EVERYBODY WINS! ELIMINATION OF THE ABSOLUTE PRIORITY RULE FOR INDIVIDUALS UNDER BAPCPA: A MIDDLE GROUND

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INTRODUCTION

Chapter 11 of the Bankruptcy Code[1] (the Code) allows debtors to reorganize by rewriting the relationship between a debtor and his creditors. Repayment of debt is made in accordance with a plan submitted for court and creditor approval.[2] In the event of an impaired[3] dissenting[4] class[5] of unsecured[6] creditors, the debtor may impose a "cram down"[7] paying creditors in accordance with the priority of their claims. No junior creditor may be paid prior to the satisfaction of all debts in a more senior class of creditors.[8] This is known as the absolute priority rule.

This rule was traditionally recognized to apply to both individual and corporate reorganizations.[9] However, the amended Code following

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1 11 U.S.C. §§ 1101–1174 (2012).

2 *See infra* Part I.A.

3 An "impaired" creditor is one receiving less than full repayment under the plan. 11 U.S.C. § 1124. For example, a plan may propose that a creditor will be paid ten cents for every dollar owed, rather than the full payment ratio of one dollar in payment for every one dollar of debt.

4 A "dissenting" creditor is one voting against the plan's confirmation.

5 Creditors are divided into classes according to the type and size of their debt, creating a hierarchical order, or "priority," for repayment. Creditors holding the same type of debt are deemed to be similarly situated, and are treated as one class receiving the same terms under the repayment plan. 11 U.S.C. § 1122.

6 An "unsecured" creditor holds a debt that has no special assurance of repayment. *Bankruptcy Basics: Glossary*, U.S. COURTS, http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Glossary.aspx (last visited Jan. 5, 2014) [hereinafter *Glossary*, U.S. COURTS]. The credit is usually extended based solely on the creditor's belief regarding the debtor's future ability to pay. *Id.* For example, a creditor may look at a company's financial statements and decide that the business is generating enough income to pay off a loan and thus extends credit—but that loan is not secured by any collateral.

7 The phrase "cram down" refers to a form of confirmation where the plan is forced or "crammed down the throats of the objecting class(es) of creditors." *In re* Bonner Mall P'ship, 2 F.3d 899, 906 (9th Cir. 1993) (alteration in original) (discussing the effect of 11 U.S.C. § 1129(b)). As long as a plan receives the necessary votes and satisfies 11 U.S.C. § 1129, a court can approve it despite the objections of dissenting creditors. For a detailed discussion of the origin of the term and its function, see Kenneth N. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133 (1979). For a further explanation of the cram down procedure, see *infra* Part I.A.

8 11 U.S.C. § 1129(b)(2)(B)(ii); *see also id.* § 1129(b)(2)(A) (discussing cram down of secured creditors).

9 Prior to the 2005 amendment, the absolute priority rule clearly applied to both types of Chapter 11 debtors because the original Code did not contain the additional language specifically distinguishing individual debtors. *In re* Gosman, 282 B.R. 45, 50–51 (Bankr. S.D. Fla. 2002). Furthermore, the original Code did not consider postpetition wages and property to be part of the estate rather than belonging to the individual debtor. The BAPCPA's revisionary language is discussed in detail *infra* Part I.B.

the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[10] (BAPCPA) brings the applicability of the rule into question in individual Chapter 11 bankruptcies.[11] The courts are split between a "broad view"—that the BAPCPA intended to entirely eliminate the absolute priority rule, based on the revised sections of the Code—and a "narrow view"—that the rule still applies to prepetition[12] assets, because of Congressional intent to curb abuse of the Code by effectuating stronger control over debtor behavior.[13] Eliminating the absolute priority rule would allow debtors to retain prepetition assets and those acquired postpetition,[14] rather than allocating them toward repayment of outstanding debts to creditors. The driving question is whether the BAPCPA intended to preserve the Code's debtor-friendly theme of allowing a fresh start—consistent with the majority "broad view"—or was purposely enacted to protect creditors and increase the probability of repayment—in line with the minority "narrow view." The Ninth Circuit's Bankruptcy Appellate Panel (BAP),[15] which is currently one of the highest courts to speak on the issue,[16] adopted the majority broad view[17] in *In re Freidman*.[18] However, because of the debate over the

10 Pub. L. No. 109-8, 119 Stat. 23 (2005).

11 The language added by BAPCPA that created this debate is discussed *infra* Part I.B.

12 The term "prepetition" refers to property acquired before filing for bankruptcy. NATHALIE MARTIN & STEWART PALEY, J.K. LASSER'S THE NEW BANKRUPTCY LAW AND YOU 216 (2006). Filing a petition with the court marks the commencement of a bankruptcy proceeding. All property acquired after this point is designated as "post-petition." *See id.*

13 For a detailed discussion of the different views on applicability of the absolute priority rule, see *infra* Part II. Congressional intent in enacting the BAPCPA is discussed *infra* Part III.B.1.

14 *See supra* note 12.

15 BAPs were authorized by Congress due to the need for expertise in bankruptcy that is necessary to decide highly technical questions of law. *See, e.g.*, 140 CONG. REC. S14461-01 (daily ed. Oct. 6, 1994) (statement of Sen. Grassley) (asserting that BAPs "foster expertise . . . of bankruptcy judges"). BAPs consist of three rotating current judges appointed by the judicial council. 28 U.S.C. § 158(b) (2012). BAPs are part of the circuit courts but serve as intermediaries between the district and circuit courts, hearing appeals. *See* 28 U.S.C. § 158(b)(1). However, BAP decisions are subject to review by the circuit courts. *Id.* § 158(d)(1). The authority of the Ninth Circuit BAP and its impact on the circuit split are discussed *infra* Parts II.A–B.

16 Courts in other circuits have recognized the issue, but declined to decide it. *See In re* Lindsey, 726 F.3d 857 (6th Cir. 2013) (declining to decide the applicability of the absolute priority rule and dismissing the case for lack of jurisdiction); Stephens v. Stephens, 704 F.3d 1279 (10th Cir. 2013) (deciding the case on mootness grounds and holding the rule inapplicable as a secondary issue). The Fourth Circuit is one of the few to address it directly. *See In re* Maharaj, 681 F.3d 558 (4th Cir. 2012) (holding that the rule did not apply and affirming denial of a plan that stripped a junior lien).

17 Although the Ninth Circuit joined the majority of courts, adopting the broad view, there are strong indications that the narrow view is gaining momentum in the courts. *See, e.g.*, *In re* Gelin, 437 B.R. 435, 442 (Bankr. M.D. Fla. 2010) (holding that § 1115 did not absorb § 541); *In re* Mullins, 435 B.R. 352, 360 (Bankr. W.D. Va. 2010) (holding that the statute contains no ambiguity and that Congress would have explicitly made the rule inapplicable had it intended that interpretation); *In re* Gbadebo, 431 B.R. 222, 229 (Bankr. N.D. Cal. 2010) (holding that BAPCPA was not "designed to enhance the individual debtor's 'fresh start'"); *see also In re*

scope of a BAP's authority, applicability of the absolute priority rule remains an open question, and the circuits are split.[19]

This Note rejects both views, finding the broad view over-inclusive and the narrow view under-inclusive. Instead, it argues that the BAPCPA abrogates application of the absolute priority rule only for individual Chapter 11 debtors themselves, allowing retention of pre- and postpetition property of the estate. This view is consistent with the plain reading of the relevant statutes, the intent of the BAPCPA, and the central goal of bankruptcy law—to afford debtors a fresh start.[20] This Note highlights that the amendment does not eliminate the long recognized "new value" exception,[21] and uses this exception as an illustration of how debtor retention of estate assets benefits both the debtor and his creditors.

Part I of this Note provides background information on the progression of a Chapter 11 bankruptcy, its benefits, and how a Chapter 11 filing is distinct from filings under Chapters 13 and 7. It also explains the impact of the BAPCPA on individual Chapter 11 debtors and the implications of the polarizing views adopted by the bankruptcy courts. It analyzes the specific language of the revised Code that is causing the debate in the legal community about the applicability of the absolute priority rule. Part II discusses treatment of the issue by courts around the country through an analysis of specific case law supporting both the broad and narrow views of the BAPCPA. Part III advocates a middle ground of interpretation and carves out an exception that makes the absolute priority rule inapplicable only when triggered by debtors, not creditors. It further explains how such a reading illustrates the true legislative intent of the BAPCPA: To establish a balance between the interests of both parties—a fresh start for debtors and fair repayment for creditors.

Brown, No. 12-14058, 2013 Bankr. LEXIS 4015, at *47 (Bankr. E.D. Pa. Sept. 26, 2013) (stating that the narrow view became the majority position by 2013).

18 466 B.R. 471 (B.A.P. 9th Cir. 2012) (holding that the absolute priority rule no longer applies to individuals in post-BAPCA Chapter 11 cases and approving a plan that did not provide for hierarchical, full repayment to creditors).

19 Some district courts have refused to accept BAP decisions as binding, thereby refusing to follow the abolition of the absolute priority rule as precedent. *See, e.g.*, *In re* Arnold, 471 B.R. 578, 589 (Bankr. C.D. Cal. 2012) ("The bankruptcy courts of the circuit are divided as to whether BAP decisions are binding on them . . . .").

20 The Code allows for a discharge of debts upon successful completion of the process and closure of the case. 11 U.S.C. § 727 (for Chapter 7); *id.* § 1328 (for Chapter 13); *id.* § 1141 (for Chapter 11).

21 *See infra* Part III.C.

I. BACKGROUND

A. *Reorganization Under Chapter 11*

Chapter 11 of the Bankruptcy Code allows a distressed debtor to reorganize and formulate a repayment plan for accrued debts.[22] While it was designed primarily with business reorganizations in mind, the Supreme Court held in *Toibb v. Radloff*[23] that Chapter 11 is available to individual debtors seeking similar relief.[24] The advantage of Chapter 11 is that it allows individual debtors who surpass the maximum debt ceiling of Chapter 13[25] to avoid Chapter 7 liquidation[26] while retaining some of the benefits[27] of the traditional Chapter 13[28] individual reorganization.[29] Once a bankruptcy petition is filed, all existing assets[30]

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22 *See generally* 11 U.S.C. §§ 101–1330.

23 501 U.S. 157, 161 (1991) (granting a conversion from Chapter 7 to Chapter 11 for an individual debtor).

24 *See In re* Canion, 129 B.R. 465, 468–69 (Bankr. S.D. Tex. 1989) (noting that, while legislative history suggests that Chapter 11 was designed primarily for businesses, it is available to consumer debtors who can fund a Chapter 11 plan); *see also* 11 U.S.C. § 109(d) ("[A] *person* that may be a debtor under chapter 7 of this title . . . may be a debtor under chapter 11 of this title." (emphasis added)). A "Chapter 7 debtor" is defined as a person. 11 U.S.C. § 109(b). A "person" is defined as an individual, partnership, or corporation. 11 U.S.C. § 101(41).

25 Eligibility under Chapter 13 is reserved for:

> [A]n individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $383,175 and noncontingent, liquidated, secured debts of less than $1,149,525, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $383,175 and noncontingent, liquidated, secured debts of less than $1,149,525 . . . .

