EXPANDING BANKRUPTCY PROTECTION TO THE INDIVIDUAL BUSINESSMAN: TAKING CHAPTER 12 ONE STEP FURTHER

The individual businessman involved in a substantial enterprise cannot practically reorganize under the existing Bankruptcy Code. While the Code provides both consumer debtors and large corporations with a mechanism for restructuring their debts and continuing an on-going concern, it does not address the needs of individual businessmen with large business structures. Congress recently responded to this gap in the Code by enacting a new Chapter 12 designed to provide individual farmers with the chance to reorganize. This Comment argues that Congress should expand this newly afforded protection to all individual bankrupts, including those outside of the farming industry, so that the Code will more accurately reflect the needs of today's business community.

INTRODUCTION

The Bankruptcy Code[1] provides individual businessmen with a chance to reorganize.[2] Businesses that cannot revive, or choose not to try, can liquidate under Chapter 7[3] of the Code. Otherwise, title 11

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1. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, *reprinted in* 1978 U.S. CODE & CONG. ADMIN. NEWS 5787 (enacting 11 U.S.C. § 101-151326 (1982)), *as amended by* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (codified at scattered sections of 11 U.S.C. and 28 U.S.C.) [hereinafter Bankruptcy Code or Code].

2. The Code has two primary purposes: 1) reorganization, a procedure which gives the bankrupt a chance to restructure a business' finances so that it may continue to operate, provide jobs, pay its creditors and produce a return for shareholders; and 2) liquidation, a procedure that equitably distributes the assets of the debtor among his creditors. *See* 5 W. COLLIER, COLLIER ON BANKRUPTCY §§ 1100.01, 1300.01 (15th ed. 1986); *see also* Blum, *The Law and Language of Corporate Reorganization*, 17 U. CHI. L. REV. 565 (1950).

3. 11 U.S.C. §§ 701-66 (1982 & Supp. IV 1986). Liquidation involves the collection, liquidation and distribution of the property of the debtor and culminates in the discharge of the debts of the bankrupt. 4 W. COLLIER, *supra* note 2, at § 700.01.

twice provides the debtor with the opportunity for a reorganization proceeding, under Chapters 11 and 13.[4] However, neither chapter adequately addresses the problems or financial circumstances of the individual debtor[5] operating a large business.

Chapter 11 focuses on financially debilitated corporations.[6] It is a costly[7] and time consuming process requiring compliance with a cumbersome set of statutory provisions.[8] Individual businessmen find it needlessly complex and ill-suited for their particular financial situations. The Chapter 13 proceeding is designed for the individual in need of reorganization.[9] Yet low unsecured and secured debt requirements of $100,000 and $350,000,[10] respectively, significantly restrict eligibility for protection under this chapter. Therefore, individual debtors conducting substantial business enterprises are trapped between two bankruptcy chapters that substantively ignore their unique circumstances. These debtors generally fail to qualify for Chapter 13 and cannot practically reorganize under Chapter 11 because of its corporate-oriented focus.

The effect has been devastating for the individual businessman, particularly in the farming industry.[11] Recent economic developments in the agricultural markets have compounded the problem, forcing family farmers into bankruptcy at an alarming rate. Unable to reorganize under Chapter 11 or 13, these farmers have found mandatory liquidation to be their only alternative. Congress, concerned about the farmers vanishing from America's economy, moved to deflect their ebb with the enactment of the Family Farmer Bank-

4. 11 U.S.C. §§ 1100-1330 (1982 & Supp. IV 1986). Under title 11, Chapters 1, 3, and 5 do not offer debtors substantive relief and apply regardless of the chapter under which the petitioner files. Chapters 7, 9, 11, and 13 offer substantive relief and have separate and distinct eligibility requirements. *See* R. GINSBERG, BANKRUPTCY § 1004 (1985).

5. For purposes of this Comment, "businessman," "individual debtor," or "debtor" will refer to the financial entities that represent their owners' livelihood and sole means of income; essentially this group consists of noncorporate, nonpublicly held businesses which do not qualify for Chapter 13, such as closely held businesses, partnerships and sole proprietorships.

6. LoPucki, *The Debtor in Full Control-Systems Failure Under Chapter 11 of the Bankruptcy Code*, 57 AM. BANKR. L.J. 99, 105 (1983) ("Chapter 11 tends to be more appropriate for larger businesses, because it was designed with them in mind.").

7. Both the legal and filing fees for a Chapter 11 reorganization continue to accrue throughout the petitioning period while Chapter 13 proceedings usually cost a flat rate. *See* Butenas, *Establishing Attorney's Fees Under the New Bankruptcy Code*, 37 BUS. LAW. 77 (1981).

8. 11 U.S.C. §§ 1101-74. Most notable are the absolute priority rule and adequate protection payments. *See infra* notes 54-58 and accompanying text.

9. 11 U.S.C. §§ 1301-30; *see also* 5 W. COLLIER, *supra* note 2, at § 1300.02 ("Chapter 13 is designed to facilitate adjustments of the debts of individuals with regular income through extension and composition plans funded out of future income, under the protection of the court.").

10. 11 U.S.C. § 109(e) (1982).

11. *See* Wall St. J., Nov. 9, 1984, at 1, col. 6.

ruptcy Act of 1986.[12] The law creates a new Chapter 12[13] under title 11 that specifically addresses the family farmer threatened by economic hardship. Congress designed the new chapter to keep the family farmer in business when circumstances make it a practical and realistic alternative.[14] However, other individual businessmen are equally disadvantaged by the narrow focus of the present Code. Congress needs to provide adequate bankruptcy relief for all individual businessmen, not just family farmers or other restricted classes. Instead of devising piecemeal legislation to cure the problems that haunt federal bankruptcy statutes, Congress should amend the Code to make it responsive to those business entities that need and deserve bankruptcy protection. Such an amendment remains consistent with the Code's clear policy of resuscitating viable business enterprises, rather than ending them, whenever it is practical to do so.[15] Moreover, since the amendment can be structured in a way that visits no additional hardship upon the debtor's creditors, it represents an expedient and attractive solution to the problem.

This Comment will briefly trace the development of the existing Bankruptcy Code in order to illustrate the origin and nature of the problem confronting individual businessmen. The Comment will then examine how individual debtors are treated under both Chapter 11 and Chapter 13 proceedings. Finally, it will analyze the new Chapter 12 and conclude by recommending an amendment that would expand the chapter's eligibility criterion to include all individual debtors who are not addressed by the existing Code.

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12. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, H.R. CONF. REP. NO. 958, 99th Cong., 2d Sess., 132 CONG. REC. H8986 (daily ed. Oct. 2, 1986). The statute amends title 28 of the United States Code to increase the number of bankruptcy courts and trustees. It also creates a new Chapter 12 which provides substantive bankruptcy relief for the family farmer under title 11. *See* Martin, *Bankruptcy Judges, U.S. Trustees and Family Farmer Bankruptcy Act of 1986*, 16 COLO. LAW. 221 (1987).

13. The amendment to title 11 adds the following subtitle: "Chapter 12 - Adjustment of Debts of a Family Farmer with Regular Annual Income." H.R. CONF. REP. NO. 958, 99th Cong., 2d Sess., § 1201-1231, 132 CONG. REC. H8991 (daily ed. Oct. 2, 1986).

14. *See infra* notes 92-101 and accompanying text.

