

1 case in order to conduct a nonjudicial foreclosure of the
2 debtor's Knoll Road property. For purposes of this motion SDCCU
3 stipulates to the debtor's value of \$1.33 million. SDCCU is owed
4 over \$2.8 million. SDCCU's core argument is that the Knoll Road
5 property is not necessary to an effective reorganization. To the
6 contrary, it impairs a reorganization. The debtor proposes to
7 strip down the undersecured portion of the debt - approximately
8 \$1.477 million - and add that amount to the unsecured debt to be
9 addressed in the debtor's Chapter 11 plan. SDCCU argues even if
10 that were accomplished, the Knoll Road property would generate
11 little net cash flow to the estate (as acknowledged by debtor in
12 her draft disclosure statement) for the next several years, while
13 adding a large amount of debt to the class of unsecured
14 creditors, thereby diluting the return to other unsecured
15 creditors significantly.

16 Section 362(d)(2) of Title 11 provides that relief from the
17 automatic stay should be granted if the debtor has no equity in
18 the property and the property is not necessary for
19 reorganization. It is stipulated, for purposes of the hearing,
20 that debtor has no equity in the property. So, as SDCCU argues,
21 necessity for reorganization is the remaining issue. While SDCCU
22 argued its position from every conceivable facet, including the
23 inability of the debtor to meet the absolute priority rule, the
24 debtor argued that knowing whether the absolute priority rule
25 applies in individual Chapter 11 cases is essential for the
26 debtor to determine how to proceed. Debtor argues that SDCCU

1 would have the opportunity to elect certain treatment of the debt
2 owed to it under 11 U.S.C. § 1111(b) which, in turn, would affect
3 how the debtor would be able to deal with the debt. Debtor says
4 she wants to keep the Knoll Road property so she can recover the
5 capital invested in it when the market improves. At the hearing
6 on the motion for relief from stay, the parties and the Court
7 concluded that before the parties can fully discuss and resolve
8 whether the property is necessary to an effective reorganization,
9 the Court must decide whether the absolute priority rule applies
10 in this case. The Court took the matter under submission to
11 answer that question.

12 DISCUSSION

13 If a plan is not accepted by all classes of creditors it
14 may still be confirmed so long as it is "fair and equitable."
15 11 U.S.C. § 1129(b)(1). With respect to the members of a class
16 of unsecured creditors, a plan is "fair and equitable" under
17 section 1129(b)(2)(B) if they are paid in full or no junior class
18 retains any interest in estate property. This is typically
19 referred to as the "absolute priority rule." Section 1129(b) is
20 one of several sections which was amended by the Bankruptcy Abuse
21 Prevention and Consumer Protection Act of 2005 ("BAPCPA"). The
22 amendments have given rise to disagreement between the courts, as
23 well as the parties to this case, on whether the absolute
24 priority rule, as amended by BAPCPA, still applies to individual
25 chapter 11 debtors. The prior and current forms of the absolute
26 priority rule were well discussed in In re Gbadebo:

1 Prior to the enactment of the Bankruptcy Abuse
2 Prevention and Consumer Protection Act of 2005
3 ("BAPCPA"), 11 U.S.C. § 1129(b)(2)(B) stated that, if
4 an impaired class of unsecured claims voted against a
5 plan, the plan could not be confirmed unless the court
6 found that it was "fair and equitable." "Fair and
7 equitable" meant, at a minimum, that either the class
8 would receive property with a present value equal to
9 its claim or no one with a claim or interest junior to
10 the class of unsecured claims would retain any
11 property. This provision applied to both individual
12 debtors and debtors that were entities. This provision
13 is generally referred to as the "absolute priority"
14 rule.

15 BAPCPA modified the "absolute priority" rule as
16 applied to individual debtors. Section
17 1129(b)(2)(B)(ii) now states that a plan may be "fair
18 and equitable" even though the debtor retains "property
19 *included in the estate under section 1115....*" 11
20 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added). Section
21 1115 is a new provision, also added by BAPCPA. It
22 states as follows:

23 (a) In a case in which the debtor is an
24 individual, property of the estate includes,
25 in addition to the property specified in
26 section 541-

(1) all property of the kind specified
in section 541 that the debtor acquires after
the commencement of the case but before the
case is closed, dismissed, or converted to a
case under chapter 7, 12, or 13, whichever
occurs first; and

(2) earnings from services performed by
the debtor after the commencement of the case
but before the case is closed, dismissed, or
converted to a case under chapter 7, 12, or
13, whichever occurs first.