11 U.S.C. § 109(e) (footnotes omitted).

26 Chapter 7 provides for the sale and distribution of all nonexempt estate assets to creditors. 11 U.S.C. § 726.

27 A Chapter 13 filing offers several advantages over liquidation; most notably, it allows debtors to avoid foreclosure and the forced sale of a home by structuring a catch-up monthly payment plan. *Bankruptcy Basics: Chapter 13*, U.S. COURTS, http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter13.aspx (last visited Jan. 5, 2014) [hereinafter *Chapter 13*, U.S. COURTS]. Chapter 13 also allows for the exemption of certain personal and real property under 11 U.S.C. § 522. Furthermore, confirmation of a Chapter 13 plan does not require the approval of creditors. Stacy L. Daly, Note, *Post-Petition Earnings and Individual Chapter 11 Debtors: Avoiding a Head Start*, 68 FORDHAM L. REV. 1745, 1758–59 (2000). In fact, there is no voting process at all in a Chapter 13. *Id.* Instead, the debtor simply proposes his plan to the court for approval. *Id.* at 1745.

28 Chapter 13 was designed to mirror the Chapter 11 restructuring opportunity that is available to businesses, making the benefit of reorganization (rather than liquidation) available to consumers. *See* Rafael Efrat, Tolbb v. Radloff *Reconsidered: Reorganization Under Chapter 11 of the Bankruptcy Code by a Consumer Debtor*, 26 BEVERLY HILLS B. ASS'N J. 82, 91 (1992).

29 When deciding to file for bankruptcy, a debtor chooses between a full liquidation (involving the sale of all assets) in a Chapter 7 and a repayment plan (allowing him to retain some property) in a Chapter 13 or Chapter 11. Daly, *supra* note 27, at 1753. The primary reason

of the debtor become characterized as property of the estate and may be used to satisfy outstanding debts.[31]

In a Chapter 11, a repayment plan consistent with § 1123(a) of the Code must be filed with the court.[32] The plan typically differentiates between different classes of creditors,[33] specifically: secured creditors,[34] unsecured creditors entitled to priority,[35] general unsecured creditors,[36] and equity holders.[37] The classes are further categorized as either impaired[38] or non-impaired.[39] The court will only confirm the proposed plan upon its acceptance by the creditors.[40] If there are impaired classes, at least one class of non-insider[41] impaired creditors must vote for the

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that a debtor may elect Chapter 11 instead of 13 is because of ineligibility for Chapter 13 due to its debt ceiling provision (discussed *supra* note 25). *Id.* at 1759.

30 In addition to assets existing at the commencement of bankruptcy proceedings, assets found to have been transferred via fraudulent conveyance or preferential treatment may be added to the estate by the trustee. 11 U.S.C. §§ 547–548.

31 In a Chapter 7 case, all prepetition assets are liquidated in a trustee sale for the benefit of creditors. *See* 11 U.S.C. §§ 725–726. In Chapter 11 and 13 filings, the prepetition assets can be used to satisfy some debts, subject to the exemptions in § 522. *See* 11 U.S.C. § 522. The most notable is the homestead exemption in Chapter 13, which allows a debtor to keep his residence. *Id.* § 522(o)(4). Debtors often choose to file under Chapter 13 (rather than Chapter 7) specifically because they desire to save their homes. *See Chapter 13*, U.S. COURTS, *supra* note 27.

32 *See* 11 U.S.C. § 1123(a)(1).

33 *See supra* note 5.

34 A "secured" creditor is one whose claims are attached to the debtor's property that is serving as collateral for the debt. *See Glossary*, U.S. COURTS, *supra* note 6. The claim is secured up to the value of that property interest and the creditor has the right to sell the property to satisfy the debt in the event of a default. *Id.* Home mortgages, auto loans, tax liens, and general property liens can all act as collateral. *Id.* For example, a loan for $100,000 is secured by a lien on a home valued at $100,000. The creditor can force the sale of that home if the debtor stops loan payments. Similarly, if the loan is for $50,000 and the home's value is $100,000, the creditor can force the sale to satisfy his $50,000 secured claim. Conversely, if the loan is for $100,000 but the home is worth $50,000, only $50,000 is the secured claim (the value of the home). *Id.*

35 For example, if there are multiple mortgages on a home, the first creditor typically holds the first lien, entitling him to repayment priority. *See* Vicki Been et al., *Sticky Seconds: The Problems Second Liens Pose to the Resolution of Distressed Mortgages*, 9 N.Y.U. J.L. & BUS. 71, 81–82 (2012).

36 *See supra* note 6.

37 The term "equity" refers to the value of a debtor's interest in property that remains after liens and other creditor interests are considered. *See Glossary*, U.S. COURTS, *supra* note 6. For example, if a house is valued at $100,000 but has an $80,000 mortgage, there is $20,000 of equity. *Id.*

38 *See supra* note 3.

39 A "non-impaired" creditor is one who receives payment in full under the plan. *See* 11 U.S.C. § 1124.

40 *See id.* § 1126.

41 An "insider" is an affiliate of the debtor. *Id.* § 101(31)(E). In the context of a corporate Chapter 11 debtor, the term "insider" refers to a director, officer, or any person in control of the debtor. *Id.* § 101(31)(B). In the context of an individual Chapter 11 bankruptcy, the term "insider" refers to a relative, general partner, partnership, or corporation that is affiliated with the debtor. *Id.* § 101(31)(A).

proposed plan.[42] If there are dissenting[43] impaired unsecured creditors, the court will only confirm the plan if: (a) the disapproving class will be paid in full;[44] or (b) no claim junior[45] to the dissenting unsecured creditor is paid under the plan.[46]

The approach in (b) allows courts to confirm a plan despite the objection of creditors as long as the terms are found to be fair and equitable. This requirement is met if the plan treats all similarly situated creditors alike and preserves the hierarchical order of repayment based on creditor classes.[47] Such a forced acceptance, or "cram down,"[48] is known as the absolute priority rule,[49] since repayment order depends on the priority of claims.[50] A conflict emerges when debtors—whose claims as equity holders are always treated as junior to creditors'—desire to retain an asset before all creditor claims are satisfied. The tension is even more evident in the context of an individual Chapter 11 cram down where a debtor aims to retain real property, typically a home not within the protection of exemptions allotted under § 522 of the Code,[51] or a small business in an attempt to reorganize and continue its operation. [52]

B. *Impact of BAPCPA on Individual Debtors*

The BAPCPA made substantial changes to bankruptcy law, thereby increasing the threshold for consumers to obtain the protections of the

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42 *Id.* § 1129(a)(10). Unimpaired claim holders are deemed to have accepted the plan. *Id.* § 1126(f).

43 *See supra* note 4; *see also, e.g.*, Wayne Johnson, *In re* Bonner Mall Partnership: *The Ninth Circuit Embraces the New Value "Exception,"* 21 CAL. BANKR. J. 259, 259 n.8 (1993).

44 11 U.S.C. § 1129(b)(2)(B)(i).

45 One creditor's claim is "junior" to another creditor's claim if it is lower in the repayment hierarchy. *See* HARLAN D. PLATT, PRINCIPLES OF CORPORATE RENEWAL 32 (2d ed. 2004). Repayment is always made in the following order: secured creditors, unsecured creditors entitled to priority, general unsecured creditors, and equity holders. *Id.* at 32–34.

46 11 U.S.C. § 1129(b)(2)(B)(ii).

47 *See supra* note 45.

48 *See supra* note 7.

49 For a history of the absolute priority rule, see *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988). The rule was judicially created to prevent collusion between senior creditors and equity holders that would impose unfair terms in the plan at the expense of junior unsecured creditors. *See* M. Jonathan Haynes, *Ninth Circuit BAP Confirms: No Absolute Priority Rule in Individual Chapter 11 Cases*, 4 NORTON BANKR. L. ADVISER 2 (2012).

50 The absolute priority rule is subject to some exceptions, most notably the judicially created new value exception, which is discussed *infra* Part III.C.1.

51 All allowed exceptions are limited in amount. For example, a debtor's interest in real property cannot exceed $22,975 in value. 11 U.S.C. § 522(d)(1). These limits are adjusted every three years to reflect changes in the Consumer Price Index for All Urban Consumers. *Id.* § 104(a)(1).

52 Continued operation of a business while in bankruptcy is generally allowed unless the court orders otherwise. *Id.* § 1108. However, the debtor's claim to the *asset* is what is at stake here.

Code. Most notably, the BAPCA: (1) instituted a "means test"[53] for Chapter 7 petitioners;[54] (2) created a presumption of abuse[55] and lowered the requirement from "substantial abuse" to simply "abuse" to warrant dismissal or conversion of the case;[56] and (3) removed the restriction that only the United States Trustee could bring a motion for abuse.[57]

However, the most significant change affecting individual Chapter 11 cases was the expansion of the definition of "property of the estate."[58] Originally, under § 541 of the Code, the debtor's estate comprised all property and interest owned by the debtor as of the commencement of the bankruptcy—the petition date. The revised § 1115 of the Code reads:

> (a) In a case in which the debtor is an individual, property of the estate includes, *in addition to* the property specified in section 541[59]—

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53 Debtors whose current monthly income surpasses the median income of their state are not eligible to file under Chapter 7. The term "current monthly income" is defined in 11 U.S.C. § 101(10A) as the average income from all sources within six months prior to the petition date, subject to exclusions (such as social security benefits) and deductions (such as living expenses). *Id.* § 101(10A).

54 The "means test" has the effect of forcing debtors from a Chapter 7 liquidation into a Chapter 13 reorganization if their income exceeds the given threshold. *See* Eugene R. Wedoff, *Means Testing in the New § 707(b)*, 79 AM. BANKR. L.J. 231, 231 (2005). However, Chapter 13 is also subject to a test, the "debt limit test," which forces debtors to file under a different chapter, Chapter 11. *See* DANIEL M. PRESS & BRETT WEISS, CHAPTER 11 FOR INDIVIDUAL DEBTORS 20 (2012). Therefore, the real result of the new "means test" is increased Chapter 11 filings.

55 Abuse is established when a petitioner files in bad faith, typically withholding information. *See* 11 U.S.C. § 727. For example, abuse occurs when a debtor attempts to conceal assets in a Chapter 7 liquidation to avoid their sale. *Id.* § 727(a). Similarly, a debtor may elect Chapter 7 and not disclose his additional income to avoid being in a Chapter 13, which requires repayment rather than the full discharge of debt afforded by Chapter 7. *See* A. Mechele Dickerson, *Race Matters in Bankruptcy*, 61 WASH. & LEE L. REV. 1725, 1729–30 (2004).

56 A case filed under one bankruptcy chapter may be converted to a different chapter if the petitioner qualifies as a "debtor" under the definition of the desired chapter. For example, if the debtor files in Chapter 7 but sufficient income is found, the court may convert the case to a Chapter 13 proceeding. *See* 11 U.S.C. § 707(b)(1). Alternatively, if the debt limit for a Chapter 13 filing is exceeded, the court will convert the case to a Chapter 11 proceeding. *See id.* For an explanation of who qualifies as a debtor under Chapters 7 and 11, see *supra* note 24. For an explanation of who qualifies as a "debtor" under Chapter 13, see *supra* note 25.

57 *See* 11 U.S.C. § 707(b).

58 *Id.* § 541.