15. *See In re* Chugiak Boat Works, Inc., 18 Bankr. 292 (Bankr. D. Alaska 1982) (Bankrkuptcy law's purpose is to prevent those liquidations that are avoidable); Hughes, *Wavering Between the Profit and the Loss: Operating a Business During Reorganization Under Chapter 11 of the Bankruptcy Code*, 54 AM. BANKR. L.J. 45 (1980).

THE PROBLEM IN HISTORICAL CONTEXT

Bankruptcy law first emerged as a means for creditors to foreclose upon and liquidate hopelessly indebted businesses.[16] Yet, since 1868 the thrust of bankruptcy law has gravitated toward the protection of the debtor.[17] One primary aim of the current Bankruptcy Code lies in providing a troubled business with the chance to reorganize and remain alive as a functioning entity.[18] Unfortunately, the current Code has been distilled from various provisions originating in different economic eras.[19] Consequently, the Code does not adequately reflect an understanding of the modern debtor's needs. The problem is particularly acute for individual debtors, partnerships, and small corporations. Congress chose not to provide these financial entities with a separate chapter in the current Code, intending instead to consolidate all bankruptcy petitions into either Chapter 11 or Chapter 13.[20] In short, these entities are unable to practically reorganize under the present Code because it does not address their unique financial circumstances.

Prior to the present Code's enactment in 1978, the Bankruptcy Act[21] contained two chapters which specifically applied to the reorganization of the individual debtor — Chapters XI[22] and XII.[23] The chapters recognized the special circumstances surrounding a noncorporate entity's reorganization; accordingly, they made it possi-

16. The first federal bankruptcy laws were designed to temper the harsh effects of state "grab laws" — generally considered to be the first bankruptcy laws — which condoned the use of coercion and physical force by creditors in effecting debt recovery. 5 W. COLLIER, *supra* note 2, at § 1300.01; *see also Hearings on H.R. 6434 before the Comm. on the Judiciary*, 75th Cong., 1st Sess. 9 (1937). ("Creditors would not merely destroy going-concern value, they would sometimes literally tear the assets to pieces. . . .").

17. *See* Local Loan Co. v. Hunt, 292 U.S. 234 (1934); *see also* 1 NORTON BANKR. L. & PRAC. § 1.02 (W. Norton ed. 1981).

18. Beall v. Picnckn, 150 F.2d 467 (5th Cir. 1945); *In re* Cummings, 84 F. Supp. 65 (S.D. Cal. 1949).

19. *See generally* H.R. REP. No. 595, 95th Cong., 1st Sess., ch. 5 (1977). For a discussion of the origin and meaning of the various terms of art in bankruptcy, see 5 W. COLLIER, *supra* note 2, §§ 1100.01, 1300.01.

20. H.R. REP. No. 595, 95th Cong., 1st Sess. 6 (1977).

21. Prior to the Bankruptcy Reform Act of 1978, bankruptcy law was governed by the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 [hereinafter Bankruptcy Act]. The Act was repealed by the enactment of the Code. *See supra* note 1.

22. Bankruptcy Act, ch. 541, §§ 301-399. Chapter XI provided individuals, partnerships, and small corporations with a vehicle to negotiate extension or composition plans with creditors. Although it was intended to be used primarily by the individual businessman, eligible corporations filed a majority of the petitions under this chapter. *See* 5 W. COLLIER, *supra* note 2, at § 1100.01.

23. Bankruptcy Act, ch. 541, §§ 401-526. Chapter XII was created to deal with the specific type of debtor involved in real estate during the aftermath of the Great Depression. Congress contemplated the protection of individual debtors confronted with numerous creditors of the same class possessing varying viewpoints and positions incapable of reaching an agreement. *See In re* Pine Gate Assocs., 10 C.B.C. 581 (N.D. Ga. 1976); Merrick & Bufithis, *Chapter XII - Why Is It?*, 52 AM. BANKR. L.J. 213 (1978).

ble for the debtor to remain in possession of his business during the critical rebuilding period.[24] Unfortunately, the chapters ultimately failed to provide the individual debtor with adequate bankruptcy relief, as evidenced by the enactment of the current Code.[25] However, the fact that Congress created these chapters strongly suggests its recognition that these debtors need some special form of financial protection distinct from that available to corporate entities.

Corporations filing for bankruptcy did so under Chapter X[26] of the Act. The chapter contained a series of provisions uniquely tailored to the corporate structure.[27] Most notably, a Chapter X reorganization had to be "fair and equitable" with respect to all of the creditors involved in the debted business.[28] But the Act did not define what constituted fair and equitable treatment,[29] leaving that task to the judiciary. The Supreme Court chose to apply a rigid test to determine whether or not a particular reorganization plan was fair and equitable. One aspect of the test, the absolute priority rule,[30] made

24. H.R. REP. No. 595, 95th Cong., 1st Sess. 249 (1977). In addition, the chapters offered "simplicity and flexibility" during the filing period which greatly expedited the entire process. 5 W. COLLIER, *supra* note 2, at § 1100.01.

25. The primary problem with Chapter XI was the ambiguity surrounding its eligibility requirements. Corporations looking for a uncomplicated proceeding tried to squeeze their petitions in notwithstanding the fact that a Chapter X proceeding was clearly more appropriate. An overwhelming mass of litigation concerning each petitioner's eligibility resulted. 5 W. COLLIER, *supra* note 2, at § 1100.01. The problem with Chapter XII is discussed *supra* note 23.

26. Bankruptcy Act, ch. 541, §§ 101-276.

27. The painstaking process of a Chapter X filing included compliance with a number of provisions that, taken together, were tantamount to relinquishing control of the corporate entity. As described in a Senate debate,

> Chapter X mandates that, first, an independent trustee be appointed and assume management control from the officers and directors of the corporation; second, the Securities and Exchange Commission must be afforded an opportunity to participate both as an advisor to the court and as a representative of the interests of public security holders, third the court must approve any proposed plan of reorganization, and prior to such approval, acceptances of creditors and shareholders may not be solicited; fourth, the court must apply the absolute priority rule; and fifth, the court has the power to affect and grant the debtor a discharge in respect of, all types of claims. . . .

5 W. COLLIER, *supra* note 2, at § 1100.01 (quoting floor statements of Sen. DeConcini, 124 CONG. REC. § 17,417-419 (daily ed. Oct. 6, 1978).

28. Bankruptcy Act, ch. 541, § 221(2).

29. The Act does not specifically define what constitutes fair and equitable treatment. This omission resulted in a great deal of confusion in subsequent bankruptcy proceedings. Judicial interpretation gradually gave form to this term of art. Consolidated Rock Prod. Co. v. Du Bois, 312 U.S. 510 (1941).

30. The absolute priority rule was first articulated by the Court in Northern Pac. Ry. v. Boyd, 228 U.S. 482 (1913); 3 NORTON BANKR. L. & PRAC. § 63.21 (W. Norton ed. 1981). *See infra* notes 62-66 and accompanying text.

the corporation's compliance with the Act extremely difficult[31] and effectively chilled its usefulness as a means of reorganization for the corporate debtor. The creation of the Code is testimony to the inadequacy of the Act and Chapter X.

