11 and made sense when considered as part of an implementation of congressional intent to make Chapter 11 function for individuals the way Chapter 13 functions.[94]

Congressional intent to abolish the absolute priority rule was not explicitly stated in the BAPCPA amendments,[95] but the *Roedemeier* court discerned a pattern in the way many of the BAPCPA changes to Chapter 11 applied only to individual debtors and were modeled upon Chapter 13.[96] The court identified six specific changes to the Code that made Chapter 11 function for individuals the way Chapter 13 functions,[97] that were described above.

The *Roedemeier* court concluded, "Significantly, Chapter 13 does not impose the absolute priority rule on debtors. Taken together, these changes indicate Congress intended to extend the exemption from the absolute priority rule to individual Chapter 11 debtors as well."[98]

C. *In re Shat*

The distinction between the narrow and broad interpretations of §1129(b)(2)(B)(ii) was the focus of *In re Shat*[99] the third opinion to consider whether the absolute priority rule applies to individual debtors in Chapter 11. The opinion contains a threadbare recitation of the facts. The debtors owned a profitable dry cleaning sole proprietorship as well as several less profitable residential rental properties. The debtors' Chapter 11 plan contained eight classes of creditors,[100] only one of which voted against the plan. The plan proposed to pay that dissenting

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class of unsecured creditors *less than the full amount* (approximately 90% less than the full amount) of their allowed claims over five years,[101] while allowing the debtors to retain ownership of the dry cleaning business assets.[102]

Whether the court could approve the plan depended, according to the court, upon whether the new exception in §1129(b)(2)(B)(ii) modified the application of the absolute priority rule to individual debtors. The court first examined the legislative history of BAPCPA and concluded that Congress generally intended to apply the provisions of Chapter 13 to individual debtors in Chapter 11 apparently "to ensure no easy escape from means testing."[103] The court then parsed the statutory language of §§1129(b)(2)(B)(ii) and 1115 and found the new exception in §1129(b)(2)(B)(ii) allowing individual debtors to retain "property included in the estate under section 1115" to be ambiguous because of the use of the word "included."[104]

According to the court, "included" could be interpreted broadly to mean all of the property described in §1115(a), including prepetition property included in property of the estate under §541, which §1115(a) supplants and adds to, an interpretation that would except individuals from the application of the absolute priority rule. Alternatively, according to the court, "included" could be interpreted narrowly to mean only property that was included in the estate specifically under §1115(a) that was not already included in the estate under §541.[105]

The narrow interpretation of *Shat* is actually much narrower than the narrow interpretation of *Roedemeier*. In *Roedemeier*, the court included within the narrow interpretation the two types of property in numbered parentheticals in §1115(a): (1) property the debtor acquires postcommencement and (2) personal service income the debtor earns postcommencement. Both of these types of property would not be included within the definition of property of the estate under §541. In *Shat*, the court apparently considered the narrow interpretation to include only postpetition income from services, not property acquired by the debtor postpetition.[106]

The narrow interpretation of *Shat* gets even narrower than all postpetition income from services. Because under §1123(a)(8)[107] the debtor must provide for the payment to creditors under the plan of all or that portion of postpetition earnings necessary for the execution of the plan and under §1129(a)(15)[108] the debtor must devote his projected disposable income[109] to the plan (if an unsecured creditor objects), the debtor, according to the court, cannot be said to be retaining that income.[110] The only postpetition income that the debtor can be said to retain, therefore, is the postpetition income earned by the debtor after the five-year

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payment period in §1129(a)(15). Thus, the narrow interpretation of §1129(b)(2)(B)(ii) in *Shat* only permits individual debtors in Chapter 11 to retain their earnings starting after the end of the payment period in §1129(a)(15).[111] That is indeed a very narrow interpretation.

Despite having apparently found the new exception language in §1129(b)(2)(B)(ii) to be "ambiguous," the *Shat* opinion concluded that the plain language of the statue compelled the adoption of the broad interpretation:[112]

> Given the relatively straightforward reading of the statute supporting the broader reading, and the general rehabilitative aim of chapter 11, the court understands the phrase "in addition to the property specified in section 541" to mean that Section 1115 absorbs and then supersedes Section 541 for individual chapter 11 cases. This construction, in turn, leads to the position that Section 1129(b)(2)(B)(ii)'s exception extends to all property of the estate, including such things as prepetition ownership interest of nonexempt property. This conclusion is supported by the revisions in 2005 to bring individual chapter 11's more in line with chapter 13. It is also supported by the few cases to examine the topic.[113]

D. *In re Gbadebo*

The fourth opinion to consider whether the absolute priority rule applies to individual debtors in Chapter 11, *In re Gbadebo*,[114] was decided the other way. The debtor was a licensed professional engineer who performed engineering services through his wholly-owned engineering corporation.[115] The debtor was the sole owner of real property on which the business was located. The debtor also owned a house and two automobiles, one of which was primarily used in the business. The plan proposed to pay the unsecured creditors approximately 2.6% of their claims over five years, while allowing the debtor to retain ownership of his business (and nonbusiness) assets.[116] The class of general, unsecured claims voted against the plan and at least the largest holder of general, unsecured claims filed several objections to confirmation of the plan.[117]

The court refused to approve confirmation of the plan because it was not proposed in good faith and because it did not satisfy §1129(a)(15).[118] Given that the debtor was proposing to pay unsecured creditors $100 per month, the court found it bad faith for the debtor to propose to continue to make payments on a Jetta that was being driven by his college-age daughter and on a four-bedroom house in which he lived alone and in which he had no equity. Had those payments gone instead to the unsecured creditors, the court found, the dividend would have

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risen from 2.6% to 26%. As a result, the court found the plan to be in bad faith.[119]

The court could not rely on the debtor's calculation of income and expenses, because the debtor apparently disregarded the separate existence of his wholly-owned corporation and used it as his personal "piggy bank." Since the debtor failed to meet the burden of proof that his financial information was credible, the court held that the plan did not satisfy §1129(a)(15).[120]

Once it had upheld those two of the unsecured creditor's objections to confirmation of the plan, the court addressed a question no one had asked: did the plan violate the absolute priority rule?[121] After reviewing the three prior decisions on point, the court then went on to reach the opposite conclusion: the plan could not be confirmed because it did not satisfy the absolute priority rule pursuant to §1129(b)(2)(B), namely that the debtor cannot retain any prepetition property if creditors are not paid the full amount of their allowed claims. The court found the language of §1129(b)(2)(B)(ii) to be unambiguous, at least to some extent.

> 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.[122]

The implication is that had the three prior cases not all read the phrase "included in the estate under section 1115" broadly to include prepetition property, the court would have been more definitive on the lack of ambiguity in the provision.[123]

The next paragraph of the *Gbadebo* opinion focuses on §1115 and finds that prepetition property is included in property of the estate of an individual in Chapter 11 under §1115.

> Section 1115 provides that, in an individual chapter 11 case, in addition to the property specified in § 541, the estate includes the debtor's post-petition property. If the clause referring to § 541 had not been included in §1115 and if §1115 had merely stated that an individual chapter 11 debtor's estate included post-petition property, the argument could have been made that an individual chapter 11 debtor's estate did not include his pre-petition property.[124]

This last sentence is confusing. It is certainly true that if §1115 only cited to postpetition property, it could be argued that an individual's Chapter 11 estate did not include prepetition property. No one, however,

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was arguing that point. It is also true that if §1115 only cited to postpetition property, there would be no ambiguity as to what the new exception language in §1129(b)(2)(B)(ii) meant to include and thus no need to choose between the narrow and broad interpretations of that provision. Only the narrow interpretation would apply. However, the clause "in addition to the property specified in section 541" is included in §1115. Since the words do exist in §1115, there must be at least some ambiguity as to what an individual debtor may retain under §1129(b)(2)(B)(ii). Yet, in the prior paragraph, the court found §1129(b)(2)(B)(ii) to be unambiguous and reasonably susceptible to only one meaning—an individual Chapter 11 debtor's estate does not include prepetition property.

The court was not persuaded by the argument that because Congress made Chapter 11 for individuals function like Chapter 13, Congress also intended that the absolute priority rule not apply in Chapter 11. Instead, the court discerned congressional intent in BAPCPA to make it harder for debtors to be relieved of debt, not easier.

> The Court does not find the other provisions added by BAPCPA, designed to make individual chapter 11 cases mores like chapter 13 cases, persuasive evidence that Congress intended to eliminate the "absolute priority" rule as to individual debtors. Each one of these new provisions appears designed to impose greater burdens on individual chapter 11 debtor's rights so as to ensure a greater payout to creditors. This was a frequently expressed overall purpose of BAPCPA: i.e., to ensure that debtors who can pay back a portion of their debts do so. H.R.Rep. No. 109-31, pt. 1, at 2 (2005). No one who reads BAPCPA as a whole can reasonably conclude that it was designed to enhance the individual debtor's "fresh start."[125]

The court was not persuaded by the argument that the narrow interpretation would have very limited affect on the ability of a debtor to reorganize absent payment in full to creditors. Instead, the court found that while it may be impossible to confirm a nonconsensual plan under the narrow interpretation, debtors could still achieve a consensual confirmation of a plan if it offered creditors a higher dividend than they would receive in liquidation in Chapter 7.