(b) Except as provided in section 1104 or a
confirmed plan or order confirming a plan,
the debtor shall remain in possession of all
property of the estate.

11 U.S.C. § 1115 (emphasis added).

431 B.R. 222, 227 (Bankr.N.D.Cal. 2010).

1 Since these amendments to the Code several courts have
2 addressed this issue and have reached divergent results. One
3 camp has held that Congress abolished the absolute priority rule
4 with respect to individual debtors, the other that it did not.
5 For the reasons set for below, this Court believes the latter
6 side more correctly explains Congress' action.

7 Section 1129(b) (2) (B) (ii) does not expressly exclude
8 individuals. It does, however, provide that, unlike other
9 chapter 11 debtors, individuals may retain some property -
10 "property included in the estate under section 1115..."
11 As set forth above, § 1115 provides that in the case of an
12 individual chapter 11 debtor "property of the estate includes, in
13 addition to the property specified in section 541 ... all
14 property of the kind specified in section 541 that the debtor
15 acquires after the commencement of the case...." So for an
16 individual chapter 11 debtor property of the estate includes all
17 non-exempt property which would be property of the estate for any
18 chapter 11 debtor plus, as added by § 1115, property acquired
19 post-petition.¹

20 The courts that held that the absolute priority rule is
21 abolished with respect to individual debtors begin by finding
22 ambiguity in § 1129(b) (2) (b) (ii) and its reference to § 1115.

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26 ¹Before and after BAPCPA the individual chapter 11 debtor is, unlike his entity counterparts,
entitled to exempt property under § 522.

1 They conclude that the sections are susceptible to the
2 interpretation that all property of an individual may be retained
3 under § 1129(b)(2)(B)(ii):

4 This new provision both refers to the property already
5 brought into the bankruptcy estate by § 541 and brings
6 more property into the estate. Unfortunately, the
7 exception and § 1115(a) are worded in such a way that
8 the exception could be construed narrowly to cover only
9 the additional, postpetition property brought into the
10 Chapter 11 bankruptcy estate by § 1115(a), or broadly
11 to cover not only that property but also all the
12 property brought into the estate by § 541, most of
13 which is property the debtor had before filing for
14 bankruptcy. The first construction would greatly limit
15 the impact of the new exception under §
16 1129(b)(2)(B)(ii), but the second would exempt an
17 individual Chapter 11 debtor from the main facet of the
18 absolute priority rule, allowing him or her to retain
19 both pre-and postpetition property under a plan even
20 though a class of unsecured creditors would not be paid
21 in full. The Court must determine which interpretation
22 matches Congress's intent in making these changes.

23 In re Roedemeier, 374 B.R. 264, 274 (Bankr.D.Kan. 2007). See
24 also In re Shat, 424 B.R. 854, 862 (Bankr.D.Nev. 2010).

25 This Court disagrees with the foregoing and holds that the
26 most reasonable interpretation is the one referred to as
"narrow." The Court in Gbadebo explained:

27 If the Court were writing on a clean slate, it would
28 view the language of § 1129(b)(2)(B)(ii) as
29 unambiguous. The Court would read the phrase "included
30 in the estate under section 1115" to be reasonably
31 susceptible to only one meaning: i.e., added to the
32 bankruptcy estate by § 1115.

33 431 B.R. at 229. The Court parts company with Gbadebo
34 in that this Court finds it is writing on a clean slate. The
35 Court appreciates the analysis of the prior courts. However,
36 none of them are binding on this Court. Without binding

1 precedent, the Court's first step in statutory analysis is to
2 review the statutory scheme and determine if there is a clear
3 unambiguous answer. "[A]s long as the statutory scheme is
4 coherent and consistent, there generally is no need for a court
5 to inquire beyond the plain language of the statute." United
6 States v. Ron-Pair Enterprises, Inc., 489 U.S. 235, 241, 109
7 S.Ct. 1026, 1030, 103 L.Ed.2d 290 (1989). When statutory
8 language is plain, "the sole function of the courts is to enforce
9 it according to its terms." Id.