The new Code streamlines the bankruptcy process by consolidating the previous Chapters X, XI, and XII together into the present Chapter 11.[32] Under the Code, Congress opted not to delineate between individual businessmen and corporations. Instead, both business entities are eligible for Chapter 11. In formulating the Chapter, however, Congress seems to have concentrated exclusively on the corporate entity.[33] Chapter 11 contains a modified version of the absolute priority rule and other protective measures geared toward corporate bankruptcy.[34] Meanwhile the expedient features of Chapters XII and XIII,[35] which specifically dealt with individuals, have been excluded. Congress intended to shield creditors from shareholder fraud and abuse through the inclusion of these corporate-oriented rules. However, the practical effect has been to seriously impair the individual businessman's ability to reorganize. Simply stated, since such entities cannot comply with the complicated provisions of Chapter 11 they are frequently forced to settle out of court or liquidate instead.[36]

Therefore, the present Code's failure to distinguish between individual businessmen and corporations lingers as a continuing problem for the noncorporate debtor in need of bankruptcy relief. In order to highlight the nature of the problem, an analysis of the individual's treatment under the present Code is necessary.

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31. The absolute priority rule was forged in an era when shareholder fraud posed a serious threat to creditors' interests. The rule therefore required that no shareholder could be paid anything from the assets of the debted business until all creditors were paid first. *Boyd*, 228 U.S. at 508. In addition, the corporation had to undergo several valuation proceedings and pay expensive filing fees. *See* Blum & Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 U. CHI. L. REV. 651, 658 (1974).

32. 5 W. COLLIER, *supra* note 2, at § 1100.01.

33. H.R. REP. No. 595, 95th Cong., 1st Sess. 6 (1977). ("Chapter 11, reorganization, is primarily designed for businesses, but permits individuals to use the Chapter. The procedures of Chapter 11, however, are sufficiently burdensome that their use will only make sense in the business context, and not in the [sole proprietorship] context.").

34. *See* 3 NORTON BANKR. L. & PRAC. *supra* note 30, at § 49.04.

35. Chapter XIII was designed to allow individuals with regular income (consumer debtors) to adjust their debts by making payments to their creditors over a period of time. It is expanded in Chapter 13 of the Code to allow a debtor to keep his business or job while repaying creditors. 11 U.S.C. §§ 1301-1330. *See infra* notes 91-92 and accompanying text.

36. Although the Code encourages settlement, the outcome is never equitable when it becomes mandatory for the debtor. *See* Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative*, 39 BUS. LAW. 441 (1984).

INDIVIDUAL BUSINESSMEN UNDER THE PRESENT CODE

Chapter 11

While the tenor of Chapter 11 is distinctly corporate, individual debtors are eligible for its protection under section 109.[37] Under a Chapter 11 proceeding, a debtor files a business reorganization plan with the bankruptcy court.[38] The basic goal of any plan is to make the necessary adjustments in the business operation and capital structure so that the business can continue to function.[39] A plan must meet each of eleven provisions set forth in 11 U.S.C. section 1129(a) before the court may confirm it.[40] Most notably, it must be approved by all of the debtor's impaired creditors.[41] Unanimous creditor approval of a plan will allow a court to confirm it provided the other applicable requirements are satisfied.

When one or more creditors within an accepting class[42] objects to

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37. 11 U.S.C. § 109.

38. The bankruptcy petition will trigger an "automatic stay" which restrains creditors from engaging in "any act to collect, assess, or recover a claim against the debtor which arose before the commencement of the case." The stay, in fact, prohibits the debtor from paying his creditors until the court determines otherwise. 11 U.S.C. § 362(a).

39. *Id.* § 1123. This section, "Contents of a Plan," enumerates the minimum requirements that a plan must meet before it can be considered for approval. *See also id.* § 1121(c) ("Who May File a Plan" — plan may be filed by any party in interest subject to the conditions of the Code).

40. *Id.* § 1129(a). Confirmation of a plan requires that a plan be proposed in good faith and be feasible. In addition, § 1129(a)(7) requires that a plan provide the following:

(7) With respect to each impaired class of claims or interest —
(A) each holder of a claim or interest or such class —
(i) has accepted the plan; or
(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date:. . .
(8) With respect to each class of claims or interests —
(A) such class has accepted the plan; or
(B) such class is not impaired under the plan.

Id. § 1129(a)(7).

41. At the outset of the bankruptcy proceeding creditors will be categorized as possessing claims that are either "impaired" or "unimpaired." Unimpaired creditors have been paid in full by the effective date of the plan. In fact, their claims are extinguished by the debtor's satisfaction of them. Unimpaired creditors have no voice in the subsequent proceeding and are presumed to have accepted the plan.

A claim that cannot be categorized as unimpaired will be considered "impaired." Impaired claims that have not voted for acceptance are considered dissenting and thereby evoke the fair and equitable test. *Id.* §§ 1122, 1124, 1129(a)(10).

42. Creditors will be grouped into "classes" and treated accordingly when their claims against the debtor are "substantially similar." *Id.* § 1122(a).

the reorganization plan, the plan can be "crammed down" — confirmed in spite of the creditor's objection — if the "best interest of the creditors" test is satisfied.[43] This test, set forth at section 1129(a)(7)(A), requires that the dissenting creditor receive at least as much from the plan as he would if the debtor were liquidated at that time instead of reorganized.[44] Since a debtor's plan usually provides each creditor with deferred payments totaling more than the claim would be worth in an immediate liquidation, this test rarely presents a problem.

When an entire class of creditors objects to the debtor's plan, confirmation becomes more problematic.[45] A court will issue confirmation only if the plan satisfies the strict statutory requirements for "cram down" set forth at section 1129(b).[46] The court must determine that, regarding the dissenting class,[47] the plan "does not discriminate unfairly, and is fair and equitable. . . ."[48] The Code specifies the test the court must apply in making this evaluation. It addresses each class of creditors differently, depending on the nature and priority of the claims.[49]

43. The best interest of the creditors test concerns the situations where one creditor within an accepting class objects to the plan. It must be distinguished from the fair and equitable test which applies when an entire class objects to a plan. *Id.* § 1129(a)(7)(A), (b)(2).

44. Since liquidation is the alternative to the proposed reorganization plan, creditors either will be provided for in the plan or will take what they can from the liquidation of the business. Therefore, when a creditor will receive from the plan at least as much as it would from a liquidation, the court will consider the plan to be in the creditor's best interest. The dissenting creditor will be compelled to accept the decision of the class majority. *Id.* § 1129(a)(7)(A)(ii). *See* 5 W. COLLIER, *supra* note 2, at § 1129.02(a).

45. A class can be a single creditor under § 1122. In such a case, the creditor is empowered with the rights of an entire class. In other words, one creditor's objection to a plan can require the debtor to comply with the fair and equitable test for cram down, instead of the easier best interest test generally intended to be applied when a single creditor objects to a plan. *See infra* note 46.

46. 5 W. COLLIER, *supra* note 2, at § 1129.03(3)(a). For a discussion of the general history and significance of the term "cram down," see generally Broude, *supra* note 36; Coogan, *Confirmation of a Plan Under the Bankruptcy Code*, 32 CASE W. RES. L. REV. 301 (1982); Pachulski, *The Cram Down and Valuation Under Chapter 11 of the Bankruptcy Code*, 58 N.C.L. REV. 925 (1980); Klee, *All You Ever Wanted to Know About Cram Down Under the Bankruptcy Code*, 53 AM. BANKR. L.J. 133 (1979).