> The Shat court asserts that the "absolute priority" rule makes it virtually impossible for an individual chapter 11 debtor to confirm a plan that does not provide for payment in full to the holders of unsecured claims. To the contrary, such a plan may be confirmed if the holders of such claims vote in favor of the plan. They are likely

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> to do so if a reasonable dividend is proposed, and they conclude that they will receive no dividend in a chapter 7 case.[126]

The court then identified what it called a "procedural anomaly" created by the apparent need to send the debtor a ballot in the cram down vote even though the debtor's vote will not be counted.

> Finally, if §§ 1129(b)(2)(B)(ii) and 1115 are read to eliminate the "absolute priority" rule for individual chapter 11 debtors, the Court is faced with a procedural anomaly. If the plan proposes to pay them anything, the debtor is required to send them a ballot. Yet, their vote can be ignored. This makes no sense.[127]

Assuming that courts actually do require that debtors send themselves ballots that will not be counted, that anomalous requirement is a consequence of the wholesale adoption of provisions applicable to debtors in Chapter 13, where there is no voting, into Chapter 11, where there is voting. While Congress might have thought through that anomaly a little more before enacting the BAPCPA provision, the existence of this minor anomaly surely should not be dispositive as to whether a debtor can keep prepetition property.

Based upon the language of the statutes themselves and as they relate to other Code sections and based upon what it concluded was the intent of Congress, the court concluded that the narrow interpretation of §1129(b)(2)(B)(ii) was correct.

> The Court reads §§ 1129(b)(2)(B)(ii) and 1115 to eliminate the "absolute priority" rule only as to an individual chapter 11 debtor's post-petition property. It bases this conclusion on both the language of the statute, both in isolation and viewed in the context of the Bankruptcy Code as a whole. It finds this reading most consistent with the intent of Congress as expressed in the legislative history.[128]

Presumably, when the opinion mentions the elimination of the absolute priority rule only as to the debtor's "post-petition property" the court is referring both to postpetition earnings from services and property acquired postpetition, both of which are the kinds of property added to the property of the estate of an individual in Chapter 11 under §1115.

Clearly, the court was unhappy with the proposed 2.6% dividend to unsecured creditors and the apparent concealment of income or property within the debtor's wholly owned corporation that was not being made available to unsecured creditors. Still, the court could have simply rejected the plan on the basis of bad faith and failure to satisfy §1129(a)

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(15). There was no reason to reject the plan on the basis of the absolute priority rule, particularly since no party in interest had raised the issue.

Had the court needed another justification for rejecting the plan, failure to satisfy §1129(a)(7), the best interests of creditors test, would have been a superior justification more than failure to satisfy the absolute priority rule. If the wholly owned corporation or any other property of the debtor had value that was not being distributed to creditors under the plan, the creditors would have received more by liquidating the debtor than by receiving the proposed payments under than plan. As a result, the plan would fail the best interests of creditors test.

Applying the best interests of creditors test is a better method of protecting creditors than applying the absolute priority rule. Whatever value the wholly owned engineering corporation might have as a going concern managed by the debtor will be destroyed by turning over the stock of the corporation to the unsecured creditors under the absolute priority rule. The debtor will have no interest in continuing to work for an engineering corporation he does not own. The debtor will move on to work for another entity. The creditors will have achieved a pyrrhic victory.

E. *In re Mullins*

The fifth opinion to consider whether the absolute priority rule applies to individual debtors in Chapter 11, *In re Mullins*,[129] followed *Gbadebo*.

Like the debtor in the *Roedemeier* case, the debtor in *Mullins* practiced dentistry through a wholly owned professional corporation. In both cases, only the dentist, not the professional corporation, filed for bankruptcy, and, as in *Roedemeier,* Dr. Mullins proposed to maintain ownership of his professional corporation under his Chapter 11 reorganization plan.

There were five classes of creditors in the debtor's plan,[130] three secured and two unsecured. The three secured classes consisted of secured claims against, respectively, the debtor's home,[131] rental property,[132] and a 2006 Ford Freestyle automobile.[133] Apparently, the plan proposed to make regular monthly payments of principal and interest on the secured debts in accordance with their contracts. The plan also called for the rental property to continue to be marketed and sold with the proceeds going first towards marketing costs, then to repay the debt securing the rental property, with any remaining proceeds going to general unsecured creditors.

The two unsecured classes consisted of a class of general unsecured claims totaling $970,844.46 and a class of contingent unsecured claims

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against the debtor on his guarantees of the indebtedness of his professional corporation totaling $443,539.28. The debtor's plan proposed to pay the class of general unsecured creditors the debtor's net monthly income of not less than $1,000 per month over a period of between 96 and 105 months until the creditors received a total distribution of 12% of their claims.[134] At a discount rate of 6%, the present value of that stream of payments was approximately $81,534, which was more than twice the $40,350 stated liquidation value of the debtor's property that the unsecured creditors would have received under a Chapter 7 liquidation. The debtor's plan proposed to cap the debtor's guarantees on the indebtedness of his professional corporation at 50% of their outstanding balances on the plan's effective date.

Although the opinion is sketchy in details, it appears that all of the creditor classes were impaired, because all apparently were entitled to vote on the plan. The only secured creditor to vote, representing the claim against the automobile, voted in favor of the plan. Of the $970,844.46 in unsecured claims, one creditor holding $114,048 in claims voted in favor of the plan and five creditors with claims aggregating $58,294 voted against the plan.[135] Of the class of contingent unsecured claims against the debtor on his guarantees of the indebtedness of his professional corporation totaling $443,539.28, one creditor holding $324,142 in claims voted in favor of the plan. No objection to either the plan or the disclosure statement was filed by any creditor or the U.S. Trustee.[136]

With the rejection of the plan by the unsecured creditor class, and the acceptance of the plan by at least one impaired class of claims,[137] the court found that the Mullins Chapter 11 plan could only be confirmed on a "cramdown" basis under §1129(b)(1) if the plan did not discriminate unfairly and was fair and equitable with respect to each impaired class that did not accept the plan. Addressing the unfair discrimination prong of the "cramdown" test, the court noted that the general unsecured creditor class stood to receive a maximum repayment of 12% of its claims, while the unsecured guarantee class was only taking a 50% reduction in the amount of the debtor's guarantees. The debts which had the debtor's unsecured guarantees, although unsecured by assets directly owned by the debtor, were directly secured by assets owned by the debtor's professional corporation.[138] The unsecured guarantee class could thus receive repayment in full of its debt by the debtor's professional corporation. The court found that the treatment of the two classes of unsecured creditors was discriminatory, but that the discrimination was not "unfair." The court stated:

> The ability of Dr. Mullins to practice dentistry is dependent upon his ability to retain the equipment owned by his professional cor-

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> poration which its secured creditors have financed. Accordingly, the support of those creditors seems to be essential to his ability to propose a reorganization plan. Although these creditors will fare much better in the reorganization than will his general unsecured creditors, they are providing the means for the other creditors to be paid in part.[139]

Addressing the "fair and equitable" prong of the "cramdown" test, also known as the absolute priority rule, the court noted that while the three prior decisions which found that the absolute priority rule did not apply to individual debtors in Chapter 11 were "very practical" and "made sense from a bankruptcy policy perspective," the one contrary decision, *Gbadebo,* "is more consistent with the language of the statute."[140]

The *Mullins* court, following the *Gbadebo* court, concluded that the language of §1129(b)(2)(B)(ii) was not ambiguous and that it only excepts from the absolute priority rule the debtor's postpetition earnings and postpetition property acquisitions. The court stated:

> This Court believes that the courts in the majority have strained to find ambiguity in the statute in order to arrive at a construction which is more in keeping with the broader intent of certain BAPCPA provisions intended to make individual chapter 11 cases more similar to chapter 13 cases, which are not subject to the absolute priority rule.[141]

The *Mullins* court determined that Congress's purpose in enacting the new exception language in §1129(b)(2)(B)(ii) was to address the "chief problem" of pre-BAPCPA cases—that the postpetition earnings of individual debtors in Chapter 11 were not deemed to be property of the bankruptcy estate. "The new statutory language quite clearly changed that prior rule."[142]

Actually, it was the new BAPCPA language in §1115 that quite clearly changed that prior rule. Section 1115 was the provision that added postpetition earnings from services and property acquired postpetition to the property of the estate of an individual in Chapter 11 "in addition to the property specified in section 541." The new exception language in §1129(b)(2)(B)(ii) does something else; it enables an individual debtor to "retain property included in the estate under section 1115" notwithstanding that such property is deemed property of the estate in §1115. If all Congress wanted to do was to address the "chief problem" of pre-BAPCPA cases, as the *Mullins* opinion suggests, there was no reason to enact the new exception language in §1129(b)(2)(B)(ii) at all. The *Mullins* court recognized a "broader intent" by Congress to make individual

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Chapter 11 cases more similar to Chapter 13 cases, but somehow didn't believe that exempting individual debtors in Chapter 11 from the application of the absolute priority rule was part of that package.

