

Individual Chapter 11 Cases: Case Closing Reconsidered

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Individuals have been filing chapter 11 petitions since the early days of the Bankruptcy Code. The U.S. Supreme Court finally resolved any question over the eligibility of individuals for chapter 11 relief in *Toibb v. Radloff*,¹ holding that even individuals who were not engaged in business could seek to confirm a plan under chapter 11. While several issues continually bubbled to the surface in reported decisions, one is left with the sense that most individual chapter 11 cases were resolved by consent according to local practice.

Amendments contained in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005² (BAPCPA) changed the treatment of individual chapter 11 cases. These changes seem to have been designed to carry the “means testing” concept from chapters 7 and 13 into chapter 11 and to respond to a perception that the “super-rich” were obtaining unfair relief under chapter 11.³ In many ways, the BAPCPA amendments appear to have been intended to make individual chapter 11 cases work like “big” chapter 13 cases. The changes have given rise to numerous thorny issues. This article will deal with only one of those issues: May an individual chapter 11 case be closed before the court has entered an order discharging the debtor?

Chapter 11 Case Closure Before BAPCPA

Chapter 11 case closure was never much of an issue before 1996. Under § 350(a) of the Bankruptcy Code and Rule 3022, courts were to close a chapter 11 case when the estate had been “fully administered.”⁴ Courts liked to close cases to clean up their dockets, but generally a chapter 11 debtor suffered no adverse consequences by keeping the case open for a while. This changed in 1996. Congress amended the statute that requires chapter 11 debtors to pay quarterly fees to the U.S. Trustee Program (USTP). While prior law terminated the quarterly fee obligation upon plan confirmation, the revised law continued the obligation “until the case is converted or dismissed, whichever occurs first.”⁵ The obligation also terminates upon the

¹ 501 U.S. 157 (1991).

² Pub. L. No. 109-8, 119 Stat. 23 (2005).

³ See Bruce A. Markell, *The Sub Rosa Subchapter: Individual Debtors in Chapter 11 After BAPCPA*, 2007 U. Ill. L. Rev. 67, 73-75 (2006).

⁴ 11 U.S.C. § 350(a); Fed. R. Bankr. P. 3022.

⁵ 28 U.S.C. § 1930(a)(6), as amended by Pub. L. No. 104-99, 110 Stat. 26, 37-38 (1996).

closing of the case. Therefore, many reorganized chapter 11 debtors sought to close their cases very quickly to minimize their quarterly fee exposure. A number of reported decisions from the ensuing years reflect efforts by reorganized debtors to close their cases “early,” before the requirements of § 350(a) and Rule 3022 were met.⁶ Case closing issues arose less frequently in the years immediately preceding the enactment of BAPCPA.

BAPCPA Changes the Rules

BAPCPA amendments returned case closing issues to the forefront in individual chapter 11 cases. Before BAPCPA, all chapter 11 debtors, including individuals, were generally discharged by the confirmation of a plan.⁷ After BAPCPA, individual chapter 11 debtors generally do not receive a discharge until they have completed all payments under the plan.⁸ This change conformed individual chapter 11 cases to chapter 13 cases, where debtors usually receive their discharge only after completion of all plan payments.⁹ The new delay in the granting of individual chapter 11 discharges quickly caused many to question whether these cases, like chapter 13 cases, could be closed only after the debtor had completed plan payments and received a discharge.¹⁰ Many individual debtors blanched at the prospect of paying quarterly fees for periods of at least five years from confirmation.¹¹ Debtors began to seek to close their cases soon after confirmation, explaining that they would reopen their cases to obtain discharges after they had completed their plan payments.

⁶ See, e.g., *In re Aquatic Development Group, Inc.*, 352 F.2d 671 (2nd Cir. 2003) (case could not be closed *nunc pro tunc* to date of substantial consummation); *In re Commonwealth Avenue Corp.*, 213 B.R. 794 (Bankr. D. Mass. 1997) (case could not be closed while appeals were pending); and *In re Jr. Food Mart of Arkansas, Inc.*, 201 B.R. 522 (Bankr. E.D. Ark. 1996) (court permitted “retroactive” closing of case even though adversary proceedings remained pending).

⁷ 11 U.S.C. § 1141(d)(1).