47. H.R. REP. NO. 595, 95th Cong., 1st Sess. 141, n.6 (1977). A debtor facing a dissenting class of creditors must request a cram down as the court cannot consider this alternative *sua sponte*.

48. 11 U.S.C. § 1129(b)(2).

49. The fair and equitable test differs depending upon whether the claims are secured or unsecured. Secured claims are those supported by some collateral within the debtor's possession. Unsecured claims are those not related to any tangible property and are considered junior to secured claims. Unsecured claims are ranked according to § 507 and prioritizied in that order. 11 U.S.C. §§ 506-507; *see also* U.C.C. § 9-312 (1977).

Secured Creditors

With respect to a class of secured creditors, a plan is fair and equitable when it provides that each creditor (1) retains its lien on the collateral[50] and receives a note from the debtor for deferred cash payments totaling the amount of the value of the collateral which secures the claim,[51] or (2) receives the "indubitable equivalent" of his claim.[52] If the plan anticipates a sale of the collateral, the secured party's lien must attach to the proceeds of such sale.[53] In short, a debtor seeking cram down over a class of secured creditors must provide the secured creditors with an amount totaling no less than the value of their collateral.

A recent Ninth Circuit decision, *In re American Mariner Industries*[54] further complicates the confirmation of a debtor's plan. The holding in that case interprets the Code's "adequate protection"[55] language to mean that debtors must pay secured creditors interest on their collateral from the time the petition is filed until it is confirmed. Because the filing of a Chapter 11 petition triggers an automatic stay[56] which prevents the creditor from foreclosing upon the

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50. 11 U.S.C. § 1129(b)(2)(A)(i)(I); *see also* Booth, *The Cramdown on Secured Creditors: An Impetus Toward Settlement*, 60 AM. BANKR. L.J. 69 (1985).

51. 11 U.S.C. § 1129(b)(2)(A)(i)(I). Often the collateral which secures the claim has depreciated in value and is worth considerably less than the creditor's claim. In such a case, the creditor's claim will be bifurcated into a secured and unsecured interest against the debtor. For example, a debtor with property valued at $1 million securing a loan for $1.2 million must issue a valid note and property lien to the creditor for $1 million. The additional $200,000 can be pursued by the creditor as an unsecured claim.

52. *Id.* § 1129(b)(2)(A)(iii). The term "indubitable equivalent" is not statutorily defined. Judge Learned Hand first used the term in *Metropolitan Life Ins. Co. v. Murel Holding Corp.*, 75 F.2d 941 (2d Cir. 1935), where he discussed the need to ensure that creditors received "adequate protection" under the Code:

> It is plain that "adequate protection" must be completely compensatory; and that payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference, but a creditor who fears the safety of his principal will scarcely be content with that; he wishes to get his money or at least the property. We see no reason to suppose that the statute was intended to deprive him of that in the interest of junior holders, unless by a substitute of the most indubitable equivalence.

Id. at 942.

53. 11 U.S.C. § 1129(b)(2)(A)(ii).

54. 734 F.2d 426 (9th Cir. 1984). For a discussion of the problems expressed by the Eighth Circuit in deciding what is required by "adequte protection," see Note, *Lost Opportunity Cost to Undersecured Creditors: The Shifting Sands of the Eighth Circuit Position*, 13 WM. MITCHELL L. REV. 411 (1987).

55. 11 U.S.C. § 361 (1982 & Supp. IV 1986).

56. A stay automatically goes into effect when a Chapter 11 petition is filed. 11 U.S.C. § 362 (1982 & Supp. IV 1986). This section lists the actions against the debtor that are rendered illegal by the imposition of the stay. The rationale behind the stay is to

assets of the debtor, the creditor must be compensated. The court in *American Mariner* held that the impact the automatic stay has on creditors must be tempered with a provision that protects their interest. Accordingly, debtors must tender interest payments to creditors based on the value of the securing collateral.[57] Because a debtor generally needs to keep the property and equipment that secures his loans for the continued operation of the reorganized business, the debtor necessarily faces an expensive payment schedule in order to comply with the adequate protection payment requirement.[58]

UNSECURED CREDITORS — THE ABSOLUTE PRIORITY RULE

With respect to a class of unsecured creditors, the fair and equitable test requires that the plan satisfy one of two standards set forth in section 1129(b)(2)(B).[59] The first alternative, section 1129(b)(2)(B)(i), permits confirmation where each member of the dissenting class receives full payment for his or her claim.[60] Full payment converts the unsecured impaired claim into an unimpaired claim, thereby obviating the need for that class' approval.[61] Most debtors in bankruptcy are unable to employ this alternative since their inability to repay their debts in full is the very reason they need to reorganize.

The other alternative is section 1129(b)(2)(B)(ii), which codifies the absolute priority rule.[62] To satisfy this rule, no creditor junior to the dissenting class of creditors can receive anything under the plan until all senior creditors have been paid in full.[63] The court will look at the list of creditors as a ladder of prioritized claims. If any creditor on the priority ladder objects to the plan, cram down will issue only if no other creditors beneath the dissenting creditor receive anything.[64]

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give the debtor an opportunity to articulate a workable plan, and to prevent creditors from obtaining preferential treatment over one another by acting quickly.

57. 11 U.S.C. § 361.

58. Depending on the discount rate selected by the court, a debtor may face monthly payments of several thousand dollars. The strains such payments pose for a debtor struggling to regain solvency are obvious.

59. 11 U.S.C. § 1129(b)(2)(B).

60. *Id.* § 1129(b)(2)(B)(i).

61. *See supra* note 41.

62. 11 U.S.C. § 1129(b)(2)(B)(ii); *see also* 5 W. COLLIER, *supra* note 2, at § 1129.03 (3)(e).

63. The owners of a debted business, whether many shareholders or one individual, are always last on the creditor ladder. Any claim or interest that the owner asserts against the business is junior to all other creditors' claims. 11 U.S.C. § 510 (1982 & Supp. IV 1986).

64. To facilitate an understanding of the absolute priority rule, one author used the following example:

> As a model, one might think of the going concern value [the debtor's business] as sand and various creditor and ownership interests as boxes aligned

The absolute priority rule was designed to prevent shareholders and other owners of the debted business from retaining an equity interest in the reorganized business entity without first fully extinguishing the debts of the business.[65] Congress felt that debtors should not be allowed to discharge their debts at bargain rates while keeping their own interests intact.[66] In a corporate context, the rule serves its purpose. Since the owners of the bankrupt business are stockholders, a divestment of their interest is neither unexpected nor tragic given the business' insolvency. When applied to the individual debtor, however, the rule operates to make cram down virtually impossible.

The thrust of the problem lies in the businessman's need to remain on his property or involved with his business in order to implement the reoganization plan.[67] Since the business represents the individual's livelihood, his plan invariably envisions his management of the business throughout the rebuilding process. In fact, the debtor's contribution often represents an indispensable part of the plan's success. Yet the debtor's participation in the business can be perceived as a retention of an equity interest which violates the absolute priority rule.[68] In *In re East*,[69] the bankruptcy court held that even where the interest retained by the debtor had "negative value," the individual's possession of it violated the absolute priority rule.[70]

> according to their order of priority . . . . Under the fair and equitable rule a plan must provide that the going concern value, that is, the sand in our model, is poured into boxes in their order of priority and no box junior to a senior box may receive any sand unless the prior box is filled or its owner has agreed to accept less than full payment."