59 Section 541(a) defines property of the estate as:

> (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
>
> (2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case . . . .
>
> (3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.
>
> (4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

> (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 . . . and
>
> (2) earnings from services *performed by the debtor after* the commencement of the case but before the case is closed, dismissed, or converted . . . .[60]

The new definition highlights that even assets obtained after commencement can be used to satisfy creditor claims and plan payments. Expanding the definition to include postpetition wages and property was consistent with the overall theme of BAPCPA—to increase the likelihood of repayment during a bankruptcy.[61] However, this broad definition had the effect of creating confusion among the courts when applied to BAPCPA's addition to § 1129, which provided that individual debtors "may retain property included in the estate under section 1115."[62]

The use of the phrase "property included in the estate" in § 1129 has stirred great debate in the legal community and caused a sharp split among the courts creating a "broad" and "narrow" reading of the statute. The issue is whether property "included" only relates to § 541—prepetition assets—referenced within § 1115, or encompasses § 1115 in its entirety, covering postpetition assets as well.[63]

> (5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date . . . .
>
> (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.

11 U.S.C. § 541(a). For a list of assets explicitly excluded from the estate, see *id.* § 541(b).

60 11 U.S.C. § 1115 (emphasis added).

61 Including postpetition assets in the bankruptcy estate increases the likelihood of repayment by enlarging the general pool of funds that can be used to satisfy creditor claims. *See* Brief for Respondent at 26, Lamie v. United States Trustee, 540 U.S. 526 (2004) (No. 02-693), 2003 WL 21839367, at *26.

62 11 U.S.C. § 1129(b)(2)(B)(ii). The full statue reads:

> [T]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* . . . .

Id. (emphasis added). The italicized portion was added by the BAPCPA.

63 The "broad view," which adopts the expanded definition of "property of the estate," is discussed *infra* Part II.A. The "narrow view," which preserves the traditional definition, is discussed *infra* Part II.C.

C. *Effects of Abrogating or Salvaging the Rule*

The effect of reading the amended § 1129 to include both pre- and postpetition assets is to allow the debtor, a junior equity holder, to retain his interest even though senior unsecured creditor claims remain unsatisfied. Such out-of-order payment eliminates the absolute priority rule from individual Chapter 11 cases and is known as the "broad view" of the BAPCPA.[64] This reading aligns Chapter 11 more closely with Chapter 13, which does not have the absolute priority rule.[65] This could indeed be what the drafters intended, since Chapter 11 is an alternative for debtors who do not qualify for Chapter 13 (because their debts surpass the limit under that chapter).[66] However, while certainly helpful, this single factor does not fully explain the motivation for the expanded definition.[67]

Courts adopting the "narrow view"[68] argue that Congress did not intend to eliminate the absolute priority rule, which is the greatest protection for creditors in Chapter 11s.[69] Instead, they argue, the rule still applies to prepetition assets, and the word "included" in § 1129 only refers to the postpetition property defined under § 1115, since postpetition assets are in § 1115 "in addition to" the prepetition property of § 541.[70] In other words, the narrow view suggests that § 1129 only allows for the absolute priority rule to be ignored when dealing with the additional, postpetition, property. This reading would

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64 For example, if a debtor is allowed to keep his prepetition house worth $500,000, then there is $500,000 less in the general pool of assets to be used for repayment to creditors. Because the debtor kept the house, his claim for that house is deemed to be "satisfied" (in other words, repaid); but creditors with higher priority claims have not been paid. Now there are fewer funds in the pool, and the creditors will receive less or no payment. Therefore, the rule of payment according to priority of claims has not been followed. This "broad view" of BAPCPA is further discussed *infra* Part II.A.

65 *See generally* 11 U.S.C. §§ 1301–1330.

66 *See supra* note 25.

67 See *infra* Part III, for a discussion of other motivating factors.

68 The narrow view of the BAPCPA is discussed in detail *infra* Part II.C.

69 The absolute priority rule protects unsecured creditors by preserving the order of repayment according to the hierarchy of the types of debt. It assures that creditors lower down on the hierarchy are not paid before more senior creditors. *See* Stanley E. Goldich, *Plain Meaning Rules: Did BAPCPA Abolish the Absolute Priority Rule?*, 31 AM. BANKR. INST. J. 34, 34 n.2 (2012). This is important because the total pool of funds available for repayment is less than the total amount owed. Therefore, if a junior creditor is paid first in exchange for approving the plan of reorganization, a more senior creditor might get cut out and not receive any payment at all. *See, e.g.*, *In re* Aweco, Inc., 725 F.2d 293, 298 (5th Cir. 1984). The scenario is entirely possible since § 1129(a)(10) requires only one class of impaired creditors to approve the plan. Of course, § 1129(b)(2)(B)(ii) imposes the absolute priority rule restriction, which affords protection to creditors.

70 Judge Theodore C. Albert of the Central District of California strongly advocates for this position in his opinion in *In re Kamell*, 451 B.R. 505 (Bankr. C.D. Cal. 2011), arguing that BAPCPA only "modified" the absolute priority rule rather than fully "abrogat[ing]" it. *Id.* at 512.

preclude debtors from retaining prepetition assets before senior claims are satisfied, frustrating the idea of a fresh start.[71]

D. *Particular Vulnerability of Single-Asset Cases*

Reading the amended § 1129 to retain the absolute priority rule has a particularly noticeable impact in cases where the debtor elects to file in Chapter 11 because his sole asset is a business that he is attempting to save. Adopting the narrow view and disallowing the debtor from retaining his business would make reorganization impossible and therefore force him into a Chapter 7 liquidation.[72] Without the ability to preserve operations of his business, the debtor has no means of funding a plan since he cannot generate income. This is troubling because application of the rule would effectively render Chapter 11 unavailable to single-asset individuals.[73] However, under the new means test, a debtor may not even be eligible for a Chapter 7.[74] This would lead to a denial of discharge under any chapter and leave the debtor with absolutely no recourse. The legislative record of the BAPCPA does not contain any evidence suggesting that Congress intended this outcome in adopting the revisions.[75] There is no indication that the goal of the amendment was to exclude some debtors from bankruptcy protection entirely.[76] Although other means (such as paying creditors in full, convincing them to approve the plan despite nonpayment, or contributing via the new value exception) are available,[77] a single-asset debtor who seeks the protection of bankruptcy is often not in a position to utilize such alternatives due to financial strain or lack of bargaining power.

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71 For example, if a debtor is not allowed to keep his prepetition business because his claim is junior to creditors, the value of that business will be poured into the general pool of funds for repayment to creditors. But if the business is worth $1 million while the debtor owes $3 million, the full debt cannot be satisfied; the debtor has no means of generating further income sufficient to meet his plan payments. Thus, while the order of payment priority has been preserved, the debtor's effort to exit out of bankruptcy and obtain a fresh start has been frustrated.

72 If a debtor cannot meet his payments under the already-confirmed plan, the case will be converted to a Chapter 7 by the court in order to liquidate the debtor's assets. *See* 11 U.S.C. § 1112.

73 *See supra* note 71.

74 Currently, a debtor cannot file for Chapter 7 if his aggregate monthly income over the last five years is more than $12,475 or 25% of his unsecured debt where that debt is at least $7,475. 11 U.S.C. § 707(b)(2)(A)(i).

75 *See generally* Pub. L. No. 109-8, 119 Stat. 23 (2005).

76 *See id.*

77 *See In re* Bonner Mall P'ship, 2 F.3d 899, 908–09 (9th Cir. 1993); *see also In re* Tucker, 479 B.R. 873, 877–78 (Bankr. D. Or. 2012).

II. CURRENT TREATMENT OF THE ABSOLUTE PRIORITY RULE BY THE COURTS

To date, the Supreme Court has not spoken on this issue of the absolute priority rule. While it has been raised in some circuits,[78] in other jurisdictions only district courts and Bankruptcy Appellate Panels—which have concurrent appellate jurisdiction[79]—have addressed the problem. Therefore, the applicability of the rule is far from settled. Both sides of the debate recognize that given the lack of a record of explicit congressional intent, § 1129 must be analyzed within the context of the Code as a whole, in accordance with the aims of the BAPCPA and relevant case law.

A. *The Broad View*

Without any binding precedent to follow, a majority of the courts have adopted a "broad" reading of the BAPCPA, eliminating the absolute priority rule from individual Chapter 11 bankruptcies. A Nevada district court in *In re Shat*[80] explored the legislative history of the amendment to argue that the purpose of BAPCPA was to subject debtors to a means-test requirement.[81] *Shat* highlighted that the central motivation for the amendments in the originally drafted 1999 version was to "link[] the availability of bankruptcy relief to a debtor's income and other means."[82] Therefore, the *Shat* court argued, the intent of the legislature was to make Chapter 11 more closely aligned with Chapter 13, which contains similar provisions.[83] However, it is not clear—and the court did not discuss—why Congress expanded its revisions to encompass Chapter 11 without explicitly making debtors subject to any income requirement in that chapter. In any case, the *Shat* court analyzed the statute using several principles of statutory interpretation[84] and adopted a broad meaning of the term "included," arguing that § 1115 supplants § 541 to include all property in § 541 (prepetition) as well as

78 *See supra* note 16.

79 Technically, district courts have original jurisdiction over bankruptcy matters and "refer" cases to the bankruptcy courts. 28 U.S.C. § 1334. However, as a practical matter, bankruptcy petitions are filed directly with the bankruptcy courts. *See, e.g.*, Paul P. Daley & George W. Shuster, Jr., *Bankruptcy Court Jurisdiction*, 3 DEPAUL BUS. & COM. L.J. 383, 431 (2005). An appeal may be heard by either the district court or the BAP as a matter of choice by the appellee. 28 U.S.C. § 158(a), (b)(1), (c)(1). The authority of BAPs is discussed *infra* Part II.B.

80 424 B.R. 854 (Bankr. D. Nev. 2010) (confirming a plan despite objections of unsecured creditors whose claims would not be satisfied under the plan).

81 *Id.* at 862. For the means-test requirement for Chapter 13, see *supra* note 25.

82 *Shat*, 424 B.R at 859.

83 *Id.* at 862.

84 *Id.* at 864–65.

postpetition income and assets.[85] This of course eliminates the absolute priority rule.

The *Shat* court conceded that reading the statute to eliminate the rule is "convoluted" and "arguably indicative that Congress did not fully appreciate the effect of the language it chose."[86] However, it ultimately dismissed this shortcoming, and relied on *In re Tegeder*[87] and *In re Bullard*[88] to argue that abolition of the absolute priority rule is consistent with the plain reading of the statute.[89] *Shat* adopted the view expressed in *In re Roedemeier*[90] that without the broad reading of the statute, the amendments would be meaningless.[91]

In *SPCP Group, LLC v. Biggins*,[92] a Florida district court similarly adopted the plain meaning approach and considered the statute to be facially unambiguous. The court analyzed the common meaning of the language used by Congress and found consideration of legislative history to be unnecessary because the words of the statute are clearly written.[93] Therefore, the court read § 1129 to allow confirmation of a plan despite unsecured creditors' objections even when the debtor retains property of the estate as defined in § 1115.[94] That section, according to the court in *Biggins*, defines "property" to include § 541's prepetition property in addition to the BAPCPA expansion of § 1115 to include postpetition assets.[95] Finding that § 1129 refers to pre- and postpetition property, the court concluded that the effect of the BAPCPA was to make the absolute priority rule inapplicable, thus

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85 *Id.* at 868.