⁸ 11 U.S.C. § 1141(d)(5).

⁹ 11 U.S.C. § 1328(a). Chapter 13 debtors can seek a “hardship discharge” under § 1328(b). Individual chapter 11 debtors are afforded a similar right under § 1141(d)(5)(B).

¹⁰ See, e.g., Robert J. Landry III, *Individual Chapter 11 Cases After BAPCPA: Can You Still Close the Case Early*, Am. Bankr. Inst. J., August 2006, at 10.

¹¹ See 11 U.S.C. § 1129(a)(15), which on its face seems to require that, if an unsecured creditor objects to confirmation, the plan provide that the debtor devote all of the debtor’s projected disposable income to plan payments for at least five years (unless the plan provides for full payment over time).

The courts that have considered whether an individual chapter 11 debtor must receive a discharge before the case can be closed have reached a variety of results. While some courts are closing these cases, reported decisions are sparse. In *In re Ball*,¹² the court rejected the debtor's argument that he was entitled to a discharge because he had completed all payments under his plan by executing a secured promissory note in favor of his unsecured creditors. The court further concluded that the case should remain open because the debtor was not entitled to a discharge. Noting that the plan called for payments over a short time, the court left open the question whether some accommodation might be made for a debtor whose plan called for payments over a longer period.¹³

In *In re Sheridan*,¹⁴ the debtor sought an "early" discharge under 11 U.S.C. § 1141(d)(5)(A), which provides that the court may approve, "for cause," a discharge before all payments have been made. Because the court approved an early discharge, the court did not need to reach the issue of whether a case could be closed before discharge. Nevertheless, the court, in a lengthy footnote, prescribed procedures for early closing cases of where discharge will not be granted until the completion of periodic payments to creditors.¹⁵

In two recently reported decisions, the courts considered this issue very carefully – and disagreed. The court in *In re Johnson*¹⁶ focused on 11 U.S.C. § 350(a)¹⁷ and Bankruptcy Rule 3022¹⁸ in holding that an estate can be considered fully administered even if a discharge has not yet been granted. Two factors influenced the court's analysis. First, because the debtor's plan was a "pot plan," payment of the quarterly fee over the life of the plan would have a material impact on the return to unsecured creditors.¹⁹ Second, a debtor might be saddled with quarterly fees for many years because of the possibly open-ended nature of individual chapter 11 cases.²⁰

¹² No. 06-1002, 2008 WL 2223865 (Bankr. N.D. W. Va., May 23, 2008).

¹³ *Id.* at *4.

¹⁴ 391 B.R. 287 (Bankr. E.D.N.C. 2008).

¹⁵ *Id.* at 290, n.2. See also Hon. A. Thomas Small, *Memorandum: Discharge Procedure in Chapter 11 Cases Involving Debtors Who are Individuals* (December 12, 2007), <http://www.nceb.uscourts.gov/documents/Chapter%2011%20Individual.pdf>

¹⁶ 402 B.R. 851 (Bankr. N.D. Ind. 2009).

¹⁷ 11 U.S.C. § 350(a).

¹⁸ Fed. R. Bankr. P. 3022.

¹⁹ 402 B.R. at 857.

²⁰ 402 B.R. at 855.

By contrast, the court in *In re Belcher*²¹ rejected the *Johnson* analysis and concluded that a case cannot be closed until a discharge has been granted upon the completion of plan payments. The *Belcher* court pointed out that, pre-BAPCPA, a confirmed plan could be modified only before substantial consummation.²² Under BAPCPA, new 11 U.S.C. § 1127(c) permits many parties in interest to seek modifications to a substantially consummated confirmed plan in an individual chapter 11 case at any time before the completion of plan payments.²³ The *Belcher* court reasoned that the possibility that a party might seek such a modification prevented it from finding that the estate had been fully administered and, therefore, prevented it from allowing a pre-discharge closing of the case.²⁴

And most recently in *Shotkoski v. Fokkena (In re Shotkoski)*,²⁵ the bankruptcy appellate panel (BAP) for the Eight Circuit affirmed the bankruptcy court's order denying the individual debtors' motion for entry of a final decree. The BAP ruled that "bankruptcy courts are charged with reviewing each request for entry of a final decree on a case-by-case basis in determining whether the estate has been fully administered."²⁶ In finding that the bankruptcy court had not abused its discretion in that particular case, the BAP clarified that "we are *not* holding that every individual Chapter 11 case must remain open until such time as all long-term plan payments have been completed and a discharge is entered."²⁷