Carr, *When Can the Owners Participate in the Reorganized Debtor?; Cram Down as a "Shield" for Creditors*, 15 IND. L. REV. 547, 554 (1982).

65. *Boyd*, 228 U.S. at 482 (congressional concern over the potential abuse of such a provision was echoed in the Court's language: "A transfer by stockholders from themselves to themselves cannot defeat the claim of a nonassenting creditor."); *see also* 3 NORTON BANKR. L. & PRAC., *supra* note 30, at § 63.22.

66. H.R. REP. NO. 595, 95th Cong., 1st Sess. 222 (1977).

67. *See generally* Carr, *supra* note 64.

68. In some cases a plan can propose the creation of a corporation which essentially will be the same business but owned by the debtor's creditors. If the corporation hires the debtor to manage the business, then the debtor's participation would not violate the absolute priority rule. The debtor would merely be an employee of the creditors who owned the corporation. Obviously creditor approval is a prerequisite for such a situation to materalize.

69. 57 Bankr. 14 (Bankr. M.D. La. 1985).

70. *Id.* at 18. In *In re* East the debtor was forced to relinquish his business even though it was of "negative value," since his creditors objected to his reorganization plan. The court noted that the absolute priority rule does not bend when a debtor retains an interest that is not "valuable" or "substantial." Instead, the rule stipulates that "[t]he

In other words, when a creditor objects to a reorganization plan, the plan cannot be crammed down if it provides that the junior most creditor, the petitioning debtor,[71] gets an interest before all senior creditors are paid in full. Unless the creditors are paid in full, or they unanimously consent to the plan, the debtor will not be able to retain an interest in the business, even if that interest can be characterized as nothing more than continued participation in the business.

The absolute priority rule does not differentiate between a retained interest held by a corporate shareholder and a retained interest held by an individual businessman. Arguably, the rule applies equitably to the shareholder who seeks to retain cash from the publicly held business. It is generally agreed that a stockholder should not be permitted to redeem his stock for value while the bankrupt business still has outstanding claims against it. Conversely, the businessman only desires to continue working and operating his business. His retained equity interest is merely the continued operation of his business and livelihood. While the two interests are dramatically different, they are treated the same under the Code.[72] Therefore, any plan proposed by an individual which contemplates his continued involvement in the business operation cannot be crammed down.[73] The devastating consequence for the individual debtor is that one recalcitrant class of creditors can destroy an entire reorganization plan merely by objecting to it.

Recent cases have recognized the hardships the absolute priority rule poses for individual businessmen engaged in a Chapter 11 proceeding.[74] Unfortunately, the inflexible nature of the rule mandates a strict application of it in all cases. In *In re Witt*,[75] the court reluctantly forced an individual debtor to liquidate his business in spite of his ardent desire to work out a plan and a perceived ability to do so successfully. The court noted that it "does not believe the absolute priority rule is appropriate in [individual debtor's] bankruptcies and realizes that it makes [individual debtor's] reorganizations extremely difficult. Nevertheless, it is clearly the law, as the Bankruptcy Code and case law indicate, and if the law is to be changed. [sic] Congress must do so."[76]

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plan cannot be crammed down if the [debtor] receives or retains *any* property." *Id.* (emphasis added).

71. *See supra* note 63 and accompanying text.

72. 5 W. COLLIER, *supra* note 2, at § 1100.01; *see supra* note 33.

73. For an exception, *see infra* notes 77-88 and accompanying text.

74. *In re* Ahlers, 794 F.2d 388 (8th Cir. 1986); *In re* Witt, 60 Bankr. 556 (Bankr. N.D. Iowa 1986).

75. 60 Bankr. 556 (Bankr. N.D. Iowa 1986).

76. *Id.* at 560. The *Witt* court was referring to agricultural bankruptcies. However, this Comment recognizes that a sole proprietorship is nearly identical to the family farm as a business entity.

Under certain circumstances, however, courts have recognized an exception to the absolute priority rule.[77] When owners inject a "substantial" amount of new capital into the debted business, a new interest can be created.[78] The owners can retain this new equity interest in the business based on the value of their contribution even though some creditor's claims remain outstanding.[79] In *Case v. Los Angeles Lumber Products Co.*,[80] the Supreme Court set forth the conditions that allow a debtor to acquire a new equity interest based on an investment of fresh capital. Generally, the new money must be essential to the success of the enterprise, and the resulting retained interest must be "reasonably equivalent" to such contribution.[81]

In a corporate context, this exception to the absolute priority rule is practical. Shareholders of publicly held corporations rarely have all of their assets locked up in one corporation. Generating the fresh capital to validate a new interest generally does not pose an impossible burden for them, especially if they have maintained a diverse portfolio. Yet an individual businessman does not have the same access to new capital. His assets are tied up in his business, which usually represents his exclusive source of income. Thus, the financial constraints that bind the sole proprietor make his use of the "fresh capital" exception established in *Case* nearly impossible. As the court in *East* stated, "[I]t is easier in a corporate context to consider the concept of the injection of outside capital; when an individual is involved, it is difficult to imagine the source of such funds. . . ."[82] Clearly the articulation of this precedent does not make the absolute priority rule any more palpable for the individual debtor in bankruptcy.

With the exception of a recent Eighth Circuit decision, no court has approved an individual debtor's retention of any equity interest based on a new capital contribution.[83] In *In re Ahlers*,[84] the court

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77. *See, e.g., In re* Ahlers, 794 F.2d 388 (8th Cir. 1986); *In re* Potter Material Serv., Inc., 781 F.2d 99 (7th Cir. 1986); Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106 (1939).

78. *Potter*, 781 F.2d at 101.

79. *Id.*; *see also In re* Marston Enters., 13 Bankr. 514, 518 (Bankr. E.D.N.Y. 1981). ("There is no statutory prohibition against original shareholders making a substantial necessary capital contribution in consideration for which they receive shares of stock in the reorganized corporation.")

80. 308 U.S. 106 (1939).

81. *Id.* at 121-27.

82. *East*, 57 Bankr. at 19. The court rejected petitioner's argument that since individuals cannot give up their future interests in the debted business as stockholders can by cancelling their shares, the exception is effectively denied to individuals. *Id.* at 18.

83. *In re* Ahlers, 794 F.2d 388 (8th Cir. 1986).

84. *Id.*

held that an individual's plan that proposed he make a substantial contribution of time and expertise in managing his business' reorganization was sufficient to meet the standard promulgated in *Case*.[85] In *Case*, the court indicated that the value of a contribution had to be "money or money's worth."[86] The *Ahlers* court considered the debtor's labor skills and trade knowledge exercised in conjunction with the management of his farm to be intangible assets of significant and definable value. In turn, the debtors were permitted to retain an interest in the business and continue as an on-going concern based on that contribution and in spite of the fact that an objecting creditor did not receive full payment.[87]

The *Ahlers* decision seems to express a judicially perceived need to fabricate an exception to the present Code's harsh consequences. Yet, while allowing a debtor to keep his business against the demands of an intransigent and unreasonable creditor seems applaudable, it is clearly not the law. As the *Ahlers* dissent noted, "this reasoning works an expansion of the rule of absolute priority that is unprecedented, illogical, and unfair."[88] The dissent felt that the judiciary should not carve out a complicated exception to the Code in framing a remedy for the individual debtor with a reorganization plan ensnarled in the absolute priority rule. The better approach is, as this Comment argues, to amend the Bankruptcy Code so that the absolute priority rule applies only to corporate debtors.