The *Mullins* court found the language of §1129(b)(2)(B)(ii) to be unambiguous even though it "might lead one quite reasonably to the conclusion that it was not well thought out and didn't envision some of the practical problems that it would generate for the courts"[143] including the "anomalous" result that under the court's interpretation the debtor could retain postpetition earnings through an exception to the absolute priority rule, but not the professional corporation that generated the earnings.[144]

The *Mullins* court found further justification for its conclusion that the absolute priority rule still applied to an individual Chapter 11 debtor's prepetition property based on the "obvious reality" that had Congress wanted to reach the contrary result, there were "clearer, easier and more direct" ways to do so than the new exception language in §1129(b)(2)(B)(ii).[145] This argument proves too much. In retrospect, there are always "clearer, easier and more direct" ways for Congress to have drafted a statute. Should the existence of a "clearer, easier and more direct" way to have drafted a statute entitle a court to any statutory interpretation it pleases?

Finally, the *Mullins* court acknowledged that while its ruling undoubtedly would make individual Chapter 11 cases less attractive and perhaps less available, the fact that debtors such as Dr. Mullins could use the exception from the absolute priority rule, had it existed, to retain not only his professional practice, which was the source of his postpetition earnings, but also his house, his rental property, and his nonexempt personal property, provided the court with a policy justification for its statutory interpretation.[146] Apparently, the policy result the court was concerned with was the unfairness of capping the unsecured creditors at a dividend of 12% while the debtor enjoyed equity appreciation as his debts were repaid.

The problem with that policy justification is that §1129(a)(7), the best interests of creditors test, is designed to deal with that unfairness. If the value of Dr. Mullins' professional corporation, his equity in his home and rental property and any nonexempt personal property exceeded the payments that were to be distributed to creditors under the plan, then the creditors would have received more by liquidating Dr. Mullins' property than by receiving the proposed payments under than plan. As a result, the plan would have failed the best interests of creditors test.

As in *Gbadebo*, applying the best interests of creditors test is a better method of protecting creditors than applying the absolute priority rule. Whatever value Dr. Mullins' professional dental corporation might have

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as a going concern managed by the debtor will be destroyed by turning over the stock of the corporation to the unsecured creditors under the absolute priority rule. The debtor will have no interest in continuing to work for a dental corporation he does not own. The debtor will have to incur the expense of creating another professional corporation. Without Dr. Mullins, the debt secured by assets of the dental corporation will be defaulted and the contingent guarantees of Dr. Mullins on that debt will be called on. Whatever assets the debtor had to satisfy the general unsecured creditors will have to be shared to satisfy those guarantees. As in *Gbadebo,* the creditors will have achieved a pyrrhic victory.

Ironically, in reaching its decision on the unfair discrimination prong of the "cramdown" test, the *Mullins* court acknowledged that although unfair, providing the unsecured guarantee creditors with a better deal enhanced the return to the general, unsecured creditors, but in reaching its decision on the absolute priority rule prong of the "cramdown" test, the *Mullins* court reached the opposite conclusion. By enforcing the absolute priority rule and thereby delivering the professional corporation from Dr Mullins to the general unsecured creditors, the return to general unsecured creditors would be diminished.

Did the *Mullins* court have an ulterior motive behind its interpretation of §1129(b)(2)(B)(ii)? The last two paragraphs of the decision seem to suggest just that. By refusing to approve a "cramdown" plan pursuant to which the debtor could retain valuable prepetition assets, the court would force the debtor to negotiate a consensual plan, presumably by providing general unsecured creditors with more of his personal earnings from the practice of dentistry. The opinion concluded:

> It should not be a difficult thing for Dr. Mullins to negotiate with some or all of the dissenting [general, unsecured] creditors, just as he did with [unsecured guarantee] creditors, to provide some additional consideration to that Class which will make enough of those creditors supporters of a sweetened Amended Plan and thereby obtain the consent of such Class to the treatment provided for them by such Plan.[147]

F. *In re Steedley*

The sixth opinion to consider whether the absolute priority rule applies to individual debtors in Chapter 11, *In re Steedley*[148] marks the development of the jurisprudence in this area where courts no longer feel compelled to analyze the issue on their own. Faced with the issue

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of whether the absolute priority rule applied to an individual debtor in Chapter 11, the *Steedley* court simply concluded that the "plain language of the relevant provisions is unambiguous" and cited *Gbadebo* as support for its conclusion that an individual debtor in Chapter 11 may not retain valuable, nonexempt, prepetition property.

G. *In re Gelin*

The court in *In re Gelin*,[149] the seventh opinion to consider whether the absolute priority rule applies to individual debtors in Chapter 11, agreed with the court in *Gbadebo* that "the narrow reading of § 1115 is the best, most likely interpretation of Congress' intent."[150] Finding the language of §§1115 and 1129(b)(2)(B)(ii) as well as the BAPCPA legislative history to be ambiguous, the *Gelin* court decided that the broad interpretation was more plausible than the narrow interpretation.[151] Had Congress meant to eliminate the application of the absolute priority rule to an individual debtor in Chapter 11, the *Gelin* court reasoned, Congress would have found a better way to draft the appropriate language.[152] The court stated:

> Reading §§ 1129(b)(2)(B)(ii) and 1115 to exempt individual debtors from the absolute priority rule is an incredibly complicated and forced interpretation of these sections, especially given the dearth of onpoint legislative history. It requires the reader to interpret "property included in the estate under section 1115" to mean simply "property of the estate," which is difficult to swallow given that property of the estate has long been defined under § 541. If Congress truly meant to exempt an individual debtor's entire estate, it likely would have referred to both §§ 541 and 1115. The more likely interpretation, then, is that the phrase "included in the estate under section 1115" refers only to the post-petition property added to the estate under § 1115, which estate is otherwise defined under § 541.[153]

As described above, such a reading is neither incredibly complicated nor forced and there is adequate legislative history to support such a reading. Although property of the estate had long been defined under §541, Congress added §1115 to the Code as part of BAPCPA specifically to define property of the estate for an individual debtor in Chapter 11. There was no need for Congress to include references to both §§541 and 1115 in §1129(b)(2)(B)(ii) because the property specified in §541 was included in §1115. What does seem a little forced, however, is the argument that had Congress meant to eliminate the application of the absolute priority rule to an individual debtor in Chapter 11, Congress

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would have found a better way to draft the appropriate language. That argument could be used by a court to nullify any statute the application of which produced a result the court disliked. In retrospect, statutes can always be drafted differently. In *Gelin*, exempting the debtor from the application of the absolute priority rule would have left the court approving a "cramdown" plan in which unsecured creditors would have received less than 1% of their claims. The court was clearly unwilling to confirm such a plan and, apparently, found no other way to deny confirmation than by adopting the narrow interpretation of §§1115 and 1129(b)(2)(B)(ii).

H. *In re Karlovich*

In the eighth opinion to consider this issue, *In re Karlovich*,[154] the court also followed *Gbadebo*, but unlike the court in *Gelin*, the *Karlovich* court found §§1115 and 1129(b)(2)(B)(ii) to be unambiguous. The court stated:

> [T]here is a plain, unambiguous reading of the statutes. Section 1129(b)(2)(B)(ii) limits the application of the absolute priority rule by allowing an individual to retain only the "property included in the estate under 1115." The property included under §1115 is property "the debtor acquires after the commencement of the case."[155]

The *Karlovich* court concluded that all §1129(b)(2)(B)(ii) was designed to do was to return an individual debtor in Chapter 11 to the same position he had been in prior to the enactment of BAPCPA, i.e., only able to retain postpetition property. Since §1115 expanded the definition of property of the estate to encompass postpetiton earnings and acquired property, an exception was needed in §1129(b)(2)(B)(ii) to allow individual debtors to retain such earnings and property. According to the court:

> [P]rior to BAPCPA, property of the estate did not include post-petition acquired property and earnings for individuals and nonindividuals alike. Hence, post-petition acquired property and earnings could be retained by a Chapter 11 debtor, individual and non-individual alike, without running afoul of the absolute priority rule. The addition of §1115 potentially changed that by adding to the property of the estate of an individual postpetition acquired property and earnings. Without a corresponding change to §1129(b)(2)(B)(ii), individual debtors could no longer retain post-petition acquired property and earnings if they wished to "cram down" a

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> plan. By adding the language excepting the §1115 property from the absolute priority rule of §1129(b)(2)(B)(ii), Congress merely ensured that the absolute priority rule would be the same as it had been prior to BAPCPA and be the same for all Chapter 11 debtors. In other words, what Congress took from the individual debtor with its §1115- hand, it returned for application of the absolute priority rule with its §1129(b)(2)(B)(ii)-hand.[156]

The *Karlovich* court then went on to conclude that had "Congress intended to abrogate the absolute priority rule for individuals..., Congress could easily have added "except with respect to individuals" at the beginning of § 1129(b)(2)(B)(ii), or stated that an individual could retain all property."[157] This is another variation of the argument that had Congress meant to eliminate the application of the absolute priority rule to an individual debtor in Chapter 11, Congress would have found a better way to draft the appropriate language, except that the new exception language that Congress inserted in § 1129(b)(2)(B)(ii) is extremely close to what the *Karlovich* court proposed.