The Case for Pre-Discharge Closure

Where does this leave us? The USTP will not object to an individual chapter 11 debtor's request to close the case before discharge, subject to reopening for the entry of a discharge upon the completion of plan payments, if the estate has been fully administered and any trustee has been discharged.²⁸ The USTP's analysis begins with the language of § 350(a) of the Code: "After an estate is fully administered and the court has discharged the trustee, the court shall close the case."²⁹ Since very few chapter 11 cases have trustees,³⁰ the issue boils down to

²¹ 410 B.R. 206 (Bankr. W.D. Va. 2009).

²² 11 U.S.C. § 1127(b).

²³ 11 U.S.C. § 1127(c).

²⁴ 410 B.R. at 219.

²⁵ No. 09-6063, 2009 WL 4042665 (B.A.P 8th Cir. Nov. 24, 2009)

²⁶ *Id.* at *3.

²⁷ *Id.* at *4.

²⁸ The USTP will not be a proponent of closing cases because the decision to close better resides in the debtor, subject to objection from creditors and adjudication by the court.

²⁹ 11 U.S.C. § 350(a).

whether the estate has been fully administered. Rule 3022 states that “[a]fter an estate is fully administered in a chapter 11 reorganization case, the court, on its own motion or on motion of party in interest, shall enter a final decree closing the case.”³¹ The Advisory Committee Notes to the Rule are instructive:

Entry of a final decree closing a chapter 11 case should not be delayed solely because the payments required by the plan have not been completed. Factors that the court should consider in determining whether the estate has been fully administered include (1) whether the order confirming the plan has become final, (2) whether deposits required by the plan have been distributed, (3) whether the property proposed by the plan to be transferred has been transferred, (4) whether the debtor or the successor of the debtor under the plan has assumed the business or the management of the property dealt with by the plan, (5) whether payments under the plan have commenced, and (6) whether all motions, contested matters, and adversary proceedings have been finally resolved.

The court should not keep the case open only because of the possibility that the court’s jurisdiction may be invoked in the future. A final decree closing the case after the estate is fully administered does not deprive the court of jurisdiction to enforce or interpret its own orders and does not prevent the court from reopening the case for cause pursuant to § 350(b) of the Code.³²

Committee notes do not control over the language of a rule, and rules cannot vary the meaning of a statute. These committee notes, however, date from 1991. A lot of water has passed under the bankruptcy bridge since then, and neither Congress nor the Rules Committee has seen fit to modify § 350(a), Rule 3022, or the notes.³³

³⁰ Some might argue that because Congress intended that individual chapter 11 cases “work like” chapter 13 cases, and because chapter 13 cases remain open until discharge, individual chapter 11 cases should remain open until discharge. This line of argument fails, however, as all chapter 13 cases have trustees, and must therefore remain open until the trustee is discharged. 11 U.S.C. § 1302.

³¹ Fed. R. Bankr. P. 3022.

³² Fed. R. Bankr. P. 3022, Advisory Committee Note (1991).

³³ *But see Shotkoski*, 2009 WL 4042665, at *3 (the panel questioned “the current applicability of the Advisory Committee Note considering that it was drafted in 1991, at which time a discharge would be entered in an individual Chapter 11 case upon plan confirmation”).

An exhaustive search of reported authorities reveals no cases holding that a bankruptcy case must remain open because a debtor might receive a discharge in the future. The drafters of the committee notes advised against keeping a chapter 11 case open because the court's jurisdiction could possibly be invoked in the future. Further, a payment default will now prevent the debtor from receiving a discharge.