86 *Id.* at 867.

87 369 B.R. 477 (Bankr. D. Neb. 2007) (holding that a plan allowing debtor to retain pre- and postpetition property was fair and equitable).

88 358 B.R. 541 (Bankr. D. Conn. 2007) (confirming a plan despite debtor's retention of postpetition income and vehicle).

89 *Shat*, 424 B.R. at 868.

90 374 B.R. 264 (Bankr. D. Kan. 2007) (holding that the revised statute allowed debtor to retain his dental practice despite only a 3% distribution to unsecured creditors on their claims).

91 The *Roedemeier* court states:

> If a class of unsecured creditors who are not to be paid in full under an individual Chapter 11 debtor's plan can bar the debtor from keeping any prepetition property (which will nearly always include the debtor's interest in whatever business the debtor engages in) by rejecting the plan and invoking the absolute priority rule—that is, if the new exception in § 1129(b)(2)(B)(ii) is read narrowly—then it is difficult to see what purpose these other, related amendments can serve.

Id. at 276.

92 465 B.R. 316, 320–23 (M.D. Fla. 2011) (holding that a plan could be confirmed despite objections of unsecured creditors because BAPCPA abrogated the absolute priority rule for individual Chapter 11 debtors).

93 *Id.* at 322.

94 *Id.*

95 *Id.*

allowing individual Chapter 11 debtors to retain pre- and postpetition property over the objections of unsecured creditors.[96]

The most recent case[97] to address the issue is *In re Tucker*,[98] where an Oregon district court also adopted the view that BAPCPA abrogated the absolute priority rule for individual debtors.[99] However, the court stressed the additional requirement that a debtor must demonstrate that the proposed plan is nonetheless "fair and equitable" in its treatment of creditors.[100] In fact, *Tucker* indicated that showing that a plan is "fair and equitable" is a prerequisite[101] to a cram down that allows a debtor to retain estate assets, and criticized other followers of the broad view for ignoring this requirement.[102] *Tucker* relied on *In re Dollar Associates*,[103] which stated that the absolute priority rule is "only a minimum requirement for confirmation"[104] to justify elevating fairness to be a central part of confirming a repayment plan.

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96 *Id.* at 322–23.

97 The latest case adopting the broad view is *In re Sample*, No. 2:10-38373-DPC, 2013 Bankr. LEXIS 2814 (Bankr. D. Ariz. July 15, 2013). However, the *Sample* court felt bound to follow the precedent of *Friedman* even though it did not fully subscribe to *Friedman*'s rationale. *Id.* at *4–5.

98 479 B.R. 873 (Bankr. D. Or. 2012) (upholding a plan as fair and equitable to objecting unsecured creditors and finding the absolute priority rule inapplicable).

99 *Id.* at 875–76.

100 *Id.* at 878–79.

101 Although the court in *In re Tegeder*, 369 B.R. 477 (Bankr. D. Neb. 2007), recognized the importance of preserving fairness in the plan, it did not (unlike *Tucker*) make the showing a prerequisite. *Id.* at 480–81.

102 The *Tucker* court is particularly critical of *Friedman*'s analysis, which (according to the *Tucker* court) does not place sufficient emphasis on the "fair and equitable" requirement. *See Tucker*, 479 B.R. at 878. *Friedman* is discussed in detail *infra* Part II.B.

103 172 B.R. 945, 949 (Bankr. N.D. Cal. 1994) (finding that a proposed plan was not fair and equitable because it did not further the goals of reorganization and the relevant statutes). Although *Dollar* considered a plan submitted under the new value exception to the absolute priority rule, it explained that the applicability of the exception was secondary to a finding of fairness as a prerequisite in approving a plan over creditors' objections. *Id.*

104 *Tucker* outlines the following criteria from *Dollar* to be considered in analyzing the fair and equitable standard:

> Whether the plan furthers the reorganization goal of preserving equity of the debtor;
>
> Whether the plan preserves jobs and going concern value;
>
> Whether the plan significantly furthers the goal of maximizing distribution to creditors; . . .
>
> Whether the plan has been rejected by the overwhelming majority of claims. . . .
>
> Whether the plan provides for equal treatment of the creditors in the dissenting class;
>
> Whether the net value of the assets retained is small relative to the amount to be paid out to unsecured creditors over the life of the plan; and
>
> Whether the assets retained are used to generate funds to be paid to creditors under the plan.

Tucker, 479 B.R. at 879. The last three criteria are characterized as particularly applicable to individual debtor plans. *Id.*

B. *Authority of Bankruptcy Appellate Panels*

The broad view was adopted by the Ninth Circuit BAP.[105] However, the question of whether the BAP's authority is binding on district courts further fuels the debate on applicability of the absolute priority rule rather than resolving it.[106] If BAP decisions are precedent, a BAP's ruling will communicate the circuit's position since the panels are part of the circuit courts.[107] While this would not resolve the split among the circuits, it would at least settle the controversy of the rule's applicability among the district courts within the circuits, lending some clarification to the rule as a whole.[108]

1. Dispute over Precedent

In 2012, the Ninth Circuit BAP addressed the absolute priority rule in *In re Friedman*[109] as an issue of first impression. It held that the rule is inapplicable to individual Chapter 11 debtors.[110] In its analysis, the BAP emphasized the importance of context in statutory interpretation and highlighted that elimination of the rule does not violate—and, in fact, is in accordance with—the other requirements of plan confirmation.[111] While this initially appeared to have resolved the controversy within the circuit, that hope was short-lived because not all district courts view BAP decisions as binding on them.[112] In fact, shortly after the *Friedman* opinion was issued, Judge Kwan of the Central District of California refused to follow the BAP's interpretation and held in *In re Arnold*[113] that the rule does apply in some limited circumstances.[114] This had the

105 For a discussion of the structure and function of BAPs, see *supra* note 15.

106 Some district courts have refused to follow BAP precedent. Instead, the district courts continue to read the BAPCPA amendments in light of their own views on the applicability of the absolute priority rule. The decision of some courts to decline to adopt the Ninth Circuit's broad view of the BAPCPA is discussed *infra* Part II.B.

107 *See supra* note 15.

108 This Note uses the Ninth Circuit BAP as an illustration of the problem within circuits throughout the country. It does not suggest that the decisions of the Ninth Circuit BAP are binding on other circuit BAPs. The split between circuits can only be resolved by the Supreme Court.

109 466 B.R. 471 (B.A.P. 9th Cir. 2012).

110 *Id.* at 482.

111 *Id.* at 481.

112 For a detailed analysis of BAP precedent, its creation, and its purpose, see *Bank of Maui v. Estate Analysis, Inc.*, 904 F.2d 470, 471–72 (9th Cir. 1990).

113 471 B.R. 578 (Bankr. C.D. Cal. 2012), *appeal dismissed*, No. 12-57265 (9th Cir. Jan. 16, 2013).

114 Specifically, *Arnold* held that the rule applies to treatment of prepetition property but has been abrogated with respect to postpetition property, allowing debtors to retain postpetition property brought into the estate, as defined in § 1115, without paying unsecured creditors in full. *Id.* at 604–05, 613.

effect of questioning the binding authority of the BAP, which the Ninth Circuit has not yet addressed.[115]

Unfortunately, the split between the courts as to whether BAP decisions are binding[116] undermines the impact of *Friedman*. The disagreement regarding the absolute priority rule can only be effectively addressed by the Supreme Court, either directly—by addressing the issue of applicability of the rule to individual Chapter 11 debtors—or indirectly—by addressing the binding authority of the BAP on district courts.

2. Effect of BAP Precedent Uncertainty

Without a binding precedent to follow, the courts are virtually free to create their own interpretations of the statute. This raises the problem of forum shopping,[117] since if an appeal is brought in front of the BAP, it will hold its own precedent as binding,[118] but an appeal brought in front of a district court will be subject to the sitting judge's reading of the statute. Therefore, a debtor who wants to obtain a more favorable outcome will appeal to the BAP. On the other hand, a creditor seeking an outcome that better serves his interest will file in the district court that still recognizes the absolute priority rule.[119] In *In re Windmill*, the panel explicitly stated that "to achieve . . . uniformity, the decisions of the [BAP] must be binding on all of the bankruptcy courts from which review may be sought . . . . Any decisions to the contrary are in error."[120] The court in *Tucker*[121] similarly argued that BAP precedent is binding, noting that the legislature's intent in creating the BAP was to provide a

115 *Bank of Maui*, 904 F.2d at 472; *see also* Zimmer v. PSB Lending Corp., 313 F.3d 1220, 1225–26 (9th Cir. 2002).

116 *See, e.g.*, *In re* Windmill Farms, Inc., 70 B.R. 618, 622 (B.A.P. 9th Cir. 1987), *rev'd other grounds*, 841 F.2d 1467 (9th Cir. 1988) (asserting that BAP's decisions are binding on district courts); Life Ins. Co. of Va. v. Barakat (*In re* Barakat), 173 B.R. 672, 676 (Bankr. C.D. Cal. 1994) (same); Coyne v. Westinghouse Credit Corp. (*In re* Globe Illumination Co.), 149 B.R. 614 (Bankr. C.D. Cal. 1993) (same). *Contra* Rinard v. Positive Invs. (*In re* Rinard), 451 B.R. 12, 21 (Bankr. C.D. Cal. 2011); Crain v. PSB Lending Corp. (*In re* Crain), 243 B.R. 75, 81 (Bankr. C.D. Cal. 1999).

117 The BAP has concurrent jurisdiction over bankruptcy appeals with the district courts. Therefore, debtors are free to choose whether to file an appeal in a district court or with the BAP. *See supra* note 79.

118 *See Windmill Farms*, 70 B.R. at 622 (holding that the BAP's decisions are binding on all courts within its circuit).

119 Continuation of the absolute priority rule serves the interests of creditors since it allows for newly defined "property of the estate" assets, including postpetition property, to be used for satisfaction of creditor claims. Abrogation of the rule also serves debtors, since it allows them to retain both prepetition and postpetition assets (as defined in 11 U.S.C. § 1115 (2012)). *See* Goldich, *supra* note 69, at 82.

120 *Windmill Farms*, 70 B.R. at 622 (citations omitted).

121 479 B.R. 873 (Bankr. D. Or. 2012).

"consistent body of bankruptcy law throughout the circuit."[122] *Tucker*'s complete adoption of the precedent is evidenced by the fact that the court accepted largely the same amended plan[123] submitted after the *Friedman* decision that it had previously rejected as violating the absolute priority rule.[124] Although *Friedman* forced the court to revise its understanding of the amended § 1129, Judge Alley stressed in *Tucker* that recognizing such precedent will solve the problem of forum shopping and bring fairness to the parties.[125] A similar result was achieved in *In re Sample*.[126] Recognizing the precedential value of BAP decisions, Judge Collins followed *Friedman* despite his disagreement with its rationale.[127] If this obedience were uniformly adopted by the district courts, then the issue of the absolute priority rule would certainly gain long-awaited resolution, making *Friedman* binding in the Ninth Circuit and perhaps serving as a model for other circuits.