The weakness in the *Karlovich* court's argument that what Congress giveth in §1115 it taketh away in §1129(b)(2)(B)(ii) is that it fails to account for §1129(a)(15), which permits the confirmation of an individual debtor's plan notwithstanding the objection of a holder of an allowed unsecured claim, provided the debtor either pays the unsecured claim in full or distributes under the plan property of a value that is not less than the projected disposable income to be received by the debtor during the five-year period beginning on the date the first payment is due or during the plan payment period, whichever is longer, and §1123(a)(8), which requires that an individual's Chapter 11 plan provide for the payment of creditors through postpetition service income or other future income of the debtor to the extent necessary for the execution of the plan. In other words, the new exception language in §1129(b)(2)(B)(ii) cannot be read as allowing an individual debtor in Chapter 11 to retain postpetition earnings and acquired property when such property must be devoted to paying creditors under the debtor's plan, a point that was spelled out in *Shat*.[158]

I. Summary of the Cases

To date, eight courts have been faced with interpreting a new exception in §1129(b)(2)(B)(ii) that referenced two other Code provisions—§§1115 and 541. The plain meaning of §1129(b)(2)(B)(ii) allows the debtor to retain property included in the estate under §1115. The plain meaning of §1115 is that property of the estate includes, "in addition to the property specified in section 541," earnings from postpetition services and property acquired postpe-

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tition. The plain meaning of §541 is that property of the estate includes all legal or equitable interests of the debtor in property as of the commencement of the case. There is no legislative history contrary to that plain meaning. The plain meaning does not produce a patently absurd result. In the absence of any clear legislative history or a patently absurd result, three courts, *Tegeder*, *Roedemeier*, and *Shat*, properly applied these provisions according to their plain language. One court supported its decision by reference to the favorable opinion of commentators. The other two courts supported their decisions by discerning congressional intent from the pattern of statutory changes that made Chapter 11 function for individuals the way Chapter 13 functions. Each court could have based its decision solely on the basis of the plain language of the legislation, but supported its result by resorting to statutory interpretative methodologies. All three courts held that the absolute priority rule no longer prevented confirmation of a plan by an individual debtor because of the debtor's retention of valuable prepetition property.

Five courts, *Gbadebo*, *Mullins*, *Steedley*, *Gelin,* and *Karlovich*, went the other way, finding that the ambiguous or unambiguous language of §1129(b)(2)(B)(ii) allowed the debtor to retain only property added to property of the estate under §1115, even though under §1115 property of the estate clearly included §541 prepetition property. The *Gbadebo* court discerned a punitive pattern in BAPCPA to make debt relief for individuals more difficult that outweighed any discernable pattern in BAPCPA to make Chapter 11 for individuals operate like Chapter 13, including exemption from application of the absolute priority rule. The Gbadebo court apparently accepted the result that under the narrow interpretation it was adopting, an individual debtor in Chapter 11 would likely never be permitted to retain valuable, nonexempt prepetition assets in a nonconsensual confirmation context. Perhaps that conclusion was in conformance with the punitive view the court held regarding the BAPCPA provisions generally. The *Mullins*, *Steedley*, *Gelin*, and *Karlovich* courts followed *Gbadebo*.

VIII. Conclusion

Although there are two possible interpretations to the new exception language in §1129(b)(2)(B)(ii), the statutory construction, the legislative history and the practical application arguments weigh in favor of the broad interpretation.

The plain meaning of §1129(b)(2)(B)(ii) allows the debtor to retain property included in the estate under §1115. The plain meaning of §1115 is that property of the estate includes, "in addition to the property

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specified in section 541," earnings from postpetition services and property acquired postpetition. The plain meaning of §541 is that property of the estate includes all legal or equitable interests of the debtor in property as of the commencement of the case. In the absence of any clear legislative history or a patently absurd result, the plain language of the statute should enable an individual Chapter 11 debtor to retain prepetition property under a confirmed plan akin to the Chapter 13 "disposable income" concept.

To argue that the new exception language in §1129(b)(2)(B)(ii) was never intended to include prepetition property of the estate is to read the words "in addition to the property specified in section 541" out of the Code.

Although Congress chose not to herald the exemption from the application of the absolute priority rule to individuals in Chapter 11 by expressing a statement of its purpose in BAPCPA, Congress created a set of confirmation requirements for individuals in Chapter 11 which is modeled upon Chapter 13, in which there is no absolute priority rule and debtors can retain and remain in possession of prepetition property subject to devoting their disposable income to their plan.

Allowing manager-owners to retain their businesses promotes the rehabilitation of small businesses and enhances the value of the estate, which in turn enhances the return to creditors.

Notes

1. Pub. L. No. 109-8, 119 Stat. 23 (April 28, 2005).

2. Between the enactment of the Bankruptcy Code in 1978 and the enactment of the BAPCPA amendments, no reported decisions have allowed individual debtors in Chapter 11 to retain valuable, nonexempt, prepetition property because the absolute priority rule required the debtor to use that property to satisfy more senior claims. See, e.g., In re Winters, 99 B.R. 658, 19 Bankr. Ct. Dec. (CRR) 625, Bankr. L. Rep. (CCH) P 72887 (Bankr. W.D. Pa. 1989) (plan proposing to pay unsecured creditors 15% of their claims while retaining valuable commercial property and corporate stock violated the absolute priority rule and could not be confirmed); and In re Tomlin, 22 B.R. 876 (Bankr. M.D. Ala. 1982) (Chapter 11 plan proposing to pay unsecured creditors 6% of their claims over six-year period while retaining property of estate that would in time be owned free and clear after paying mortgage liens could not be confirmed).

3. The term "individual" is not defined in the Code. The term "individual" is not synonymous with the term "person," which is defined in §101(41) to include an individual, partnership, and corporation but not, subject to a limited exception, a governmental unit. Thus, an "individual" ordinarily refers only to a natural human being and a corporation is ordinarily not an "individual." In other contexts, however, two circuits have held that the term "individual" includes corporations, and five circuits have held that it does not. Compare In re Atlantic Business and Community Corp., 901 F.2d 325, 328-29, 20 Bankr. Ct. Dec. (CRR) 637, 22 Collier Bankr. Cas. 2d (MB) 1176, Bankr. L. Rep. (CCH) P 73341 (3d Cir. 1990) (rejected by, In re Just Brakes Corporate Systems, Inc., 108 F.3d 881, 37 Collier Bankr. Cas. 2d (MB) 985, Bankr. L. Rep. (CCH) P 77332 (8th Cir. 1997)) and Budget Service Co. v. Better Homes of Virginia, Inc., 804 F.2d 289, 292, 15 Bankr. Ct. Dec. (CRR) 666, 15 Collier Bankr. Cas. 2d (MB) 1025, Bankr. L. Rep. (CCH) P 71494 (4th Cir. 1986) (rejected by, In re Just Brakes

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Corporate Systems, Inc., 108 F.3d 881, 37 Collier Bankr. Cas. 2d (MB) 985, Bankr. L. Rep. (CCH) P 77332 (8th Cir. 1997)), with In re Just Brakes Corporate Systems, Inc., 108 F.3d 881, 884-85, 37 Collier Bankr. Cas. 2d (MB) 985, Bankr. L. Rep. (CCH) P 77332 (8th Cir. 1997); Jove Engineering, Inc. v. I.R.S., 92 F.3d 1539, 1549-1553, 36 Collier Bankr. Cas. 2d (MB) 1270, 96-2 U.S. Tax Cas. (CCH) P 50469, 78 A.F.T.R.2d 96-6250 (11th Cir. 1996); In re Goodman, 991 F.2d 613, 618-20, 24 Bankr. Ct. Dec. (CRR) 300, 28 Collier Bankr. Cas. 2d (MB) 1261, Bankr. L. Rep. (CCH) P 75229 (9th Cir. 1993); In re Chateaugay Corp., 920 F.2d 183, 184-187, 21 Bankr. Ct. Dec. (CRR) 206, Bankr. L. Rep. (CCH) P 73764 (2d Cir. 1990); and In re Spookyworld, Inc., 346 F.3d 1, 41 Bankr. Ct. Dec. (CRR) 265, 50 Collier Bankr. Cas. 2d (MB) 1553, Bankr. L. Rep. (CCH) P 78921 (1st Cir. 2003).

4. Applicable to Chapter 11 as provided in §103(a).

5. As of April 1, 2010, the §109(e) debt limits are $360,475 for unsecured debt and $1,081,400 for secured debt.

6. Assuming the debtor can obtain the acceptance of the plan by at least one class of claims that is impaired under the plan under §1129(a)(10) and otherwise satisfy the confirmation requirements of §1129(b).