Opponents of an earlier closing sometimes cite the possibility that the debtor or another party in interest might seek to modify the plan post-consummation deter courts from closing cases when the estates have otherwise been fully administered. The focus of this argument is attenuated somewhat by the fact that chapter 11 cases are not kept open solely to await the expiration of the 180-day period, during which a party in interest may seek revocation of confirmation.³⁴ Chapter 7 cases are also routinely closed well before the expiration of the one-year period during which a revocation of discharge may be sought for fraud.³⁵ While debtors and others in individual chapter 11 cases have an extended right to seek modification of a confirmed plan, the prospect of attempted modifications is not so certain that courts should retain active jurisdiction over these cases. Cases may be reopened under § 350(b) of the Code if and when circumstances warrant.³⁶

What are the consequences to the debtor and to creditors of closing an individual chapter 11 case before discharge? The closing of the case terminates the automatic stay.³⁷ There is no discharge injunction, because no discharge has been entered.³⁸ Is the debtor at the creditors' mercy? No, because both are bound by the terms of the confirmed plan.³⁹ As long as the debtor complies with the confirmed plan, creditors may not undertake collection activities. The debtor could defend a creditor action on a pre-petition claim by proving the plan confirmation and demonstrating that the debtor was current on plan obligations.

³⁴ 11 U.S.C. § 1144.

³⁵ 11 U.S.C. § 727(e)(1).

³⁶ 11 U.S.C. § 350(b).

³⁷ 11 U.S.C. § 362(c)(2).

³⁸ 11 U.S.C. § 524(a).

³⁹ 11 U.S.C. § 1141(a).

What if the debtor defaults under the plan? Must a creditor seek to reopen the bankruptcy case? No. Upon a post-closing default, a creditor should be able to bring an action in any court of competent jurisdiction. The action should allege the terms of the plan, the confirmation of the plan, and the circumstances demonstrating the debtor's default. As damages for the default, the creditor should be able to recover the balance due on its undischarged claim, not just the balance due to the creditor under the plan. To limit the creditor's collection efforts to the remainder due under the plan would be to give the confirmation of the plan the same effect as a discharge under § 1141(d)(1), contrary to the express language of § 1141(d)(5).

While the U.S. Trustee will normally not object to an individual chapter 11 debtor's request to close the case before discharge once the estate has been fully administered, there are a number of other considerations:

- Disclosure statements and plans should clearly set out the debtor's intention to seek to close the case before the discharge and should specify the time when the debtor anticipates the case might be reopened for the grant of a discharge.
- Plans should subject debtors to clear, enforceable payment obligations. Creditors should not have to guess whether a debtor has defaulted under a confirmed plan.
- Cases should not be closed until the estate has been fully administered. Courts should be guided by the factors outlined in the notes to Rule 3022, including the vesting of property of the estate in the reorganized debtor or another entity under § 1141(b),⁴⁰ the commencement of plan payments, the payment of all quarterly fees, and the resolution of all pending issues before the court.
- Courts should not mechanically allow closure of a case upon substantial consummation. Substantial consummation, as defined in § 1101(2),⁴¹ is not the same thing as the full administration of the estate under § 350(a). For instance, a plan might be substantially consummated even though multiple appeals related to the case are pending and the court has not yet ruled on claims challenges. The case should not be closed until these pending matters are resolved.
- Courts should adopt and follow clear policies on whether reopening fees will be charged to creditors or others seeking to reopen a case to modify a confirmed plan, and to debtors seeking to reopen a case to obtain a discharge.

⁴⁰ 11 U.S.C. § 1141(b).

⁴¹ 11 U.S.C. § 1101(2).

- Rule 4006 requires the clerk to give notice to all parties in interest if an individual's case is closed without the entry of an order of discharge. Courts should assure that the notice given in individual chapter 11 cases accurately reflects the status of the case and does not mislead creditors into believing they may pursue immediate collection of the full amount of their allowed claims.
- Courts should adopt procedures requiring individual debtors seeking to reopen their cases to obtain a discharge to file a motion under § 350(b) with the court and serve all parties in interest. The motion should be accompanied by a detailed accounting demonstrating that the debtor has made all payments called for under the confirmed plan. Parties should have sufficient time to object to the motion, and the court should treat any objection to the motion or accounting as a contested matter under Rule 9014,⁴² with the debtor bearing the burden of establishing entitlement to a discharge.

Conclusion - Certainty Has Value

The USTP's decision not to object to an individual chapter 11 debtors' request to temporarily close the case after the estate has been fully administered comports with both the Bankruptcy Code and bankruptcy policy. Rights of debtors and other parties in interest are protected, and funds that debtors would otherwise use to pay quarterly fees become available to increase payments to creditors.

⁴² Fed. R. Bankr. P. 9014.