However, other judges are not as abiding as Judge Alley, and argue that even the acceptance of *Friedman* as precedent would not solve the problem completely, because *Freidman* contains several deficiencies.[128] First, the decision was made without oral argument from both sides.[129] Second, the BAP relied on a "plain reading" of § 1129(b)(2)(B)(ii) and § 1115 to support its outcome.[130] However, several courts have strongly disputed the applicability of a "plain reading" approach. Such critics recognize the clear ambiguity of the statue, calling the *Friedman* court's reading "strained,"[131] "unpersuasive,"[132] and noting that "[i]t is axiomatic that the language of § 1129(b)(2)(B)(ii) and § 1115 is

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122 *Id.* at 876 (citing *In re* Tong Seng Vue, 364 B.R. 767, 771 (Bankr. D. Or. 2007)) (accepting that the court was obligated to follow the BAP's precedent in deciding the issue at bar).

123 The only difference was that the confirmed plan allowed for distribution of cash reserves to unsecured creditors at its termination. *Id.* at 875.

124 *Id.* at 874–75.

125 In support of this assertion, Judge Alley quoted *Tong Seng Vue*; stating:

> The Doctrine of *Stare Decisis* advances two important principles: the uniformity of case law throughout a jurisdiction, and the resulting predictability of results required in order to ensure fairness of the judicial process to litigants. As a matter of fundamental fairness to parties before it, a trial court must strive to apply the law as it is held by courts which may review its decisions. Otherwise, parties will often be forced to the trouble and expense of an appeal to achieve a lawful result whenever the trial court disagrees with the higher court's view of the law. . . .

Id. at 876 (alteration in original) (quoting *Tong Seng Vue*, 364 B.R. at 771–72).

126 No. 2:10-38373-DPC, 2013 Bankr. LEXIS 2814 (Bankr. D. Ariz. July 15, 2013).

127 *Id.* at *4–5.

128 *In re* Kamell, 451 B.R. 505, 508 (Bankr. C.D. Cal. 2011).

129 The Appellants and the National Association of Consumer Bankruptcy Attorneys (who filed an amicus brief in support of the debtors) participated in oral arguments but the Appellee, P+P LLC, did not participate in the appeal. *In re* Friedman, 466 B.R. 471, 473 (B.A.P. 9th Cir. 2012).

130 *Id.* at 482.

131 *Kamell*, 451 B.R. at 508.

132 *In re* Arnold, 471 B.R. 578, 590 (Bankr. C.D. Cal. 2012).

ambiguous."[133] Most recently, Judges Kwan and Albert subscribed to this critique in their opinions in *In re Arnold*[134] and *In re Kamell*,[135] respectively. In fact, Judge Albert stated that the "plain reading" rule lacks any application to the issue of the absolute priority rule.[136] He also recognized that both the broad and narrow views accept the existence of ambiguity in the language of § 1129.[137] Of course, the critics here are supporters of the narrow view and thus, are understandably inclined to attack *Friedman* on technical grounds to shift the focus from its ruling to its perceived deficiencies. It appears that only a new decision from the BAP after consideration of a full oral argument and detailed analysis of the statute may please such critics.

C. *The Narrow View*

In addition to addressing BAP precedent, *In re Arnold*[138] expressed the strongest argument in favor of the narrow view reading of § 1129.[139] The court provided a history of the confirmation process, citing several influential academic works[140] in highlighting the importance of negotiation between creditors and the debtor in proposing a working plan. *Arnold* stressed that the absolute priority rule was created[141] specifically to protect creditors who could not bargain with debtors effectively without a clear standard of fairness and judicial control.[142] Therefore, the rule preserves fairness in the creditor-debtor negotiation

133 *In re* Lindsey, 453 B.R. 886, 903 (Bankr. E.D. Tenn. 2011), *vacated on other grounds*, No. 3:11-cv-00445, 2013 WL 5436968 (E.D. Tenn. Sept. 27, 2013).

134 *Arnold*, 471 B.R. at 590.

135 *Kamell*, 451 B.R. at 509.

136 *Id.*

137 *Id.* However, there is case law on both sides of the debate (i.e., the ambiguity and the plain reading approaches). *Compare In re* Friedman, 466 B.R. 471, 482 (B.A.P. 9th Cir. 2012) (plain reading supports broad view), *with In re* Karlovich, 456 B.R. 677, 680–81 (Bankr. S.D. Cal. 2010) (plain reading supports narrow view), and *compare In re* Shat, 424 B.R. 854, 867 (Bankr. D. Nev. 2010) (ambiguous reading supports broad view), *with In re* Gbadebo, 431 B.R. 224, 229 (Bankr. N.D. Cal. 2010) (ambiguous reading supports narrow view). Therefore, both readings are logical interpretations of the statute, each shedding light on the debate.

138 471 B.R. 578.

139 *Id.* at 590–614.

140 *Id.* at 590–97 (citing, *inter alia*, JOHN D. AYER & MICHAEL L. BERNSTEIN, BANKRUPTCY IN PRACTICE (4th ed. 2007); DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY (4th ed. 2006); ELIZABETH WARREN, CHAPTER 11: REORGANIZING AMERICAN BUSINESSES (2008); Elizabeth Warren, *A Theory of Absolute Priority*, 1991 ANN. SURV. AM. L. 9 (1991)).

141 The absolute priority rule was created by judges and codified as § 1129 of the Code in 1978. Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 202 (1988).

142 *Arnold*, 471 B.R. at 595 (citing H.R. DOC. NO. 93-137, at 255 (1973)).

by serving as a source of procedural and substantive rights.[143] *Arnold* accepted Professor Baird's argument that the rule is central—in fact the driving force—in a Chapter 11 bankruptcy[144] and argued that eliminating this protection would undermine the long-afforded equalizer. This of course, according to Baird, puts the creditors at a disadvantage when dealing with asset-hungry debtors.

The *Arnold* court also analyzed the grammatical construction of § 1129, pointing out that "includes" is a transitive verb addressing the subject "property of the estate."[145] Both sides of the debate agree, according to *Arnold*, that postpetition property is "included" as "property of the estate . . . under Section 1115."[146] However, they disagree on the "third category" of "property specified in Section 541" and whether those assets are "included" as well.[147] The *Arnold* court noted that "property specified in section 541" is not a direct object of the verb "includes," but instead part of a prepositional phrase beginning with "in addition to," and therefore does not relate to the subject of the sentence—"property of the estate."[148] *Arnold* concluded that this means that "property specified in section 541" is not "property included in the estate under section 1115."[149]

This, of course, translates to prepetition assets not being included in § 1129, and therefore preserves the absolute priority rule. To reinforce its conclusion, the *Arnold* court defines "in addition" to mean "separate from,"[150] thereby breaking down § 1115 to read "property of the estate apart from § 541."[151]

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143 Professor Baird explains this relationship in the following language:

> The ambition of every lawyer whose client files a Chapter 11 petition is to persuade each group of creditors to consent to a plan of reorganization. Whether a group consents depends on its rights under the plan versus the rights it would have if it refused to go along with the plan. The absolute priority rule is central to the law of corporate reorganizations because it is the source of substantive rights as well as the procedural protections that each participant in a reorganization enjoys. Parties can insist that the priority rights they enjoyed outside of bankruptcy be respected inside. Nevertheless, every junior party, including the shareholders, can invoke elaborate procedures before their rights are compromised. The absolute priority rule allows the senior parties to insist on full payment, but it also grants all junior parties those procedural protections necessary for a "just reorganization."

Id. at 596 (citing BAIRD, *supra* note 140, at 86).

144 *Id.*

145 *Id.* at 600.

146 *Id.* at 601 (internal quotation marks omitted).

147 *Id.* (internal quotation marks omitted).

148 *Id.* at 601–02 (internal quotation marks omitted).

149 *Id.* at 602 (internal quotation marks omitted).

150 *Id.* at 603 (citing WILLIAM STRUNK, JR. & E.B. WHITE, ELEMENTS OF STYLE 10 (3d ed. 1979)).

151 Other cases adopting the narrow view also rely on the grammatical interpretation of the statute as the crux of their reasoning. *See, e.g.*, *In re* Walsh, 447 B.R. 45, 47–48 (Bankr. D. Mass.

A more recent case, *In re Lee Min Ho Chen*,[152] also follows the narrow view, wholly adopting *Arnold*'s grammatical interpretation of the statute.[153] However, *Lee Min Ho Chen* relies on policy considerations in arguing that a narrow reading serves the "fine-tuned balance"[154] between debtor and creditor rights in a Chapter 11 proceeding. The court highlights that because a debtor may initiate a cram down without negotiations with creditors, eliminating the protection of the absolute priority rule would "chill" future lending to individuals.[155] *Lee Min Ho Chen* also adopted the stark view expressed in *Kamell*[156] that allowing highly leveraged debtors who are ineligible for Chapter 13 to retain prepetition assets in Chapter 11 will "endanger[] the equality core of chapter 11."[157] However, the court does not elaborate on this view, nor does it explain why debt not subject to the absolute priority rule in a Chapter 13 would "endanger" Chapter 11 simply because it is greater in amount.[158]

III. ANALYSIS AND ARGUMENT

A. *Response to the Narrow View*

In addition to its refusal to follow BAP precedent, the narrow view is flawed in its self-serving grammatical analysis of § 1129, which simply defies logic by turning a positive word into a negative and nullifying another section of the Code entirely.[159] It likewise errs in relying on policy considerations overemphasizing the impact of eliminating the rule on future negotiations with creditors.[160] Both arguments prove to be fruitless in advancing the narrow view's position that the BAPCPA did not intend to eliminate the absolute priority rule from § 1129 of the Code.

2011); *In re* Gelin, 437 B.R. 435, 440–42 (Bankr. M.D. Fla. 2010); *In re* Steedley, No. 09–50654, 2010 WL 3528599, at *2 (Bankr. S.D. Ga. Aug. 27, 2010).

152 482 B.R. 473 (Bankr. D.P.R. 2012).

153 *Id.* at 482.

154 *Id.* at 483.

155 *Id.* For a critique of this argument, see *infra* Part III.A.2.

156 451 B.R. 505, 512 (Bankr. C.D. Cal. 2011).

157 *Lee Min Ho Chen*, 482 B.R. at 483.

158 Chapter 13 is the traditional choice for individual debtors seeking to restructure, and they typically only elect to file in Chapter 11 due to ineligibility for Chapter 13 resulting from high debt amounts.

159 *See In re* Arnold, 471 B.R. 578 (Bankr. C.D. Cal. 2012); *see also infra* Part III.A.1.

160 *See Lee Min Ho Chen*, 482 B.R. at 483.

1. Grammatical Construction

The *Arnold* court's grammatical analysis of the language in § 1115 would lead the statute to be read in the following way:

> (a) In a case in which the debtor is an individual, property of the estate includes, ~~*in addition to*~~ *[apart from] the property specified in section 541—*
>
> (1) all property . . . debtor acquires after the commencement . . .
>
> (2) earnings from services performed by the debtor after the commencement . . . [161]

This reading of the statute completely nullifies the italicized portion above, suggesting that Congress did not intend for § 541 property to be considered within its new definition of "property of the estate" contained in § 1115. This has the effect of creating two distinct definitions of property of the estate: prepetition assets of § 541 and postpetition assets of § 1115, both of which appear to be facially correct since neither definition excludes the other. Allowing the two definitions to co-exist while keeping them entirely separate is an irrational result and cannot be the assumed intent of the legislature. Such a result would create more confusion in the legal community and thereby undermine the authority of the statute. Furthermore, § 1115 mimics § 1306, and courts analyzing § 1306 have never "bifurcated" that section into two "species" of property.[162] Indeed, separating pre- and postpetition assets to codify them in separate provisions is inconsistent with the rest of the Code, which simply refers to "property of the estate" without differentiating between § 541 and § 1115 property.[163] If, however, Congress intended to exclude § 541 property from § 1129, it could have accomplished that by amending § 1129 to read:

> (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 [postpetition] property included in the estate under section 1115*, subject to the requirements of subsection (a)(14) of this section. [164]

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161 11 U.S.C. § 1115(a) (2012) (emphasis added) (bracketed language added by author); *Arnold*, 471 B.R. at 602.