7. For a description of the BAPCPA changes affecting individuals in Chapter 11, see Bonapfel, Individual Chapter 11 Cases under BAPCPA, 25 Am. Bankr. Inst. J. 1 (July/Aug. 2006) and Markell, The Sub Rosa SubChapter: Individual Debtors in Chapter 11 After BAPCPA, 2007 U. Ill. L. Rev. 67 (2007).

8. Section 510(a) provides, "A subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankrutpcy law."

9. Section 1129(a) contains the requirements for the confirmation of a consensual plan.

10. Subsection (a)(8) provides, "With respect to each class of claims or interests—(A) such class has accepted the plan; or (B) such class is not impaired under the plan."

11. Pub.L. No. 109-8, Title III, § 321(c)(2), 119 Stat. 23, 95 (April 20, 2005).

12. Did Congress intend to refer to subsection (a)(15) instead of (a)(14)? One commentator thinks Congress may have made a drafting error. Norton Bankruptcy Law and Practice 3d § 106:1. See also In re Shat, 424 B.R. 854, 860 n.21, 63 Collier Bankr. Cas. 2d (MB) 748, Bankr. L. Rep. (CCH) P 81701 (Bankr. D. Nev. 2010) (tracing the legislative history of the reference to subsection (a)(14), which apparently began as a reference to subsection (a)(15)). The consequence of this possible drafting error is not important, however, because (a)(14), which requires the debtor to pay postpetition domestic support obligations, and (a)(15), which, in relevant part, requires the debtor to pay projected disposable income for at least five years, are both mandatory confirmation requirements of §1129(a) anyway.

13. Added Pub.L. No. 109-8, Title III, §321(a)(1), 119 Stat. 23, 94-95 (Apr. 20, 2005). The language of §1115(a) is virtually identical to the language of §1306(a) which defines property of the estate in Chapter 13 cases. Both sections add to an individual's bankruptcy estate property that is excluded from an individual's Chapter 7 estate, i.e., property acquired postpetition and postpetition service income.

14. Section 541(a)(6) specifically excludes "earnings from services performed by an individual debtor after the commencement of the case." Thus, postpetition service income, which is specifically carved out of the definition of property of the estate in §541(a), is put into the definition of property of the estate for an individual debtor in Chapter 11 by §1115(a)(2). Property that the debtor acquires postcommencement, which is not included in the definition of property of the estate in §541(a), is put into the definition of property of the estate for an individual debtor in Chapter 11 by §1115(a)(1). Including earnings from postpetition services and income from property acquired postpetition in property of the estate has interesting tax consequences. What, in the absence of §1115, would be taxable income of the debtor apparently is now taxable income of the debtor's estate under Internal Revenue Code §1398(e). See Notice 2006-83, 2006-40 I.R.B. 596, 2006-2 C.B. 596. See also Boelter, 2 Rep. Bankr. Taxpayer § 11:5.95 (May 2009) and Williams & Todres, Tax Consequences of Post-Petition Income as

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Property of the Estate in an Individual Debtor Chapter 11 Case and Tax Disclosure in Chapter 11, 13 Am. Bankr. Inst. L. Rev. 701, 702-11 (2005).

15. Section 1104 concerns the appointment of a trustee or examiner.

16. Added Pub. L. No. 109-8, Title III, §321(a)(1), 119 Stat. 23, 94-95 (Apr. 20, 2005). The language of §1115(b) is virtually identical to the language of §1306(b).

17. Under §1115(b), "the debtor shall remain in possession of all property of the estate," but "property of the estate" for purposes of §1115(b), is not "property of the estate" as defined in §1115(a) and could, therefore, be construed more broadly than "property of the estate" as defined in §1115(a). Interestingly, §1115(b) is not limited to an individual debtor as is §1115(a). It is not clear what §1115(b) adds or why a debtor would not remain in possession of property of the estate without it in Chapter 11. The virtually identical language in §1306(b) clarifies that the debtor and not the Chapter 13 trustee remains in possession of the property in Chapter 13.

18. Added Pub. L. No. 109-8, Title III, §321(c)(1), 119 Stat. 94-95 (Apr. 20, 2005). The language of §1129(a)(15) is very similar to the language of §1325(b)(1).

19. This confirmation requirement is triggered not by the election of an objecting class of unsecured creditors, but by the objection of any single holder of an allowed unsecured claim.

20. In Hamilton v. Lanning, 130 S. Ct. 2464, 177 L. Ed. 2d 23, Bankr. L. Rep. (CCH) P 81780 (2010), the Supreme Court adopted a forward-looking approach to determining a debtor's projected disposable income in Chapter 13 under which a bankruptcy court may take into account "changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation." Hamilton v. Lanning, 130 S. Ct. at 2478.

21. Added Pub. L. No. 109-8, Title III, §321(b), 119 Stat. 94-95 (Apr. 20, 2005).

22. One consequence of expanding the definition of property of the estate for an individual in Chapter 11 is to include this additional property, which will be devoted to funding a Chapter 11 plan of reorganization, within the protection of the automatic stay.

23. See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6, 120 S. Ct. 1942, 147 L. Ed. 2d 1, 36 Bankr. Ct. Dec. (CRR) 38, 43 Collier Bankr. Cas. 2d (MB) 861, Bankr. L. Rep. (CCH) P 78183 (2000); U.S. v. LaBonte, 520 U.S. 75, 7571, 117 S. Ct. 1673, 137 L. Ed. 2d 1001 (1997); and In re Hedrick, 524 F.3d 1175, 1186-1187, Bankr. L. Rep. (CCH) P 81211 (11th Cir. 2008), amended on reh'g in part by, 529 F.3d 1026 (11th Cir. 2008) and cert. denied, 129 S. Ct. 631, 172 L. Ed. 2d 610 (2008) ("We have no license to assume that Congress did not mean what it said in § 547(c)(1)(B), but we are instead bound to assume that it meant exactly what it said.") See also Waldron & Berman, Principled Principles of Statutory Interpretation: A Judicial Perspective After Two Years of BAPCPA, 81 Am. Bankr. L.J. 195, 202 (2007).

24. Connecticut Nat. Bank v. Germain, 503 U.S. 249, 253-254, 112 S. Ct. 1146, 117 L. Ed. 2d 391, 22 Bankr. Ct. Dec. (CRR) 1130, 26 Collier Bankr. Cas. 2d (MB) 175, Bankr. L. Rep. (CCH) P 74457A (1992). In Lamie v. U.S. Trustee, 540 U.S. 526, 534, 124 S. Ct. 1023, 157 L. Ed. 2d 1024, 42 Bankr. Ct. Dec. (CRR) 122, 50 Collier Bankr. Cas. 2d (MB) 1299, Bankr. L. Rep. (CCH) P 80038 (2004), the Supreme Court held that the plain language of §330(a)(1) did not authorize compensation awards to Chapter 7 debtors' attorneys from estate funds, unless the attorneys were retained by the Chapter 7 trustee and approved by the court. The Court reached this decision despite three contrary circuit courts decisions, a long history of the practice, the absence of any legislative history explaining the change, and the opinion of a leading commentator that the amendment to §330(a)(1) changing the established practice contained an unintended error. The Court stated, "When the statute's language is plain, the sole function of courts, at least where the disposition required by statute's text is not absurd, is to enforce it according to its terms," and "It is beyond our province to rescue Congress from its drafting errors, and to provide for what we might think... is the preferred result."

25. In re Philadelphia Newspapers, LLC, 418 B.R. 548, 558-560, 52 Bankr. Ct. Dec. (CRR) 102 (E.D. Pa. 2009), aff'd, 599 F.3d 298, Bankr. L. Rep. (CCH) P 81719 (3d Cir. 2010), as amended, (May 7, 2010).

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26. Lawrence v. City of Philadelphia, Pa., 527 F.3d 299, 316-17, 13 Wage & Hour Cas. 2d (BNA) 1089, 155 Lab. Cas. (CCH) P 35439 (3d Cir. 2008), cert. denied, 129 S. Ct. 763, 172 L. Ed. 2d 755, 14 Wage & Hour Cas. 2d (BNA) 704 (2008).

27. In re Catapult Entertainment, Inc., 165 F.3d 747, 753, 33 Bankr. Ct. Dec. (CRR) 1058, 41 Collier Bankr. Cas. 2d (MB) 858, Bankr. L. Rep. (CCH) P 77886 (9th Cir. 1999) (where there is no ambiguity in the plain statutory language, there is no need to resort to legislative history).

28. Catapult Entertainment, 165 F.3d at 754. See Griffin v. Oceanic Contractors, Inc., 458 U.S. 564,, 571 102 S. Ct. 3245, 73 L. Ed. 2d 973, 1982 A.M.C. 2377 (1982) and In re Kane, 336 B.R. 477, 55 Collier Bankr. Cas. 2d (MB) 1148, Bankr. L. Rep. (CCH) P 80492 (Bankr. D. Nev. 2006) discussed below. See also Eskridge, Jr. & Frickey, Foreward: Law as Equilibrium, 108 Harv. L. Rev. 26, Appendix: The Rehnquist Court's Canons Of Statutory Construction (1994).