Chapter 13

While Chapter 13 is specifically aimed at the individual debtor's financial rehabilitation,[89] it is not a comprehensive subtitle. Essentially, Chapter 13 provides individual debtors with a mechanism for refinancing their debts without completely disgorging their interests or rights in their businesses. The chapter works well for the consumer debtor for which it was designed. Small businessmen are able to keep their businesses while gradually paying off creditors. Yet the eligibility criterion for Chapter 13 is so narrow that individual debtors involved in a substantial enterprise are excluded from the chap-

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85. *Id.* at 402. ("Certainly, a farmer's efforts in operating and managing his farm is essential to any successful farm reorganization, and this yearly contribution is measurable in money or money's worth. . . . Accordingly, the farmer should be entitled to participate in the plan to the extent of this contribution. . . .").

86. *Case*, 308 U.S. at 122. This language seems to indicate an intention to leave open the possibility that something other than money would be sufficient to constitute a fresh capital contribution.

87. *Ahlers*, 794 F.2d at 404-05 (Gibson, J., dissenting).

88. *Id.* at 406.

89. 11 U.S.C. §§ 1301-1330, 109. *See* W. DRAKE & J. MORRIS, CHAPTER 13 PRACTICE AND PROCEDURE §§ 3.01-3.10 (1986); 3 NORTON BANKR. L. & PRAC., *supra* note 30, at § 68.01.

ter's coverage.[90]

Individuals operating a large enterprise need the type of protection available to Chapter 13 debtors,[91] but invariably fail to qualify because of the chapter's low debt requirement. Devoid of any other alternative for reorganizing, individual businessmen turn to Chapter 11 where they face the thorny provisions discussed above. Consequently, individual debtors are forced to settle with creditors out of court or liquidate their businesses completely.

Congress recently acknowledged the dilemma of a certain class of individual businessmen by enacting a new chapter designed to resolve the Code's inadequacies with respect to those in the farming profession. The new Chapter 12 provides the family farmer with a customized set of provisions that recognizes the unique circumstances of the individual debtor in need of bankruptcy relief.[92] Most notably, the new chapter excludes the absolute priority rule, because Congress recognized the rule to be inappropriate in bankruptcy proceedings involving a noncorporate debtor.[93]

CHAPTER 12: THE FARMERS' HYBRID

The Bankruptcy Code's narrow focus has had a catastrophic impact on the farming industry. In recent years, struggling farmers have been hit from all sides: competition from abroad, high taxes

90. In accordance with the other provisions of Chapter 13, a petitioner must file a plan that proposes to pay off creditors for the full value of their claims through deferred payments over a three-year period. Creditors receive these payments through a court-appointed trustee. At the conclusion of the three-year period, the debts are discharged. However, a Chapter 13 plan can be confirmed by the court even if it does not propose to pay all creditors the full value of their claim. In such a case, the debtor must assign all of his "disposable income" to his creditors in addition to making the scheduled payments. Disposable income is defined in § 1325(a)(2) as earnings which are not reasonably necessary for the maintenance or support of the debtor, or for "the expenditures necessary for the continuation, preservation, and operation of such business." 11 U.S.C. § 1325(a)(2); *see also* 3 NORTON BANKR. L. & PRAC., *supra* note 30, at §§ 76.01-76.17.

91. 11 U.S.C. § 109(e). To be eligible for Chapter 13 the debtor must be 1) an individual, with 2) regular income, and 3) unsecured debts totaling less than $100,00 and secured debts totaling less than $350,000. *See* Drake & Morris, *Eligibility for Relief Under Chapter 13*, 57 AM. BANKR. L. J. 195 (1983).

92. *See supra* notes 12-13.

93. H.R. CONF. REP. NO. 958, 99th Cong., 2nd Sess., 132 CONG. REC. H8999 (daily ed. Oct. 2, 1986). The chapter was designed to suit the farmer as a financial entity. The conference report noted that the new chapter was necessary because farmers ". . . have too much debt to qualify as debtors under Chapter 13 and are thus limited to relief under Chapter 11. Unfortunately, many farmers have found Chapter 11 needlessly complicated, unduly time consuming, inordinately expensive and, in many cases unworkable." *Id.*

and an ever-increasing surplus of commodities[94] have combined to financially squeeze the farmer into insolvency.[95] Yet farmers searching for a means to reorganize found no relief under the Bankruptcy Code.

The new Chapter 12 is specifically designed to resolve this problem.[96] The chapter closely follows the Chapter 13 model allowing farmers to work out a plan that pays off creditors over a three-year period.[97] The absolute priority rule and adequate protection payments that so eviscerated a farmer's ability to reorganize under Chapter 11 have been eliminated.[98] Under a Chapter 12 petition, farmers can propose a plan that involves their continued participation in the farm and seek confirmation based on a standard that is appropriate for a noncorporate debtor.[99] Approval of the plan will be issued based on the plan's feasibility rather than creditor acceptance.[100] In short, the new Chapter 12 expands bankruptcy protection to a class of businessmen whose particular problems were overlooked under the Bankruptcy Code. As noted in the conference report regarding the new chapter, "[I]t is designed to give family farmers facing bankruptcy a fighting chance to reorganize their debts and

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94. Wall St. J., Nov. 9, 1984, at 1, col. 6.

95. *See* Bland, *Insolvencies in Farming and Agribusiness*, 73 Ky. L.J. 795, 796 (1985):

> A legion of factors, many beyond the control of the farmer, have contributed to the agriculture recession which began in 1980. Those factors include liberal lending practices from 1975 through 1981, high interests rates (21% in 1980), borrowing based upon appreciated farm land values rather than upon the farmer's ability to generate sufficient income, increased competition in the world market, the grain embargo of 1980, severe drought in the crop year 1983, depressed farm commodity prices in 1984 and the dramatic increase in the cost of fuel, fertilizer, chemicals and equipment.

96. *See* Anderson, *An Analysis of Pending Bills to Provide Family Farm Debtor Relief Under the Bankruptcy Code, printed in* H.R. Conf. Rep. No. 958, 99th Cong., 2nd Sess., 132 Cong. Rec. § 15076 (daily ed. Oct. 3, 1986); Martin, *Bankruptcy Judges, U.S. Trustees and Family Farmers Bankruptcy Act of 1986*, 16 Colo. Law. 221 (1987).

97. 11 U.S.C. § 1222(c) (1982 & Supp IV 1986). Chapter 12 protection inures to any debtor that qualifies as a "family farmer." Family farmer means ". . . an individual or individual and spouse engaged in a farming operation whose aggregate debts do not exceed $1,500,000 and not less than 80 percent of whose aggregate . . . debt arises out of a farming operation. . . ." A corporation or partnership may qualify if at least 50% of the entity is owned by one family and the other requirements are satisfied. 11 U.S.C. § 201 (1986).

98. Adequate protection payments have been replaced by a "reasonable rent" payment. *See infra* notes 105-06 and accompanying text.