162 *In re* O'Neal, 490 B.R. 837, 851 (Bankr. W.D. Ark. 2013).

163 *See, e.g.*, 11 U.S.C. § 554 (abandonment of property of the estate); *id.* § 542 (turnover of property of the estate); *id.* § 363 (use, sale, lease of property of the estate); *id.* § 551 (automatic preservation of avoided transfer).

164 11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added) (bracketed language added by author).

Arnold attempted to refute the claim that its interpretation leads to two divergent definitions of property by stating: "By its very language, § 1115 does not create the bankruptcy estate of an individual Chapter 11 debtor. That is accomplished by § 541(a) . . . ."[165] While partially true, this convenient reading ignores the language of § 1115(a) that "property of the estate *includes* . . . ."[166] Whether or not one believes that § 541 assets are excluded from § 1129, one cannot ignore such clear language of § 1115 providing a list of estate assets. *Arnold* also highlights that the word "creates" is absent from § 1115 whereas it is present in § 541.[167] However, this Note does not suggest that § 1115 erases § 541, but rather argues that § 1115 simply *expands* § 541, and therefore the absence of that verbiage has no impact. In fact, the expanded definition follows the progression of a bankruptcy filing. When a petition is filed, an estate is created via § 541 encompassing all prepetition assets.[168] At that moment, however, § 1115 is triggered to add any and all postpetition property—in addition to the existing estate of § 541. In other words, § 1115 only comes alive once § 541 has played its role in creating the debtor's estate. After all, postpetition property cannot exist before the petition itself is filed. While the terms "prepetition" and "postpetition" mark specific stages in a bankruptcy case, all estate property is encompassed by § 1115 once it is evoked.

This progression illustrates how new property under § 1115 is intended to be an expansion of, or an addition to, the estate already defined under § 541. Such is the exact aim of the phrase "in addition to" in § 1115. Therefore, the estate under § 1115 of an individual debtor is composed of:

> (1) property specified in § 541;
>
> (2) property acquired postpetition (i.e., "[a]ll property of the kind specified in § 541 that the (individual) debtor acquires after the commencement"); and
>
> (3) earnings acquired postpetition (i.e., "earnings from services performed by the debtor after the commencement").[169]

While acknowledging this definition in *Arnold*, the court ultimately dismisses it for failing to recognize the "diminishing" value of the phrase "in addition to."[170] Here, again, the court's reasoning is erroneous on

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165 *Arnold*, 471 B.R. at 604 (citations omitted).

166 11 U.S.C. § 1115(a) (emphasis added).

167 *Arnold*, 471 B.R at 605.

168 *In re* Friedman, 466 B.R. 471, 488–89 (B.A.P. 9th Cir. 2012) (Jury, J., dissenting); *In re* Stephens, 445 B.R. 816, 820–21 (Bankr. S.D. Tex. 2011); *In re* Gbadebo, 431 B.R. 224, 229 (Bankr. N.D. Cal. 2010).

169 *See Friedman*, 466 B.R. at 481 (majority opinion).

170 *Arnold*, 471 B.R at 603.

two accounts. First, it projects its interpretation of the broad view's reading of "addition" to mean "supplant," which is not supported by the language of the statute.[171] Second, it defines "addition" as "to separate." This creates the completely counterintuitive result of making the addition of something in fact a subtraction. It has the effect of turning "includes, in addition to § 541" into "includes, excludes § 541." Such a conclusion is illogical and therefore flawed.

Furthermore, the narrow view is problematic when read in conjunction with § 541(a)(7), which states that "[a]ny interest in property that the estate acquires after the commencement" counts as property of the estate.[172] If the additional postpetition property coming in under § 1115 is read as "being acquired by the estate," then a narrow reading of § 1129 that preserves the absolute priority rule for property under § 541 entirely nullifies § 541(a)(7) by excluding property that was indeed acquired by the estate. Therefore, under this reading, some § 541 property is subject to the rule and some is not. Such inconsistency is absurd. Even if the language "property included under § 1115" in § 1129 refers purely to § 541 assets, postpetition property already came in to § 541 via § 541(a)(7) because it is "an interest acquired" through § 1115. Why then did the legislature add § 1115 if § 541(a)(7) can serve the same purpose? The Code itself provides the answer: § 541(a)(6) specifically excludes postpetition wages from the estate whereas § 1115 captures them in § 1115(a)(2).[173] Therefore, again, § 1115 expands the pool of estate assets by adding postpetition property and wages. Only through § 1115 are these additional assets that the *debtor* acquires pulled into the estate and therefore acquired by the *estate*.[174] Another explanation for the addition of § 1115 is that utilizing § 1115 (rather than rewriting § 541(a)(7) to include postpetition property) is an attempt to distinguish between individual and corporate debtors, and those seeking to reorganize. Indeed, the definition for Chapter 13 property of the estate is identical to that of Chapter 11 for individuals.[175] If the BAPCPA amended § 541(a)(7) to say "postpetition" then that § 541 definition of property would apply to corporate debtors under Chapters 11 and 7 and to individuals under Chapter 7. However, given

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171 In fact, even the dissent in *Friedman* explicitly rejects the view that 11 U.S.C. § 1115 (2012) absorbs § 541 and argues that pre- and postpetition property provisions should be treated as distinct from each other. *Friedman*, 466 B.R. 488–89 (Jury, J., dissenting). The dissent refers to the distinctions created by § 1115 and § 541 as "mainstays of bankruptcy law," and states that it is unlikely that Congress intended for § 1115 to supersede § 541. *Id.* at 489 (citing *In re* Borton, No. 09-00196-TLM, 2011 WL 5439285, at *4 (Bankr. D. Idaho 2011)).

172 11 U.S.C. § 541(a)(7).

173 *Id.* §§ 541(a)(6), 1115(a)(2).

174 11 U.S.C. § 1115(a) only speaks to assets acquired by the debtor, whereas § 541(a)(7) refers to property by the estate itself.

175 *Compare* 11 U.S.C. § 1115(a), *with* 11 U.S.C. § 1306.

the variance in goals of the different chapters,[176] it is understandable that estate assets should be treated differently under each chapter.

Thus, *Arnold*'s attack on the broad view and advocacy for the narrow reading of § 1129 is unpersuasive, and the expanded § 1115 definition, capturing both pre- and postpetition assets within a debtor's estate, is the valid interpretation of the statute.

2. Policy Considerations

The policy considerations of a "fine-tuned"[177] balance between interests of debtors and creditors presented in *In re Lee Min Ho Chen*[178] are appealing, but ultimately flawed. The court proposes that elimination of the absolute priority rule would "chill[] future lending for fiscally responsible Americans hoping for a second chance in fulfilling their American dream."[179] This somewhat romanticized language ignores the fact that the fairness requirement for plan confirmation focuses on the parties at hand, not the population at large.[180] The court must weigh considerations of what is fair and equitable to the parties based on the specific circumstances in a case.[181] Furthermore, no evidence is offered to support the proposition that "fiscally responsible Americans" in general may face difficulty in obtaining credit as a result of a debtor being allowed to keep his prepetition property.[182] To the contrary, it is logically in the interest of financial institutions to grant credit to responsible individuals, but particularly recent debtors since they cannot seek another discharge for a number of years.[183]

However, the inclusion of the phrase "second chance"[184] in the court's proposition suggests that it is referring to individuals who successfully confirm a plan and obtain a discharge upon conclusion of a bankruptcy proceeding. Here again, the court offers no evidence to support its assertion that the adoption of the broad view of § 1115 would influence recent debtors' ability to obtain credit post-bankruptcy.

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176 Chapter 11 and 13 to reorganize as opposed to Chapter 7 to liquidate.

177 *See supra* note 154 and accompanying text.

178 482 B.R. 473 (Bankr. D.P.R. 2012); *see supra* note 152 and accompanying text.

179 *Lee Min Ho Chen*, 482 B.R. at 483.

180 The judiciary's role is to enforce a statute while leaving the drafting, which includes considerations of repercussions of the statute, to the legislature. *See, e.g.*, *In re* Karlovich, 456 B.R. 677, 681 (Bankr. S.D. Cal. 2010) (citing United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989)) (stating that a court must simply enforce plain language according to its terms, and "there generally is no need for a court to inquire beyond the plain language of the statute").

181 For factors to be considered in the fair and equitable analysis, see *supra* note 104.

182 *Lee Min Ho Chen*, 482 B.R. at 483.

183 Under the BAPCPA, a debtor who previously filed in Chapter 11 cannot file a new Chapter 7 for eight years and a new Chapter 13 for four years. 11 U.S.C. §§ 727(a)(8), 1328(f)(1) (2012).

184 *Lee Min Ho Chen*, 482 B.R. at 483.

The reality is that, with or without the absolute priority rule, an individual will face greater difficulty in obtaining some types of loans (such as long-term mortgages) in the immediate aftermath of bankruptcy.[185] In addition to the extended time for repeat filings, the new credit counseling requirement introduced by the BAPCPA[186] may ease the concerns of creditors in extending loans post-bankruptcy, but it is too early to gauge its effectiveness with confidence. Regardless, the rule itself has no impact on credit-worthiness and thus, *Lee Min Ho Chen* is unpersuasive in its proposed policy considerations for adopting the narrow view.

B. *Response to the Broad View*

While the broad view is more persuasive in its grammatical interpretation of the Code,[187] it too is not without flaws. It ignores the true legislative history of the BAPCPA, which at first glance appears to contradict the reasons for adopting the expanded reading of § 1129 and § 1115.[188] Furthermore, it adopts an all-encompassing view, eliminating the absolute priority rule entirely from individual Chapter 11 cases rather than restricting the abrogation to the debtor himself.[189]

1. Legislative History

The broad view adopts the idealistic position that BAPCPA was intended to aid the debtor in the bankruptcy process making it consistent with the aims of the Bankruptcy Code as a whole. This position, however, contradicts legislative history and the circumstances prevalent during the Act's adoption.

The amendment was first introduced in 1998 and passed as the Bankruptcy Reform Act of 2000.[190] However, it was vetoed by President

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185 For a discussion of how bankruptcy affects post-bankruptcy borrowing, see Katherine Porter, *Life After Debt: Understanding the Credit Restraint of Bankruptcy Debtors*, 18 AM. BANKR. INST. L. REV. 1 (2010) (suggesting that market constraints resulting from the higher cost of recent-debtor credit and debtors' own self-restraint prevent them from borrowing following discharge); *see also* Jay L. Zagorsky & Lois R. Lupica, *A Study of Consumers' Post-Discharge Finances: Struggle, Stasis, or Fresh-Start?*, 16 AM. BANKR. INST. L. REV. 283 (2008) (reviewing empirical data showing that bankruptcy filers are less likely to own credit cards or homes than non-filers).