29. Kane, 336 B.R. 477.

30. Kane, 336 B.R. at 488.

31. In *Kane*, Judge Markell concluded that the text of §522(p) met both of Justice Scalia's tests. "There is no plausible purpose in linking the 1,215-day ownership requirement to a debtor's choosing between state and federal exemptions, and there is not a shred of evidence in the extensive legislative history going back to 1997 that the mansion loophole was in any way connected to a debtor's choice of exemptions. Further, it is obvious that Congress intended to close the mansion loophole in opt-in states as well as opt-out states. But the drafters of the legislation inartfully, unthinkingly, and, as it turned out, incorrectly expressed that intention by using the word "electing." They should have said, "If there is a state homestead exemption." Unfortunately, they expressed that idea as, "[A]s a result of electing... to exempt property under State or local law." All the evidence indicates that they believed—erroneously—that the two expressions were equivalent, which they are not." Kane, 336 B.R.at 489.

32. The *Shat* opinion, discussed below, which was also written by Judge Markell, did not apply the *Kane* test.

33. In re Philadelphia Newspapers, LLC, 599 F.3d 298, 323, Bankr. L. Rep. (CCH) P 81719 (3d Cir. 2010), as amended, (May 7, 2010); In re Pacific Lumber Co., 584 F.3d 229, 245, 52 Bankr. Ct. Dec. (CRR) 46, Bankr. L. Rep. (CCH) P 81642 (5th Cir. 2009).

34. Negonsott v. Samuels, 507 U.S. 99, 106, 113 S. Ct. 1119, 122 L. Ed. 2d 457 (1993). See Norman J. Singer, 2A Sutherland Statutory Construction §46.06 (5th ed. 1992).

35. One possibility is that it solves a constitutional problem. Forcing debtors to give up postpetition service income may be tantamount to involuntary servitude. See Keach, Dead Man Filing Redux: Is The New Individual Chapter Eleven Unconstitutional? 13 Am. Bankr. Inst. L. Rev. 483 (2005).

36. Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 108 S. Ct. 963, 99 L. Ed. 2d 169, 17 Bankr. Ct. Dec. (CRR) 201, 18 Collier Bankr. Cas. 2d (MB) 262, Bankr. L. Rep. (CCH) P 72186 (1988).

37. In re Roedemeier, 374 B.R. 264, 275, 48 Bankr. Ct. Dec. (CRR) 196 (Bankr. D. Kan. 2007) ("As a matter of fact, for most individual debtors, their future labor or services are the only significant source of new value they will have available to them, and Ahlers means they cannot propose a confirmable Chapter 11 plan," the court reasoned. "If the new exception in § 1129(b)(2)(B)(ii) is read narrowly, although it would mean the Debtor could keep his post petition earnings and other property he acquired post petition without violating the absolute priority rule, the exception would not help him avoid the Ahlers ruling because the new value he would be contributing to the plan would still be at least mostly his post petition earnings, and he would be retaining his prepetition ownership of [business assets]").

38. In re Shat, 424 B.R. 854, 868, 63 Collier Bankr. Cas. 2d (MB) 748, Bankr. L. Rep. (CCH) P 81701 (Bankr. D. Nev. 2010).

39. Blum v. Stenson, 465 U.S. 886, 896, 104 S. Ct. 1541, 79 L. Ed. 2d 891, 34 Fair Empl. Prac. Cas. (BNA) 417, 33 Empl. Prac. Dec. (CCH) P 34226 (1984).

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40. See Jensen, A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 79 Am. Bankr. L.J. 485 (2005); Rao, Testing The Limits Of Statutory Construction Doctrines: Deconstructing The 2005 Bankruptcy Act, 55 Am. U. L. Rev. 1427 (2006); and Markell, The Sub Rosa SubChapter: Individual Debtors in Chapter 11 After BAPCPA, 2007 U. Ill. L. Rev. 67 (2007).

41. In re McNabb, 326 B.R. 785, 789, 54 Collier Bankr. Cas. 2d (MB) 750, Bankr. L. Rep. (CCH) P 80333 (Bankr. D. Ariz. 2005) (rejected by, In re Rasmussen, 349 B.R. 747 (Bankr. M.D. Fla. 2006)).

42. National Bankruptcy Review Comm'n, Report of the National Bankruptcy Review Commission (Oct. 20, 1997), available at http://govinfo.library.unt.edu/nbrc/reporttitlepg.html. The report opposed "Chapter 10" legislation, which would have created a separate chapter for businesses with aggregate, liquidated secured and unsecured debts of less than $2.5 million, adopting both the devotion of future disposable income and the absence of the absolute priority rule from Chapter 13. "The absolute-priority rule and plan-voting concept are important tools which legitimize Chapter 11 by protecting creditors, in reality or by perception, from unfair treatment by debtors. The Commission believes that these creditor protections, albeit largely illusory, are fundamental to the Bankruptcy Code's careful balance between debtor and creditor rights. Furthermore, the Commission favors maintaining these creditor safeguards to recommending adoption of plan confirmation based on "disposable income" payments, which would likely (i) clog the courts with complex, fact-sensitive litigation about income projections of businesses, and (ii) generate strong opposition in Congress, as did similar legislation proposed as part of the Chapter 10 amendments in 1994." National Bankruptcy Review Comm'n, Report of the National Bankruptcy Review Commission at 616 n.1573.

43. H.R. Rep. No. 105-2500, 105th Cong. (as introduced, September 18, 1997).

44. S. Rep. No. 105-1301, 105th Cong. (as introduced, October 21, 1997).

45. H.R. Rep. No. 105-3150, 105th Cong. (1998).

46. H.R. Rep. No. 105-3146, 105th Cong. (1998).

47. H.R. Rep. No. 106-833, 106th Cong. (1999).

48. S. Rep. No. 106-625, 106th Cong. (1999).

49. H.R. Rep. No. 106-2415 & S. 106-3186, 106th Cong. (2000).

50. H.R. Rep. No. 107-333, 107th Cong. (2001).

51. H.R. Rep. No. 108-975, 108th Cong. (2003).

52. See Jensen, A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 79 Am. Bankr.L.J. 485 (2005).

53. S. Rep. No. 106-625, 106th Cong., § 321 (as reported by S. Comm. on the Judiciary, May 11, 1999). See Markell, The Sub Rosa Subchapter: Individual Debtors in Chapter 11 after BAPCPA, 2007 U. Ill. L.Rev. 67, 73-75.

54. Unlike the prior proposal, this amendment applies to all individual cases in Chapter 11, not just consumer cases.

55. H.R. Rep. No. 107-3(I), 107th Cong., 1st Sess. 2001, 53-54 (2001).

56. Markell, The Sub Rosa Subchapter: Individual Debtors in Chapter 11 after BAPCPA, 2007 U. Ill. L. Rev. 67, 75.

57. H.R. Rep. No. 107-617, 107th Cong., 2d Sess. 220-21 (2002).

58. Hot Topics and Issues after October 17, 060713 American Bankruptcy Institute 709, Nina M. Parker—Moderator.

59. In re Shat, 424 B.R. 854, 862, 63 Collier Bankr. Cas. 2d (MB) 748, Bankr. L. Rep. (CCH) P 81701 (Bankr. D. Nev. 2010) (containing legislative history of some of the BAPCPA amendments pertaining to individual debtors in Chapter 11. Despite the legislative history, the court could only conclude that "although not entirely free from doubt, it appears that Congress inserted the individual chapter 11 provisions to ensure no easy escape from means testing. The template for this effort was to adopt and adapt as much of chapter 13 as possible with respect to individual debtors in chapter 11.").

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60. Section 1306 provides:

> (a) Property of the estate includes, in addition to the property specified in section 541 of this title—(1) all property of the kind specified in such section 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, 11, or 12 of this title, 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, 11, or 12 of this title, whichever occurs first. (b) Except as provided in a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.

Pub. L. No. 95-598, Nov. 6, 1978, 92 Stat. 2647; Pub.L. 99-554, Title II, § 257(u), Oct. 27, 1986, 100 Stat. 3116.

61. Notes of Committee on the Judiciary, Senate Report No. 95-989, 95th Congress, 2d Sess. 140-141 (1978). The House Report states: "A slightly different rule governing property of the estate applies in a Chapter 13 case. All property of the estate, as provided in section 541, is property of the estate in a Chapter 13 case." H.R. Rep. No. 95-595, 95th Congress, 1st sess. 428 (1977). See Alan N. Resnick, Henry J. Sommer, eds., Collier Pamphlet Edition, Bankruptcy Code, Bankruptcy Reform Act of 1978, As Amended, and Related Statutory Provisions, Legislative History/Commentary And Practice Aids, Part 1, Section 1306, 1519-1520 (2008).

