

Presented:

**University of Texas
31st Annual Jay L. Westbrook
Advanced Consumer Bankruptcy Conference**

November 8-9, 2012

**Four Seasons Hotel
Austin Texas**

**Chapter 11 For Individuals & Small Businesses
(A Primer On Small Chapter 11 Cases)**

Author contact information

Eduardo V. Rodriguez
Malaise Law Firm
1265 N. Expressway 83
Brownsville Texas, 78520
Tel: 956.547.9638
Fax: 956.547.9630
Email: evr@malaiselawfirm.com

Table of Contents

I. Introduction	- 1 -
II. Types of Bankruptcy Cases.....	- 1 -
III. Advantages and Disadvantages Of Each Chapter.....	- 2 -
IV. 11 U.S.C. §109(e) – Who May Be A Debtor?.....	- 3 -
V. Specific Advantages of Chapter 11.....	- 3 -
VI. Chapter 11 Bankruptcy - Overview	- 5 -
VII. Debtor In Possession	- 5 -
VIII. Disclosure Statement.....	- 6 -
IX. Requirements for Confirmation of Debtor's Plan.....	- 7 -
X. Cramdown.....	- 8 -
XI. Votes Required for Class Acceptance	- 8 -
XII. Effect of Plan Confirmation	- 8 -
XIII. The U.S. Trustee's Role in Chapter 11	- 9 -
XIV. Election of a Case Trustee	- 9 -
XV. Appointment of an Examiner.....	- 9 -
XVI. Cash Collateral.....	- 9 -
XVII. Typical Types of Small Business Chapter 11 Plans.....	- 10 -
(A) <i>Single Asset Real Estate Chapter 11</i>	- 10 -
(B) <i>The Small Business Debtor</i>	- 10 -
How To Designate A Small Business Debtor.....	- 11 -
Requirements of a Small Business Debtor In Chapter 11.....	- 11 -
Benefits of a Small Business Debtor Designation	- 13 -
Pitfalls A Small Business Debtor Should Avoid	- 13 -
XVIII. Benefits of Chapter 11 For The Individual Consumer.....	- 15 -
XIX. Absolute Priority Rule in Individual Chapter 11 Cases.....	- 15 -
XX. Does The Absolute Priority Rule To Individual Debtors In Chapter 11?.....	- 16 -
A. The Broad View	- 17 -
B. The Narrow View.....	- 18 -
XXI. Comparison Chart of Chapter 11 to Chapter 13	- 19 -
XXII. Summary & Chapter 11 Flow Chart.....	- 30 -

I. Introduction

This primer is intended to provide guidance on basic bankruptcy issues for debtor's counsel with limited experience in the chapter 11 arena. This primer focuses primarily on individual and small business chapter 11s from the debtor's perspective. This primer does not address relief or remedies that may be available under applicable State law. This primer should, therefore, only serve as a starting point for counsel with identification of issues and concepts that frequently arise in individual and small business insolvency proceedings that arise under the United States Bankruptcy Code.

II. Types of Bankruptcy Cases

There are three different forms of consumer bankruptcy relief, chapters 7, 11 and 13. A shrinking super discharge gives greater protection to debtors in Chapter 13 than Chapter 7. An individual debtor who chooses Chapter 11 is subject to the same exceptions as an individual who chooses Chapter 7. The eligibility of a debtor to file a petition under one of the particular operative chapters (Chapters 7, 11, and 13) of the Bankruptcy Code is the starting place for determining the chapter under which a debtor should file a voluntary petition, since the Code provides who may be a debtor under particular chapters.

Thus, for example, a railroad may not be a debtor under Chapter 7, and Chapter 13 will be unavailable to a debtor who is not "an individual with regular income" or that has debt in excess of certain stated amounts. For cases filed on or after October 17, 2005, whether a debtor falls within the presumption of abuse or can rebut a presumption of abuse will have an impact on whether a debtor chooses to file Chapter 7 or instead considers Chapter 13 or 11. Any good attorney representing a voluntary debtor whose debts are primarily consumer debts must inform the debtor of the right to proceed under Chapter 7, 11, or 13 of the Code; a declaration or affidavit stating that the attorney has done so is required to be attached to and made part of the voluntary petition.

In deciding which chapter of the Bankruptcy Code to use, the consumer debtor should weigh the benefits provided by the chapter against the costs it imposes, or compare the burdens and limitations imposed in the chapter selected with those "evaded" in the chapter not selected. Chapter 7 has the advantages of speed and low cost, Chapter 13 has a more sweeping discharge and the ability to retain assets, and Chapter 11 has the benefits of retention of assets and greater flexibility in formulating a plan of reorganization than is permitted under Chapter 13. Chapter 7 imposes the cost of losing nonexempt assets, Chapter 13 debtors must pay a significant amount of future income to creditors, and Chapter 11 debtors have the costs of paying over future income and also a narrow Chapter 7-style discharge and the potentially heavy burden of formal creditor participation in the proceeding. This illustrates a general Congressional intent to give debtors a choice in exchange for a quid pro quo. A consumer can "evade" the dischargeability restrictions of Chapter 7 by paying future income to creditors in Chapter 13, or "evade" the

requirement of paying future income to creditors by liquidating under Chapter 7. The loss of current assets can be avoided by reorganization.