186 11 U.S.C. § 109 requires completion of a credit counseling session from an approved agency within 180 days preceding the petition date as a condition for obtaining bankruptcy protection. 11 U.S.C. § 109(h)(1).

187 *See In re* Shat, 424 B.R. 854 (Bankr. D. Nev. 2010).

188 *See infra* Part III.B.1.

189 *See infra* Part III.B.2.

190 H.R. 833, 106th Cong. (2000).

Clinton as being "unfair to ordinary debtors" and "pushing them over the edge financially."[191] It was reintroduced annually, but was strongly opposed by many Democrats and only gained momentum after the Republican-dominated 109th Congress took office in 2005. The reintroduced bill was widely criticized during the confirmation process at hearings in both the Senate and House of Representatives.[192] While legal scholars and consumer protection agencies opposed the bill, it was not, of course, without supporters. Financial institutions, particularly banks, backed the bill under the guise of curbing abuse.[193] Much research presented at the hearings showed that most debtors file not because of their extravagant and lavish lifestyles, but because they face medical and economic catastrophes and simply "ha[ve] no choice."[194] The opponents criticized the bill for being outdated,[195] inhumane to workers,[196] and favoring creditors "to the detriment of individuals."[197] Proponents of the bill praised its enforced debt collection practices,[198]

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191 *Clinton Vetoes Bankruptcy Bill*, DAILY REPORTER, Dec. 20, 2000, at 3, *available at* http://news.google.com/newspapers?nid=1907&dat=20001220&id=kspGAAAAIBAJ&sjid=xP0MAAAAIBAJ&pg=1524,3160493.

192 *Bankruptcy Reform: Hearing Before the S. Comm. on the Judiciary*, 109th Cong., 10–12, 18–20 (2005) [hereinafter *Bankruptcy Reform*] (statements of Elizabeth Warren, Harvard Law School; David McCall, Director, District 1, United Steel Workers of America, AFL-CIO); *Implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 109th Cong., 24–26 (2005) (statement of Travis B. Plunkett, Legislative Director, Consumer Federation of America).

193 *Bankruptcy Reform*, *supra* note 192, at 5–7, 14–16, 20–21 (statements of Kenneth H. Beine, President & Chief Executive Officer, Shoreline Credit Union; Malcolm Bennett, President & Founder, International Realty Investments, Inc.; R. Michael Menzies, President & Chief Executive Officer, Easton Bank & Trust Co.).

194 *Id.* at 231 (prepared statement of Elizabeth Warren, Harvard Law School). For an argument that the amendment was intended to discourage individuals from filing immediately, thereby increasing the total amounts indebted, see Ronald J. Mann & Katherine Porter, *Saving Up for Bankruptcy*, 98 GEO. L.J. 289, 295 (2009).

195 Elizabeth Warren describes the bill in the following terms:

> The overarching problem with this bill is that time and the American economy have passed it by. It was drafted—never mind by whom—eight years ago. Even if it had been a flawless piece of legislation then, and it surely was not, the events of the past eight years have dramatically changed the economic and social environment in which you must consider this bill.

Bankruptcy Reform, *supra* note 192, at 231 (prepared statement of Elizabeth Warren, Harvard Law School). The bill remained largely unchanged from its original draft introduced in 1997. *See* Susan L. DeJarnatt, *Once Is Not Enough: Preserving Consumers' Rights to Bankruptcy Protection*, 74 IND. L.J. 455, 456 n.5 (1999).

196 *Bankruptcy Reform*, *supra* note 192, at 18 (statement of David McCall, Director, District 1, United Steel Workers of America, AFL-CIO).

197 *Id.* at 19.

198 *Id.* at 17 (statement of Philip L. Strauss, National Child Support Enforcement Association).

including the removal of the automatic stay[199]—one of the greatest tools of bankruptcy protection[200]—from certain debts.[201] The new crippling means test to prevent Chapter 7 discharges[202] was also applauded.[203] Despite its skewed purpose, BAPCPA was signed into law by President George W. Bush on April 20, 2005, who stated that "[b]y restoring integrity to the bankruptcy process, this law will make our financial system stronger and better."[204]

The rich legislative record and the provisions of the BAPCPA itself indicate that the amendment was not enacted to ease the process of bankruptcy for debtors. Rather, its aim was to increase the difficulty of obtaining a discharge, thereby forcing the repayment of debts.[205] Or, alternatively, its aim was to discourage bankruptcy petitions altogether.

However, the BAPCPA's creditor-focused revisions should not be misunderstood to overshadow the overall debtor-friendly theme of the Bankruptcy Code. While the amendment imposed more stringent requirements to qualify for the Code's protection, it still offers a fresh

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199 An automatic stay bars all collection practices by creditors for the duration of the bankruptcy. It is triggered as soon as a bankruptcy petition is filed. However, secured creditors can petition the court for lift of the automatic stay upon a showing of cause. 11 U.S.C. § 362 (2012).

200 *In re* Russo, 94 B.R. 127, 129 (Bankr. N.D. Ill. 1988) (referring to the automatic stay as "one of the most powerful weapons known to the law").

201 For example, Section 362 of the BAPCPA allows for continued garnishment of wages for child support, *id.* § 362(b)(2)(C), as defined in 42 U.S.C. § 666(b)(8), thereby lifting the stay protection from wages.

202 Prior to the BAPCPA, debtors had the option of choosing a Chapter 7 liquidation of assets and full discharge of debts or Chapter 11 and 13 repayment plan options. The amendment imposes a means test to qualify for a Chapter 7, thereby forcing some debtors into other chapters involuntarily. *See* Chris M. Toppito, *Chapter 13 and the Path to a Better Life*, *in* BEST PRACTICES FOR FILING CHAPTER 13 1, 2, 5 (2013).

203 *Bankruptcy Reform*, *supra* note 192, at 6–7 (statement of Kenneth H. Beine, President & Chief Executive Officer, Shoreline Credit Union).

204 Press Release, White House, Statement by President George W. Bush Upon Signing S. 256 (Apr. 20, 2005).

205 In describing the amendment, the House Report states:

> [T]he proposed reforms respond to many of the factors contributing to the increase in consumer bankruptcy filings, such as lack of personal financial accountability, the proliferation of serial filings, and the absence of effective oversight to eliminate abuse in the system. The heart of the bill's consumer bankruptcy reforms consists of the implementation of an income/expense screening mechanism ("needs-based bankruptcy relief" or "means testing"), which is intended to ensure that debtors repay creditors the maximum they can afford. S. 256 also establishes new eligibility standards for consumer bankruptcy relief and includes provisions intended to deter serial and abusive bankruptcy filings. It substantially augments the responsibilities of those charged with administering consumer bankruptcy cases as well as those who counsel debtors with respect to obtaining such relief. In addition, the bill caps the amount of homestead equity a debtor may shield from creditors, under certain circumstances.

H.R. REP. NO. 109-31(I), at 2 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89 (footnote omitted).

start to debtors who successfully jump through the hoops.[206] The Code's emphasis on rehabilitation remains strong and is characteristic of its purpose. Indeed, one unfortunate amendment does not erase the rehabilitative nature of bankruptcy law.

2. Over Inclusiveness

Another problem with the broad view is that it applies the abrogation of the absolute priority rule to all parties.[207] However, § 1129 only carves out an exception for the debtor himself, without entirely eliminating the application of the rule in the treatment of creditors. In fact, the amended Code retained the original rule while adding the exception for debtors. The statute reads:

> (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 . . . .[208]

By retaining the original language codifying the absolute priority rule, Congress clearly demonstrated its intent to preserve the rule's effect on the debtor's creditors. A contrary reading would mean that Congress did not know or fully comprehend the effect of the absolute priority rule in the hierarchical scheme of repayment to creditors. However, as stated in *Lorillard v. Pons*,[209] it has long been recognized that "where, as here, Congress adopts a new law . . . Congress normally can be presumed to have had knowledge of the interpretation given to the [old] law."[210] Therefore, having known the effect of the absolute priority rule codified in § 1129, by adding the italicized language in its amendment, Congress intended to preserve the rule's treatment of creditors in Chapter 11 cases while carving out an exception for individual debtors.[211]

The court in *In re Roedemeier*,[212] which subscribes to the broad view, recognized this,[213] stating that "[t]he BAPCPA added the clause at

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206 11 U.S.C. § 727 (providing discharge for debtors acting in good faith in Chapter 7 bankruptcies); *id.* § 1328 (providing discharge to debtors who satisfy all plan payments in a Chapter 13 bankruptcy); *id.* § 1141(d)(1)(A) (providing for discharge upon plan confirmation in Chapter 11 bankruptcies).

207 *See, e.g.*, *In re* Friedman, 466 B.R. 471, 481 (B.A.P. 9th Cir. 2012) (holding that the absolute priority rule is inapplicable in individual Chapter 11 cases overall); *In re* Tucker, 479 B.R. 873, 876–78 (Bankr. D. Or. 2012) (same); *In re* Johnson, 402 B.R. 851, 852–53 (Bankr. N.D. Ind. 2009) (same).

208 11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added).

209 434 U.S. 575 (1978).

210 *Id.* at 581.

211 For the full language added by the BAPCPA, *see supra* note 62.

212 374 B.R. 264 (Bankr. D. Kan. 2007).

the end of 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."[214] The *Roedemeier* court attributed this exception to the theory that Congress intended to make Chapter 11 more aligned with Chapter 13 for individual debtors.[215] According to the *Roedemeier* court, taken together, the changes made by the BAPCPA[216] illustrate that individual debtors are to be exempted from the absolute priority rule.[217] While *Roedemeier* focused on recognizing the abrogation of the absolute priority rule contained in § 1129, it is of note that the court explicitly classified the abrogation as an exception for Chapter 11 debtors specifically.[218]

Preserving the rule in this capacity is consistent with the BAPCPA's theme of affording greater protection to creditors.[219] Here, the narrow view's argument that the rule is the greatest protection for creditors illuminates the issue.[220] Adhering to the repayment hierarchy ensures fairness in treatment of different types of creditors and assures a "just reorganization."[221] Allowing the absolute priority rule to remain a part of the repayment proposal negotiation ensures satisfaction of the "fair and equitable" requirement of plan confirmation.[222] That, in turn,

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213 *Id.* at 274.

214 *Id.*

215 *Id.* at 275.

216 The BAPCPA made the following changes to Chapter 11 that resemble Chapter 13's treatment of individual debtors:

> 1. § 1115 brings property the debtor acquires postpetition into the estate;
>
> 2. § 1123(a)(8) calls for the debtor's plan to provide for payment to creditors from the debtor's postpetition earnings from services or other future income;
>
> 3. the exception in § 1129(b)(2)(B)(ii) allows the debtor to keep property included in the estate under § 1115, without paying in full a class of unsecured creditors that rejected his or her plan;
>
> 4. § 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;
>
> 5. § 1141(d)(5) ordinarily delays the entry of the debtor's discharge until completion of all payments under the plan; and
>
> 6. § 1127(e) permits modification of a confirmed plan even after substantial consummation for certain purposes.

Id. at 275–76. This argument is certainly plausible, but the legislative record does not show clear intent to make the two chapters more aligned as BAPCPA's primary goal.