62. See Braucher, A Guide To Interpretation Of The 2005 Bankruptcy Law, 16 Am. Bankr. Inst. L. Rev. 349, 377 (2008).

63. See Green v. Bock Laundry Mach. Co., 490 U.S. 504, 521-22, 109 S. Ct. 1981, 104 L. Ed. 2d 557, 27 Fed. R. Evid. Serv. 577 (1989). See also Eskridge, Jr. & Frickey, Foreward: Law as Equilibrium, 108 Harv. L. Rev. 26, 99 (1994) (collecting the canons of statutory construction used or developed by the Rehnquist Court). This argument would be stronger had the absolute priority rule not been codified in 1978. In Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection, 474 U.S. 494, 501, 106 S. Ct. 755, 88 L. Ed. 2d 859, 13 Bankr. Ct. Dec. (CRR) 1262, 13 Bankr. Ct. Dec. (CRR) 1269, 13 Collier Bankr. Cas. 2d (MB) 1355, 23 Env't. Rep. Cas. (BNA) 1913, Bankr. L. Rep. (CCH) P 70923, 16 Envtl. L. Rep. 20278 (1986), the Supreme Court stated, "The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a *judicially* created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codification." Since 1978, the absolute priority rule has been a statutory concept not a judicially created concept.

64. In 1952, provisions were added to Chapters XI through XIII of the Bankruptcy Act specifically stating that the absolute priority rule no longer applied. Act of July 7, 1952, Pub. L. No. 82-456, § 35, 66 Stat. 420, 433 (1952). Following those amendments, the absolute priority rule ceased to be a factor in confirmation proceedings, except for publicly held corporations reorganizing under Chapter X, until 1978 when Congress replaced chapters X and XI with Chapter 11 and re-instated the absolute priority rule in 1129(b)(2). See In re Shat, 424 B.R. 854, 867, n.45, 63 Collier Bankr. Cas. 2d (MB) 748, Bankr. L. Rep. (CCH) P 81701 (Bankr. D. Nev. 2010); and In re Fross, 233 B.R. 176 (B.A.P. 10th Cir. 1999) (The fair and equitable rule of *Boyd* and *Case* "cannot realistically be applied in a chapter XI, XII, or XIII proceeding. Were it so applied, no individual debtor and, under chapter XI, 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."). See also Ayer, Rethinking Absolute Priority After Ahlers, 87 Mich. L. Rev. 963 (April 1989); and Peeples, Staying in: Chapter 11, Close Corporations and the Absolute Priority Rule, 63 Amer. Bankr.L.J. 65, 103-04 (Winter 1989).

65. Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 108 S. Ct. 963, 99 L. Ed. 2d 169, 17 Bankr. Ct. Dec. (CRR) 201, 18 Collier Bankr. Cas. 2d (MB) 262, Bankr. L. Rep. (CCH) P 72186 (1988).

66. The principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor. Grogan v. Garner, 498 U.S. 279, 286, 111 S. Ct. 654, 112 L. Ed. 2d 755, 21

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Bankr. Ct. Dec. (CRR) 342, 24 Collier Bankr. Cas. 2d (MB) 1, Bankr. L. Rep. (CCH) P 73746A, 70 A.F.T.R.2d 92-5639 (1991).

67. Small businesses are not unique in this regard. The bankruptcy of a large software development company in which management and a wide range of employees hold a significant equity stake directly or through stock options would pose a similar issue.

68. The reorganization of an insolvent company has been described as the equivalent of a going concern sale of the business to its creditors in exchange for their claims. Baird & Bernstein, Absolute Priority, Valuation Uncertainty, and The Reorganization Bargain, 115 Yale L.J. 1930 (2006). In the case of a small business, the going concern value may disappear when the manager-owner disappears.

69. It is possible that creditors could pay the manager-owner to manage the restructured business, but the excess of going concern value over liquidation value is likely to be captured by the manager-owner in the form of salary or lost to the new equity owners through monitoring costs.

70. There is a market for small businesses. The rule of thumb employed by small business brokers is that their value generally is two to three times cash flow. The market for insolvent small businesses, however, is considerably less liquid, because insolvent small businesses generally have little or no positive cash flow.

71. See National Bankruptcy Review Commission, Bankruptcy: The Next Twenty Years, Final Report, 553-554 (October 20, 1997). The full report is available over the Internet at http://govinfo.library.unt.edu/nbrc/reportcont.html. Although the Report is hostile to the idea of replacing the absolute priority rule with a disposable income test, it favors allowing manager-owners to bid for their old businesses pursuant to a statutory new value corollary. The economic reasons for allowing manager-owners to bid for their old businesses are, however, analogous to the economic reasons for allowing manager-owners to "retain and remain."

72. As of January 1, 2011.

73. In re Tegeder, 369 B.R. 477, 48 Bankr. Ct. Dec. (CRR) 88 (Bankr. D. Neb. 2007).

74. The opinion does not describe what the two businesses were. Given that the opinion also does not mention any related entity bankruptcy filings, but does mention that most of the Tegeders' debts were categorized as business debts, it is reasonable to conclude that the two businesses were sole proprietorships.

75. The Chapter 7 liquidation value of property was stated to be approximately $23,000. Tegeder, 369 B.R. at 480.

76. Tegeder, 369 B.R. at 480.

77. The Drake citation reads: "However, for cases filed on or after the October 17, 2005 effective date of the BAPCPA, amendments made by the BAPCPA have altered this result. Section 1129(b)(2)(B)(ii) will provide that, if the debtor is an individual, the debtor may retain property of the estate (see amended 11 U.S.C.A. § 1115 for a new definition of property of the estate in a Chapter 11 case) without violating the absolute priority rule, provided the debtor has satisfied any amounts owed under a "domestic support obligation" (see amended 11 U.S.C.A. § 101(14A) for the new definition of "domestic support obligation")."

78. Tegeder, 369 B.R. at 480.

79. Substantially identical language is now found at Norton Bankruptcy Law and Practice 3d §106:1 (database updated April 2010).

80. Tegeder, 369 B.R. at 480.

81. In re Roedemeier, 374 B.R. 264, 48 Bankr. Ct. Dec. (CRR) 196 (Bankr. D. Kan. 2007).

82. Two other reported cases mention, but do not reach a decision regarding, a possible exception to the absolute priority rule in §1129(b)(2)(B)(ii). In In re Bullard, 358 B.R. 541, 47 Bankr. Ct. Dec. (CRR) 183, Bankr. L. Rep. (CCH) P 80836 (Bankr. D. Conn. 2007), the court noted debtor's counsel's argument that the new exception permitted a debtor to retain valuable property and still confirm a plan, which would otherwise violate the absolute priority rule, and cited favorable commentary from William L. Norton, Jr., but did not rule on the issue because

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debtor's counsel withdrew the argument. Bullard, 358 B.R. at 544. The *Bullard* court did conclude that an individual debtor in Chapter 11 could retain postpetition earnings and property acquired post-petition under §1115(a) without violating the plan confirmation requirement of §1129(b)(2)(ii). In In re Johnson, 402 B.R. 851, 852-853 (Bankr. N.D. Ind. 2009), the court stated in dicta that "An individual debtor's plan does not need to satisfy the absolute priority rule, 11 U.S.C. 1129(b)(2)(B), and, even though unsecured creditors will not be paid in full, can be confirmed over their objection so long as the plan satisfies the disposable income test of § 1325(b)(2). 11 U.S.C.A. § 1129(a)(15)."

83. The first business was a professional corporation, the second a limited liability company.

84. The creditor had a junior security interest in dental equipment that had been used in both practices. Subsequent to the bankruptcy filing, the creditor with a first lien on the equipment foreclosed on it, thereby extinguishing the junior creditor's security interest in the equipment. A friend of the debtor bought the equipment at a foreclosure sale and leased or sold it to the debtor's second practice. Roedemeier, 374 B.R. at 268, 269.

85. It is unclear from the opinion if the equipment securing this debt was the same equipment that was purchased at the foreclosure sale.

86. Acceptance by at least one impaired class is critical to the confirmation of a nonconsensual plan. Section 1129(a)(10).

87. The only other voting unsecured creditor voted to approve the plan. Roedemeier, 374 B.R. at 267.

88. Under the plan, unsecured creditors were to receive $30,000 over five years on general unsecured debts totaling about $875,000, a dividend of less than 3%.

89. The dental practice was alleged by the debtor's attorney to be worth $0 in the absence of a noncompete covenant, which would not be present in a liquidation sale. No evidence was offered to refute that assertion. Roedemeier, 374 B.R. at 270.

90. Roedemeier, 374 B.R. at 274.

91. Roedemeier, 374 B.R. at 275.

92. Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 202-06, 108 S. Ct. 963, 99 L. Ed. 2d 169, 17 Bankr. Ct. Dec. (CRR) 201, 18 Collier Bankr. Cas. 2d (MB) 262, Bankr. L. Rep. (CCH) P 72186 (1988).

93. Norwest Bank Worthington v. Ahlers, 485 U.S. at 202-06.

94. Norwest Bank Worthington v. Ahlers, 485 U.S. at 202-06.

95. "The BAPCPA added the clause at the end of [§***1129(b)(2)(B)]*** subparagraph (ii), obviously creating some sort of exception for individual Chapter 11 debtors to the part of the absolute priority rule stated in that subparagraph. The question in this case becomes what that new exception means." Roedemeier, 374 B.R.at 274.