10 The Court finds that there is a plain, unambiguous reading
11 of the statutes. Section 1129(b)(2)(B)(ii) limits the
12 application of the absolute priority rule by allowing an
13 individual to retain only the "property included in the estate
14 under § 1115." The property included under § 1115 is property
15 "the debtor acquires after the commencement of the case..."

16 The effect of the new provision in § 1129(b)(2)(B)(ii) is
17 not to abrogate the absolute priority rule, but to make it the
18 same for individual and non-individual Chapter 11 debtors, as it
19 was prior to BAPCPA. In fact, when read in conjunction with
20 newly added § 1115, the absolute priority rule with respect to
21 individuals is exactly the same as it was pre-BAPCPA. That is,
22 prior to BAPCPA, property of the estate did not include post-
23 petition acquired property and earnings for individuals and non-
24 individuals alike. Hence, post-petition acquired property and
25 earnings could be retained by a Chapter 11 debtor, individual and
26 non-individual alike, without running afoul of the absolute

1 priority rule. The addition of § 1115 potentially changed that
2 by adding to the property of the estate of an individual post-
3 petition acquired property and earnings. Without a corresponding
4 change to § 1129(b)(2)(B)(ii), individual debtors could no longer
5 retain post-petition acquired property and earnings if they
6 wished to "cram down" a plan. By adding the language excepting
7 the § 1115 property from the absolute priority rule of §
8 1129(b)(2)(B)(ii), Congress merely ensured that the absolute
9 priority rule would be the same as it had been prior to BAPCPA
10 and be the same for all Chapter 11 debtors. In other words, what
11 Congress took from the individual debtor with its § 1115-hand, it
12 returned for application of the absolute priority rule with its §
13 1129(b)(2)(B)(ii)-hand.

14 To this Court that seems the most likely objective of the
15 new language in § 1129(b)(2)(B)(ii) - that it balances out the
16 effect of § 1115. To this Court, that is far more likely than
17 that Congress intended to abrogate the absolute priority rule for
18 individuals. Had that been the objective, Congress could easily
19 have added "except with respect to individuals" at the beginning
20 of § 1129(b)(2)(B)(ii), or stated that an individual could retain
21 all property. As it is, the Court finds no ambiguity in the
22 post-BAPCPA statutory scheme - the absolute priority rule with
23 respect to an individual debtor has been kept equal with that of
24 non-individuals, but not abrogated. See In re Gelin, ___ B.R.
25 ___, 2010 WL 3789100 (Bankr. M.D.FL 2010); In re Mullins, 435
26 B.R. 352, 360 (Bankr. W.D.VA 2010). In fact, as the Court reads

1 § 1115 and § 1129(b)(2)(B)(ii), the absolute priority rule has
2 not been altered at all by BAPCPA.

3 Some of the courts which viewed the BAPCPA amendments as an
4 abrogation of the absolute priority rule in individual Chapter 11
5 cases did so because they thought Congress was intending to make
6 individual Chapter 11 cases more like Chapter 13 cases, where
7 there is no absolute priority rule. What those courts overlook
8 is that if that were Congress' intent, Congress would simply have
9 amended the statutory debt ceilings for Chapter 13 cases set out
10 in 11 U.S.C. § 109(e), and either eliminate them altogether or
11 set them much higher. Congress did no such thing, instead
12 clearly intending that Chapter 11 statutory provisions would
13 continue to apply to individual Chapter 11 cases while
14 recognizing that post-petition earnings of individual Chapter 11
15 debtors should be available under § 1129(b)(2)(B), and protected,
16 as it is in Chapter 13 cases under 11 U.S.C. § 1306.

17 **CONCLUSION**

18 For the foregoing reason, the Court holds that the absolute
19 priority rule applies to individual chapter 11 debtors. A status
20 conference on San Diego County Credit Union's motion for relief
21 from stay will be held at 10:30 a.m. on January 18, 2011.

22 IT IS SO ORDERED.

23 DATED: NOV 16 2010

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25 _____
26 PETER W. BOWIE, Chief Judge
United States Bankruptcy Court