217 *Id.* at 276.

218 *Id.* at 274.

219 See *supra* Part II.C.3 for a discussion of the BAPCPA's goals.

220 *See supra* Part II.C.

221 *In re* Arnold, 471 B.R. 578, 596 (Bankr. C.D. Cal. 2012) (citing DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY 86 (4th ed. 2006)).

222 *See supra* Part I.A.

assures conformity with the standard articulated in *In re Tucker*.[223] Thus, while § 1129 clearly carves out an exception for debtor's retention of estate assets, it preserves the absolute priority rule for all of his creditors.

C. *A Middle Ground*

Despite its longevity in bankruptcy law,[224] the absolute priority rule is not, in fact, always absolute. Courts have long recognized the judicially created "new value" exception[225] and continue to utilize it despite its lack of codification.[226] The reasons for utilizing this exception are particularly useful in evaluating the debate regarding the amended Code. It bridges the gap between the opposing views, building on the strengths of each to serve the aims of the BAPCPA.

1. New Value Exception

The new value exception allows the debtor to retain estate property despite his junior priority status by contributing "new value" to the estate. This tool carves out an exception for the debtor through which the debtor elevates his status in the priority hierarchy.[227]

The central goal behind the absolute priority rule is to prevent unfair dealings between senior creditors and debtors and thus, the rule injects a requirement of "fairness"[228] through the payment hierarchy. However, what triggers concerns of foul play is a debtor's lack of adequate funds to pay all the creditors in full, which of course is the

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223 *See supra* notes 100–04 and accompanying text.

224 The absolute priority rule was first recognized in *N. Pac. Ry. Co. v. Boyd*, 228 U.S. 482, 508 (1913).

225 This exception allows a debtor who contributes new capital to retain an interest senior to creditors equivalent to the value of the newly invested capital, thereby facilitating stakeholder participation in the entity's reorganization. *See* Clifford S. Harris, *A Rule Unvanquished: The New Value Exception to the Absolute Priority Rule*, 89 MICH. L. REV. 2301, 2302 (1991). For example, if the debtor invests $500,000, that amount is not poured into the pool of estate assets that are used to calculate appropriate repayment to each class of creditors. Instead, the contribution is treated as a claim in itself and carries greater priority in the hierarchy of classes. If the parties cannot agree on a plan and must resort to a liquidation of assets, the debtor's $500,000 investment will be repaid before any creditor. To qualify for the exception, the investment must be in cash or its equivalent, and the investor's degree of participation must be equivalent to the investment amount (the greater the amount, the greater say the debtor has in structuring the terms of the plan of reorganization).

226 The new value exception was most recently recognized in *In re Tucker*, 479 B.R. 873 (Bankr. D. Or. 2012). *See supra* note 98.

227 For an example, see *supra* note 225.

228 The requirement that a bankruptcy plan must be "fair and equitable" is discussed in *Tucker*, 479 B.R. at 878–79; *see also supra* Part II.A.

reason for the filing in the first place. But an increased value of the estate benefits the entire pool of creditors by increasing the chances of repayment. To put it simply, the more funds there are in the estate, the more money there is to go around. This comprehensive benefit to all parties is the rationale behind allowing a debtor to make a "new, substantial, and necessary contribution"[229] to the estate in exchange for retaining an asset of the estate. This exception was recognized by the Supreme Court in *Case v. Los Angeles Lumber Products Co.*,[230] and has remained an extra tool of plan confirmation at debtors' disposal.

However, the requirements of "new value" present inherent difficulties in qualifying for the exception. A debtor who is forced into bankruptcy is less likely to find independent, "new" sources of funds that meet the "substantial" contribution requirement. Furthermore, the Supreme Court held in *Norwest Bank Worthington v. Ahlers*[231] that the new value brought into the estate to avoid the absolute priority rule had to be monetary and not in the form of services or other intangible promises.[232] The Court explained its heightened standard by highlighting that while intangibles like labor and experience do contain value, they are unenforceable, and therefore cannot provide the necessary assurance of fair treatment for creditors.[233] However, while a corporate debtor may secure new value via investments, such an option is not as easily available for individual debtors, particularly in single-asset cases.[234] This explains the language added in § 1129 that carves out an exception for individual Chapter 11 cases[235] aiming to serve the same goal.

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229 These are the requirements to qualify for the new value exception. *See In re* Friedman, 466 B.R. 471, 478 (citing Kan. City Terminal Ry. Co. v. Cent. Union Trust Co., 271 U.S. 445, 455 (1926)).

230 308 U.S. 106, 122 (1939).

231 485 U.S. 197 (1988).

232 *Id.* at 202–06.

233 *Id.* at 204–05. While the Court does not discuss this, another problem with allowing a debtor's experience to qualify as value is that it fails to meet the "new" portion of the new value exception. After all, a debtor develops experience in the operation of his business and so that experience is already present upon filing for bankruptcy. Present experience therefore lacks the quality of being "new." A possible way around this is to hire new management or other staff thereby contributing their different (new) experience to the business.

234 *See supra* Part I.D; *see also* David Gray Carlson & Jack F. Williams, *The Truth About the New Value Exception to the Bankruptcy Rule*, 21 CARDOZO L. REV. 1303, 1332 (1999) (suggesting that the new value exception was primarily utilized in single-asset real estate cases, and even then very seldom).

235 *See* Carlson & Williams, *supra* note 234, at 1318–19; *see also supra* Part III.B.2.

2. Building on the New Value Exception

Recognizing the value of a healthier,[236] engaged debtor while remaining faithful in its effort to increase creditor repayment,[237] § 1129 builds on the benefits of the new value exception but alters it in two ways. First, it eliminates the need to find new funds by allowing debtor's pre- and postpetition assets to serve as "value." Second, it codifies the aim of the exception[238] by allowing the debtor to retain that property.[239] The intended effect of the new value exception is debtor asset retention through increased priority status in the repayment hierarchy.[240] The new § 1129 shortcuts the process by simply allowing estate assets to remain with the debtor. [241] As a result, the debtor's interest is increased, and he is more engaged in the process of reorganization and better equipped to emerge from bankruptcy.

3. Abolition Serves the Aims of the BAPCPA

While there are arguments on both sides as to whether the BAPCPA was intended to protect debtors or serve creditors, it is undisputed that the driving goal of the amendment was to increase the likelihood of debtor repayment.[242] After all, one of the main concerns of Congress was curbing abuse of the bankruptcy system that allows a debtor to escape the obligations of his incurred debts. [243] Allowing the debtor to keep prepetition assets increases his chances of rehabilitation—serving his interests—and has a direct correlation with meeting his repayment obligations—serving the interests of creditors. Therefore, eliminating the absolute priority rule to allow prepetition assets to remain with the debtor via § 1129 is consistent with the aims of

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236 The word "healthier" is used here to refer to financial stability. Retaining an asset improves the debtor's financial health.

237 Allowing a debtor to remain in Chapter 11 serves creditors because they are guaranteed to a payment of at least what they would have received under a Chapter 7 liquidation, plus the additional payment provided under the plan. 11 U.S.C. § 1129(a)(7)(A)(ii) (2012).

238 This in no way suggests that the added language in § 1129 codifies the new value exception verbatim, as the differences between the two are self-evident. It merely suggests that the effect of the exception is achieved through the added language and thus, the exception is illustrative in understanding the purpose of that language.

239 11 U.S.C. § 1129(b)(2)(B)(ii) (2012).

240 *See supra* note 50.

241 *See id.*

242 The House Judiciary Committee Report explains that the BAPCPA's goals were "to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors." *In re* Lindsey, 453 B.R. 886, 904 (Bankr. E.D. Tenn. 2011) (quoting H.R. REP. NO. 109-31(I), at 2 (2005)) (internal quotation marks omitted).

243 *See supra* Part III.B.1.

the BAPCPA. Furthermore, restricting abolition of the rule to debtors preserves the "fine-tuned" balance[244] that is so crucial in maintaining the fairness aspect of a plan confirmation articulated in *Tucker*.[245] The carved out exception also eliminates any lingering concerns for backlash against recent debtors in obtaining credit post-bankruptcy,[246] since all other creditors will still be treated according to their priority status in the event of a repeat bankruptcy.[247]

CONCLUSION

The enactment of the BAPCPA in 2005 drastically changed bankruptcy law and stirred great debate in the legal community regarding its impact on the Bankruptcy Code. Several linguistic ambiguities in the BAPCPA have resulted in circuit splits across the country and generated volumes of legal scholarship. Of particular importance is the expanded definition of "property of the estate" codified in § 1115,[248] which adds postpetition assets and wages to the already existing prepetition assets defined in § 541.[249] The new definition plays a crucial role when referenced in § 1129[250] by allowing the debtor to retain property of the estate under § 1115, thereby eliminating the absolute priority rule from individual Chapter 11 cases.

Both the "narrow"[251] and "broad"[252] readings of the statute are not without merit, but are ultimately flawed. The narrow view relies on a convenient but illogical grammatical interpretation of the language to separate § 541 property from § 1115's definition, making the absolute priority rule applicable to prepetition property. The narrow view also ignores the authority of the BAP,[253] whose interpretation of the statute marks the narrow reading erroneous. The broad view, in turn, adopts an all-encompassing reading, eliminating the absolute priority rule from the entire individual Chapter 11 process. It ignores the specific language illustrating an exception for debtors only. Thus, the broad view blissfully assumes that the BAPCPA is an extension of the traditional debtor-friendly Bankruptcy Code when, in fact, the congressional record suggests the opposite.[254]

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244 *In re* Lee Min Ho Chen, 482 B.R. 473, 483 (Bankr. D.P.R. 2012).
245 479 B.R. 873, 878–79 (Bankr. D. Or. 2012).
246 *In re Lee Min Ho Chen*, 482 B.R. at 483.
247 11 U.S.C. § 1129(b)(2)(B)(ii) (2012).
248 *See supra* note 60 and accompanying text.
249 *See supra* note 59.
250 See *supra* note 62 for the full revised statute.
251 See *supra* Part II.C and the response in *supra* Part III.A.
252 See *supra* Part II.A and the response in *supra* Part III.B.
253 *See supra* Part II.B.
254 *See supra* Part III.B.1.

While the BAPCPA was enacted to increase the difficulty of obtaining bankruptcy protection for debtors, it luckily did not overshadow the provisions of the Code entirely. In fact, it carved out an exception for individual Chapter 11 debtors that had the effect of assisting them in the rehabilitation process. By allowing debtors to keep pre- and postpetition assets, elimination of the absolute priority rule has an effect similar to the new value exception,[255] in that it improves a debtor's position, thereby increasing the probability of a successful rehabilitation. This, in fact, benefits creditors as well, since it provides a greater incentive for debtors to utilize Chapter 11 rather than Chapter 7, increasing repayment. Also, by eliminating the absolute priority rule for individual Chapter 11 debtors while preserving it in the treatment of debtor's creditors, the BAPCPA maintains the fairness balance that is crucial in achieving plan confirmation.

However, in order for debtors and creditors to fully benefit from the BAPCPA's revisions of the Code, the debate regarding the applicability of the absolute priority rule needs to be addressed within the circuits or by the Supreme Court. Only then will the problems of forum shopping and confusion about the rule be resolved.

255 *See supra* Part III.C; *supra* note 50.