96. Roedemeier, 374 B.R. at 275.

97. Roedemeier, 374 B.R. at 275-276.

98. Roedemeier, 374 B.R. at 276. The bankruptcy court confirmed a plan of reorganization that paid unsecured creditors only a 3% distribution on their claims while allowing the individual debtor to retain ownership of his dental practice assets. Even though the debtor's equity interest in that property was junior to the unsecured creditors' interest, which would have clearly precluded confirmation of his plan pre-BAPCPA, the court construed the new exception in §1129(b)(2)(B)(ii) to make the absolute priority rule inapplicable to the debtor's plan.

99. In re Shat, 424 B.R. 854, 63 Collier Bankr. Cas. 2d (MB) 748, Bankr. L. Rep. (CCH) P 81701 (Bankr. D. Nev. 2010).

100. It is not clear how many of the classes were impaired. Three of the eight classes were for unsecured claims.

101. Although that class of miscellaneous general unsecured creditors with claims totaling approximately $85,000 voted against the plan, no creditor filed an objection to confirmation of the plan. Absent any objection from the holder of an allowed unsecured claim, the test

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of whether the debtor has devoted sufficient projected disposable income to the plan under §1129(a)(15) was not triggered.

102. It is unclear from the opinion whether the debtors were also proposing to retain ownership of their less profitable residential rental properties. The analysis would be the same as for the retention of the dry cleaning business assets.

103. Shat, 424 B.R. at 862.

104. Shat, 424 B.R. at 863.

105. Shat, 424 B.R. at 863.

106. Shat, 424 B.R. at 863.

107. Section 1123(a)(8) provides: In a case in which the debtor is an individual, provide for the payment to creditors under the plan of all or such portion of earnings from personal services performed by the debtor after the commencement of the case or other future income of the debtor as is necessary for the execution of the plan.

108. Section 1129(a)(15) 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.

109. Under section 1325(b)(2), the definition of "disposable income" means current monthly income received by the debtor (with certain limited exceptions) less amounts reasonably necessary to be expended—(A)(i) for the maintenance or support of the debtor... (ii) for charitable contributions...; and

> (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

110. Shat, 424 B.R. at 864.

111. Excluding the amounts reasonably necessary for maintenance and support of the debtor and for the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business.

112. The *Shat* court noted that the broad interpretation was not without its own problems. It essentially abolished the absolute priority rule, which had long been a feature of American bankruptcy law, out of individual Chapter 11 cases, without any expression of congressional intent to do so in the legislative history, which suggested to the court that Congress "did not fully appreciate the effect of the language it chose." Shat, 424 B.R. at 867. In addition, the broad interpretation effectively overruled the Supreme Court's decision in *Norwest Bank Worthington v. Ahlers*, again without any expression of congressional intent to do so in the legislative history. The normal rule of statutory construction is that if Congress intends for legislation to reverse a long-standing practice or overrule a Supreme Court decision, Congress makes that intent specific. Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection, 474 U.S. 494, 501, 106 S. Ct. 755, 88 L. Ed. 2d 859, 13 Bankr. Ct. Dec. (CRR) 1262, 13 Bankr. Ct. Dec. (CRR) 1269, 13 Collier Bankr. Cas. 2d (MB) 1355, 23 Env't. Rep. Cas. (BNA) 1913, Bankr. L. Rep. (CCH) P 70923, 16 Envtl. L. Rep. 20278 (1986).

113. Shat, 424 B.R. at 867.

114. In re Gbadebo, 431 B.R. 222, 63 Collier Bankr. Cas. 2d (MB) 1293, Bankr. L. Rep. (CCH) P 81753 (Bankr. N.D. Cal. 2010).

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115. Gbadebo, 431 B.R. at 224. The corporation apparently did not file a bankruptcy petition.

116. Gbadebo, 431 B.R. at 225.

117. The opinion is short on facts, but the plan contained at least two classes of impaired creditors. The impaired class of general, unsecured creditors voted against the plan. One impaired class of secured creditors, Wachovia Commercial Mortgage, Inc., probably the secured creditor on the business real property, voted in favor of confirmation of the plan, thereby satisfying the requirement of §1129(a)(10) that at least one impaired class of creditors vote in favor of the plan. Gbadebo, 431 B.R. at 224, n.1.

118. Section 1129(a)(15) provides that, if the holder of a general, unsecured claim objects to the plan, the plan must either pay the claim in full, or the plan must distribute to all creditors an amount not less than the projected disposable income of the debtor for a five-year period.

119. Gbadebo, 431 B.R. at 226.

120. Gbadebo, 431 B.R. at 226.

121. Although the general, unsecured creditor had not objected to the plan on the basis of the absolute priority rule, the court found that it had an independent duty to confirm a plan only if it satisfied all of the requirements of the Bankruptcy Code. Gbadebo, 431 B.R. at 226, n.5.

122. Gbadebo, 431 B.R. at 229.

123. This part of the opinion is particularly ironic, since the court pointed out in a footnote that the *Shat* court discussed a "plain meaning" interpretation of the statutes despite finding them ambiguous. "The *Shat* court then discusses the "plain meaning" doctrine. The relevance of this decision is unclear since the *Shat* court appears to acknowledge, both before and after this discussion, that the language is ambiguous." Gbadebo, 431 B.R. at 229, n.10.

124. Gbadebo, 431 B.R. at 229.

125. Gbadebo, 431 B.R. at 229.

126. Gbadebo, 431 B.R. at 229, 230.

127. Gbadebo, 431 B.R. at 230.

128. Gbadebo, 431 B.R. at 230.

129. In re Mullins, 435 B.R. 352 (Bankr. W.D. Va. 2010).

130. At issue in *Mullins* was the debtor's Third Amended Plan of Reorganization, which will be referred to herein as the "plan."

131. The secured claim against the debtor's home in Big Stone Gap, Virginia was in the amount of $272,317.65. The fair market value of the home was listed at $305,000. Mullins, 435 B.R. at 356.

132. The secured claim against the debtor's rental real property in Bristol, Tennessee was in the amount of $125,913.82. The fair market value of the rental real property was listed at $135,000. Mullins, 435 B.R. at 356.

133. The secured claim against the debtor's 2006 Ford Freestyle automobile was in the amount of $7,741.10. The fair market value of the automobile was listed at $12,650. The debtor also owned outright a 2008 Ford Fusion automobile valued at $14,325. No portion of the value of either automobile was claimed as exempt. Mullins, 435 B.R. at 356.

134. The court pointed out several discrepancies in the debtor's plan. In some sections the monthly payout was stated as $1,000 per month and in others $1,100 per month. In some sections the total distribution was stated as 10% and in others 12%. Mullins, 435 B.R. at 355, n.3 and n.4.

135. The unsecured class thus rejected the plan under §***1126(c) which requires that at least two-thirds in amount and more than one-half in number of allowed claims voting accept the plan.***

136. The U.S. Trustee did file a statement that "the debtor should be required to introduce evidence that the proposed plan meets all of the requirements for confirmation contained in 11 U.S.C.A. §***1129(a) and (b).***" Mullins, 435 B.R. at 356, 357.

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137. Acceptance by at least one impaired class is critical to the confirmation of a nonconsensual plan. Section 1129(a)(10).

138. The opinion does not state the value of the dental equipment or the extent to which the debt secured by it was under or over collateralized.

139. Mullins, 435 B.R. at 358.

140. Mullins, 435 B.R. at 359, 360.

141. Mullins, 435 B.R. at 360.

142. Mullins, 435 B.R. at 360.

143. Mullins, 435 B.R. at 360.

144. The *Mullins* court did not address the *Shat* point that b***ecause under §1123(a)(8) the debtor must provide for the payment to creditors under the plan of all or that portion of postpetition earnings necessary for the execution of the plan and under §1129(a)(15) the debtor must devote his projected disposable income to the plan (if an unsecured creditor objects), the debtor, according to the* Shat *court, cannot be said to be retaining postpetition income.***

145. Mullins, 435 B.R. at 360, 361.

146. Mullins, 435 B.R. at 361.

147. Mullins, 435 B.R. at 361.

148. In re Steedley, 2010 WL 3528599 (Bankr. S.D. Ga. 2010).

149. In re Gelin, 437 B.R. 435, Bankr. L. Rep. (CCH) P 81862 (Bankr. M.D. Fla. 2010).

150. Gelin,, 437 B.R. at 441.

151. Gelin,, 437 B.R. at 441.

152. Gelin,, 437 B.R. at 442.

153. Gelin,, 437 B.R. at 442.

154. In re Karlovich, 2010 WL 5418872 (Bankr. S.D. Cal. 2010).

155. Karlovich, 2010 WL 5418872 at *3.

156. Karlovich, 2010 WL 5418872 at *4.

157. Karlovich, 2010 WL 5418872 at *4.

158. Furthermore, the *Karlovich* court's argument fails to account for §1115(b), which provides that an individual debtor in Chapter 11 shall remain in possession of all property of the estate, except as provided in §1104 or a confirmed plan or order confirming a plan. Why would Congress amend the absolute priority rule for individual debtors in Chapter 11 to produce a result that was effected by §1115(b)?

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