Chapter 11 is a reorganizational bankruptcy that can be utilized by individuals in addition to corporations and partnerships. In chapter 11, your creditors and the court must approve a plan to repay the debts. There is no limit to the amount of debt you can have in a chapter 11 bankruptcy case. In chapter 11, the individual, corporation or partnership can continue to operate a business while paying back its creditors under a court approved bankruptcy plan. There is no trustee appointed in a chapter 11 case as the debtor acts as the trustee as long as the debtor follows the court prescribed guidelines for a debtor in possession.

III. Advantages and Disadvantages Of Each Chapter

There are some advantages of using one chapter of the bankruptcy code over the other for the discharge or repayment of taxes. If you are over your debt limits for chapter 13 you can always file a chapter 11 bankruptcy. Chapter 13 bankruptcies stop the penalties and interest from accumulating on the pre-petition priority tax debt during the chapter 13 case. Like a chapter 13, a chapter 11 case offers the tax payer a total of sixty months to pay out the tax claim. Chapter 7 does not allow the tax payer any type of repayment plan. Chapter 11 bankruptcies are typically much more expensive than a chapter 13. Your typical chapter 13 costs around \$3,500 where your typical chapter 11 can run up to \$10,000 or more. If the tax payer is dealing with a large amount of trust fund taxes such as 940/941 taxes a chapter 11 may be the better option.

In a chapter 11, unlike chapters 7 or 13, a bankruptcy court may confirm a plan that directs the plan payments made by the debtor/taxpayer first to the trust fund portion of the tax and then to the unsecured portion rather than vice versa as the I.R.S. would prefer. Why is this important? The trust fund portion of the tax is not dischargeable and the non trust fund portion of the tax is dischargeable. Each payment that is made in the bankruptcy plan that would first be applied to the trust fund portion of the tax would reduce the debtor's personal liability on the balance of the tax owed should the case be dismissed. Finally, if the debtor is attempting to discharge an income tax debt made from a fraudulent return or willfully attempted to evade the I.R.S. in order to defeat the tax, the debtor can only discharge this type of debt in a chapter 13 case.

Chapter 13 bankruptcy, unlike a chapter 7 case, gives the debtor the opportunity to adjust his or her financial affairs without having to liquidate current nonexempt assets. A chapter 13 case involves payment of debts out of future income, otherwise known as a wage earners plan. Chapter 13 is only for individuals. Corporations and partnerships are specifically excluded for this type of bankruptcy relief. A trustee is appointed in all chapter 13 cases which has the job of receiving all plan payments from the debtors and making distributions to the creditors under a court approved plan.

IV. 11 U.S.C. §109(e) – Who May Be A Debtor?

Every inquiry into bankruptcy necessarily begins with the question of who may be a debtor? Per the provisions of Section 109(e), “only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than \$360,475 and noncontingent, liquidated, secured debts of less than \$1,081,400. . . may be a debtor under chapter 13 of this title...” Therefore the maximum amount of debt that an individual can owe to qualify as a debtor under chapter 13 of the Bankruptcy Code is \$1,441,875, and even then only if neither of the two numbers cited in the provision are exceeded individually.

It is important to note that the statute clearly only allows “an individual”, not a corporation or partnership, to file chapter 13. Additionally, only noncontingent and liquidated unsecured and secured debts are counted for purposes of qualifying for chapter 13. A contingent debt is one in which a debtor will be called upon to pay only upon the occurrence or happening of a future extrinsic event which will trigger liability to the alleged creditor.¹ A liquidated debt is one that is undisputed as to amount and existence. Such a debt is one that is easily determined by reference to an agreement or judgment. Examples of unliquidated debts may include claims for damages not based on a contract or an agreement such as a tort claim. A secured claim is one where the creditor holds a perfected secured interest. Provided the secured interest is perfected, the question that follows is the value of the collateral. If the collateral is valued less than the claim, then the unsecured portion of the secured claim must also be counted towards the chapter 13 debt limits.

V. Specific Advantages of Chapter 11

Chapter 11 has many advantages over doing nothing at all.

- * The Automatic stay is in effect in all chapter 11 cases allowing the debtor to reorganize while collection efforts are brought to a halt.²

- * The debtor in possession maintains control of his/her business and or assets and there is no trustee appointed in the case unless the debtor commits some wrongful act.³

¹ *In re Sylvester* 19 B.R. 671 (9th Cir. BAP 1982); *In re Hatzenbeuhler*, 282 B.R. 828 (Bankr. N.D. Tex. 2002)
² 11 U.S.C. §362

³ 11 U.S.C. §1101(1); 11 U.S.C. § 1101(1), of Chapter 11 defines a “debtor-in-possession” as including the “debtor” for purposes of that chapter [footnote omitted]. The provisions regulating the conduct and powers of a “debtor-in-possession” (where no trustee has been appointed)-including the requirement for court approval of employment of an attorney-thus seems to apply to a “debtor” once he files a petition for reorganization under the Chapter 11 of the new Code ... [under § 101(1)] in a chapter 11 proceeding there is no distinction between the “debtor” and the “debtor-in-possession” (where no trustee has been appointed) with regard to acts or transactions performed on its behalf subsequent to the filing of the reorganization petition. *Matter of Triangle Chemicals, Inc.*, 697 F.2d 1280, 1290 (5th Cir.1983)

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](http://utcle.org/elibrary)

Title search: Chapter 11 For Individuals & Small Businesses (A Primer On Small Chapter 11 Cases)

Also available as part of the eCourse

[Westbrook Bankruptcy Conference: Consumer Issues - 2012](#)

First appeared as part of the conference materials for the
31st Annual Bankruptcy Conference session
"Individual and Small Business Chapter 11s"