99. 11 U.S.C. § 1225 (1986); *compare* 11 U.S.C. § 1325 (1982 & Supp. IV 1986). Confirmation of a Chapter 12 plan is identical to the confirmation procedure for a Chapter 13 plan designed for individual debtors.

100. Once it is determined that creditors will receive, at a minimum, the amount that they would receive in a liquidation proceeding, the emphasis in the confirmation shifts to the debtor's ability to pay. Therefore, the confirmation procedure focuses on what the debtor can pay the creditor rather than how much the creditor has as an outstanding claim against the debtor.

keep their land. It offers . . . the important protection from creditors that bankruptcy provides while, at the same time, preventing abuse of the system and ensuring that farm lenders receive a fair payment."[101]

Reasonable Market Rent

One of the most burdensome requirements of Chapter 11 bankruptcy stems from the adequate protection payment that section 361 imposes on the debtor.[102] Farmers were required to make interest payments to secured creditors based on the value of the collateral which secured the loan. Theoretically, the payments shielded creditors from the "lost opportunity costs" that accrued as a result of the automatic stay.[103] Chapter 12 eliminates this requirement, substituting a new formula for protecting creditors during this critical period. Section 1205 states that adequate protection will be sufficient when a plan provides "the reasonable rent customary in the community where the property is located based on the rental value, net income, and earning capacity of the property."[104]

The "reasonable rent" requirement will make farmer reorganization much more feasible. The provision reflects Congress' belief that creditors are adequately protected when they receive fair market rental value for their property as opposed to the full amount of their original claims.[105] Clearly, the provision shifts the emphasis of the Code from a wholesale protection of creditors to a position that supports them only to the extent that they have a realistic claim for money owed. Henceforth, creditors will share the loss with the debtor when property or collateral devalues significantly due to factors beyond anyone's control.[106]

101. H.R. CONF. REP. No. 958, 99th Cong., 2nd Sess., 132 CONG. REC. H8999 (daily ed. Oct. 2, 1986).
102. 11 U.S.C. § 361.
103. *Ahlers*, 794 F.2d at 395; *see supra* notes 54-58 and accompanying text.
104. H.R. CONF. REP. No. 958, 99th Cong., 2nd Sess. § 1205, 132 CONG. REC. H8991-92 (daily ed. Oct. 2, 1986). For example, a $300,000 loan secured by land that was worth $300,000 in 1980 might now be a debt of only $200,000 due to the sharp drop in agriculture prices.
105. *Id.* 11 U.S.C. § 1205, 132 CONG. REC. H8999. ("section 1205 of the conference report makes it clear that what needs to be protected is the value of property, not the value of creditors' interest in property.").
106. Most lenders opposed Chapter 12's enactment due to its debtor-oriented provisions. Senator Peter DeConcini summarized the position of the chapter's opponents in his statements on the Senate floor:

> I am worried that the extremely debtor oriented provisions of this Chapter may force our farm lender to write off hundreds of millions of dollars of farm debt

Disposable Income

A debtor seeking confirmation of a plan under Chapter 12 follows the same procedure established for individual debtors in Chapter 13.[107] Secured creditors must approve the plan or retain the lien on their collateral.[108] Unsecured creditors must receive payments throughout the three year plan totaling no less than the value of their claim.[109] If the plan provides creditors with less than full payment, the plan can still be confirmed if the farmer agrees to allocate all of his disposable income to creditors. Thus, the disposable income alternative equips the farmer with the flexibility that the absolute priority rule of Chapter 11 effectively prohibits. Where crop prices and property values have plunged to such an extent that a farmer cannot realistically hope to pay off his creditors in full, the farmer can still keep his farm.

Notably, this arrangement does not in any way jeopardize the creditor's claim against the debtor. Essentially, the farmer will be working throughout the plan's duration for the exclusive purposes of paying back creditors and keeping the farm. He will not be able to siphon extra profits out of the farm's yield since the Code allows him to extract only those funds essential for basic maintenance.[110]

Therefore, Chapter 12 allows a farmer to stay in business in situations that would result in a liquidation under Chapter 11 with its absolute priority rule. The new chapter recognizes that a plan that provides for creditors to the greatest extent that the debtor's finan-

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> with no hope of recovering this debt when the farm crisis ends. The provision of this bill that troubles me the most is the provision that will permit a family farmer to go into bankruptcy, write down the secured debt to the current value of the land, and then begin to pay the creditor based on what amounts to a new mortgage based on the value of the farm. The thought that a person cannot pay their debt and yet retain their property [sic] and only continue payments based on the value of the property as the filing of the bankruptcy is entirely new and dangerous. Why won't every farmer with a substantially undercollateralized loan against his farm declare bankruptcy?

132 CONG. REC. § 15092 (daily ed. Oct. 3, 1986).

Other specialists have suggested that the law is actually a "legal incentive" to bankers to negotiate settlements with financially-troubled farmers. Green, *Farm Saga: Chapter 12 Tells of Hope*, L.A. Times, June 23, 1987, at 14, col. 4:

> Now lenders know that if a farmer isn't able to get a satisfactory negotiated arrangement outside of bankruptcy, the farmer can file Chapter 12 and get significant debt write down in most cases . . . that's made private lenders more willing to accept write downs outside of court. It's changed the rules of the game, and it has given farmers some clout in these negotiations.

Id., *quoting* David Aiker, University of Nebraska.

107. 132 CONG. REC. H8992 (daily ed. Oct. 2, 1986); *compare* 11 U.S.C. § 1325.

108. 132 CONG. REC. at H8992-93.

109. *Id.*

110. The farm assets essentially become a trust fund for the creditor throughout the duration of the plan. In other words, the business continues to operate so that creditors will be paid back. The incentive for the farmer is that eventually the debts will be discharged and that, once again, the farmer will be in the business.

cial circumstances permit should not be dismissed simply because a class of creditors objects.[111] Creditors will always receive no less than they would if a liquidation were forced on the debtor at that time instead;[112] given the disposable income provision, creditors often will receive more actual dollars as a result of the plan. Therefore, the farmer's reorganization does not harm or imperil a creditor's claim against the debtor to any significant extent. It is virtually risk-free.[113] In sum, the new chapter simply expands the usefulness of the Bankruptcy Code to a type of debtor in dire need of the Code's relief.[114] The Code now has an expedient chapter for corporations (Chapter 11), consumer debtors (Chapter 13), and family farmers (Chapter 12). Why, then, is the Bankruptcy Code's usefulness being denied to another equally deserving and desperate class of debtor, namely, the individual operating a large business?

A PROPOSAL FOR AN AMENDMENT TO THE CODE

That farmers serve a valuable function to society and have a strong lobby in Congress are the primary factors accounting for the creation of Chapter 12.[115] However, a multitude of individual businessmen that share the farmer's economic disposition still suffer

111. A potential problem occurs when a class objects because the debtor's plan proposes to use only their collateral in the continuation of the business. If the use of that collateral endangers its value to a significant extent, yet no other creditors' collateral would be imperiled by the plan's implementation, such creditors would appear justified in their objection. The Comment does not address that situation for two reasons: (1) it is unlikely that any business would have its fiscal organization structured in such a way that only one piece or set of collateral would be at risk of devaluation by any plan's implementation and (2) if such a situation arose, it is likely that the court would refuse to consider it based on its inability to satisfy the basic good faith requirements of title 11.

112. This provision is the same as the best interest of creditors test (*see supra* notes 43-44 and accompanying text) and the same as the confirmation standard for a Chapter 13 petition. *See supra* note 90 and accompanying text.

113. It is possible that the reorganization plan will fail, thereby making a liquidation necessary. If the debtor's assets significantly decreased in value during the attempted reorganization, then creditors will receive less for their claims than if the debtor had been forced to liquidate initially. Additionally, some creditors, for personal reasons, may prefer actual dollars immediately rather than an increased payment in the future. They find repugnant the idea that they will be "better off" in the long run because the Code precluded them from forcing foreclosure.

114. Chapter 12 includes a number of other provisions specifically geared toward the family farmer: 1) a debtor is given 90 days to file his plan as opposed to the 15 day requirement under Chapter 13; 2) a plan can be extended to five years when the situation so warrants; and 3) farmers will be able to sell property of the estate that encumbers the reorganization, and obtain post confirmation financing when they qualify. H.R. CONF. REP. No. 958, 99th Cong., 2nd Sess., 132 CONG. REC. H8999 (daily ed. Oct. 2, 1986).

115. "The justification is, we need farmers. It's all interrelated." San Diego Daily Transcript, Oct. 31, 1986, at 3A, col. 1 (quoting bankruptcy attorney Jerry Sims).

from the inequities of the present Code. Sole proprietors, partnerships, and small family-owned corporations cannot practically reorganize under Chapter 11, and fail to qualify for Chapter 13. These business entities are no less valuable to society than the family farmer. They provide jobs, services, and products to the mainstream of America. In fact, they represent the strength and vitality of American business and must be preserved whenever possible. If Congress has designed bankruptcy reorganization law to foster the growth and development of indebted business entities, as the enactment of Chapter 12 clearly indicates, then the individual businessman must be included.

As financial entities, these debtors resemble the family farmer in every capacity.[116] Their businesses are their livelihoods and sole means of support; rescuing their enterprises from liquidation means much more than merely preserving a lost investment or job. Yet, like the family farmer prior to the enactment of Chapter 12, these debtors find little protection under the current Bankruptcy Code. Instead of needed relief, these debtors are increasingly losing their businesses when a single unsecured creditor decides to force a liquidation rather than agree to a reorganization.

These debtors should have the opportunity to work out a plan that will keep them in business while paying off creditors. A creditor who refuses to compromise should not be allowed to force a business to liquidate. Congress' creation of Chapter 12 for family farmers verifies the existing Code's inadequacy in terms of providing a certain category of individual debtors with meaningful bankruptcy relief. Congress must go one step further and incorporate all individual debtors into the Code's scope of coverage.

An amendment to the Code could be approached from a variety of directions.[117] Perhaps the most expedient solution, however, lies in extending the eligibility requirements of the new Chapter 12. Since Chapter 12 is already geared toward the farmer as a sole proprietor, a few minor changes could render it an effective tool for all bankruptcies involving individual businessmen.

The primary aim of the amendment must be to eliminate the absolute priority rule in bankruptcies involving a noncorporate

116. In terms of debt structure, the farmer might be slightly more overleveraged than most sole proprietorships. Nevertheless, their financial problems and situations are nearly identical.

117. Congress could create a new chapter under title 11 that specifically addresses the nonfarmer individual debtor. Another option would be to amend Chapter 11 so that the absolute priority rule would not apply when an individual debtor was involved. Finally, Congress could stretch the eligibility limits of Chapter 13 to include these unprotected businessmen within its scope. This Comment argues that an amendment to Chapter 12 is the best solution because the other options involve shaking up preexisting statutes which are appropriate for the purpose they are intended.

debtor.[118] To a lesser extent, the importance of adequate protection payments and other corporate-oriented features of Chapter 11 should be minimized. Chapter 12 has done precisely that for the family farmer while maintaining an appropriate level of protection for the interests of creditors. Creditors are protected because any reorganization plan must provide them with, at a minimum, payments equal to that amount they would receive if the debtor were liquidated instead. Additionally, they must receive all of the business' disposable income. Finally, a trustee is appointed to oversee the implementation of the plan and guarantee its integrity.

Interestingly, such an amendment would help clarify the purpose of Chapter 11. Henceforth, only corporate petitions would arise under Chapter 11, thereby alleviating the strain bankruptcy courts now experience in resolving cases with a set of provisions that do not seem applicable. Individual businessmen would have their own chapter and not be expected to comply with a set of statutory requirements designed for publicly held corporations.

The chapter must be structured in a way that prohibits its use where the debtor is an individual with several different businesses or sources of income. Instead, its entire focus must be on the individual debtor whose business represents his life and sole means of support and who has a realistic chance of rebounding. Chapter 12 addresses that issue with respect to family farmers by requiring that the farmer to be eligible, must derive at least eighty percent of his income from the farm business.[119] The eighty percent requirement would serve the same purpose for other sole proprietors and should be applied in the same fashion regardless of the business activity involved. Assuming these debtors will make any reasonable sacrifice to remain alive as financial entities, including compliance with the disposable income requirement, the new chapter will give them a vehicle to do so. In short, the new chapter should provide individuals, motivated by the spirit and pride that operating a business engenders, with a chance to reorganize. Congress should not discriminate against nonfarmer individual businessmen; instead, Congress should provide them all with a single expanded chapter.

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118. This was Congress' principle task in drafting Chapter 12, since this rule alone accounts for most of the individual debtor's problems under Chapter 11. H.R. CONF. REP. No. 958, 99th Cong., 2nd Sess., 132 CONG. REC. H8999 (daily ed. Oct. 2, 1986).
119. *See supra* note 97.

CONCLUSION

The existing Bankruptcy Code is in need of reform. A bankruptcy proceeding should provide a debtor with a mechanism to reorganize his business if it is practical to do so. Currently, only corporations, under Chapter 11, and individuals with low debt totals, under Chapter 13, find the Code advantageous. With the new Chapter 12 in effect, family farmers are also covered. However, an entire class of individual businessmen still face a myopic Code that is intolerant of their needs or financial circumstances. The invariable result is that the debtor's reorganization is sabotaged in its infancy by an obstinate creditor.

The Code needs to be amended in order to absorb the other individual debtors in need of bankruptcy relief. The amendment should be structured in a way that provides the sole proprietor the chance to reorganize without sacrificing the Code's ability to protect creditors. Most importantly, it must operate to prevent an application of the absolute priority rule in bankruptcies involving a noncorporate debtor. The most efficacious way to accomplish this objective is through an expansion of the eligibility requirements of Chapter 12 to include all individual businessmen instead of just family farmers.

While the amended chapter should not allow every businessman to stay in business simply because he desires to do so, the Code should afford those debtors who have a practical plan and a realistic ability to pay creditors the opportunity to reorganize. Otherwise, an individual that incurs any significant debt will have virtually placed the jugular of his business within his creditors' hands. The chilling effect that such a lack of protection has on free enterprise and courageous investment cannot be understated. The individual businessman forced to reorganize under a chapter that includes an absolute priority rule and adequate protection payments will have no practical chance at cram down. Without the unanimous consent of his creditors, the debtor's plan will be dismissed and the business dissolved. The Bankruptcy Code should not remain in a state that empowers a single junior creditor to wield the sword that kills a business. Congress never intended title 11 to sanction that type of authority.

ANDREW D. SIMONS