

Arizona Bankruptcy Essentials: Personal Bankruptcy Through Chapter 11

By Lawrence 'D' Pew, [Arizona Bankruptcy Lawyer](#)

In this article in our Arizona Bankruptcy Essentials series, I'll discuss the lynchpins of the Chapter 11 Reorganization bankruptcy. Most people don't think of Chapter 11 as a form of consumer bankruptcy. But if you happen to be an individual with substantial assets and minimal cash flow, then you may be the perfect candidate for debt relief under Chapter 11 of the U.S. Bankruptcy Code.

That's right, individual debtors and business people can seek relief under Chapter 11 along with more formal business organizations. When you're an individual debtor with significant equity in real property and minimal income, or no income, then you need to read this article and take a closer look at Chapter 11. And for those individual farmers who don't qualify for debt relief under Chapter 12's Family Farmer Reorganization, the Chapter 11 could be your bankruptcy solution.

1. Who Is Eligible for Chapter 11 Bankruptcy Protection?

The first question to ask is whether you qualify for Chapter 11 protection. The Chapter 11 is typically thought of as a commercial or business bankruptcy, but it is less exclusive than you may think. An individual proprietor, partnership, limited liability company, or corporation may file for bankruptcy under Chapter 11. As more people recognize the benefits of Chapter 11, the number of individuals filing under this chapter has steadily increased. And as with Chapters 7 and 13, husbands and wives may file jointly or separately under Chapter 11. 11 U.S.C. § 302(a).

2. What Must Be Filed in the Individual's Chapter 11?

If you are considering Chapter 11, then be prepared to file the following with your Voluntary Petition:

- *Each individual debtor must complete credit counseling within 180 days before filing. You'll file the credit counseling certificate of completion and any debt management plan developed. 11 U.S.C. §§ 109, 111.*
- *Copies of all employment payroll advices, or pay stubs, for any wages received within 60 days of filing.*
- *Schedules of assets and liabilities, current income and expenditures, executory contracts and unexpired leases.*
- *Statements of financial affairs, monthly income (net), and anticipated change in income.*
- *Report of any interest you have in a qualified education or tuition account.*
- *Proposed plan of reorganization.*
- *Disclosure statement concerning business affairs, assets and liabilities. With a small business filing, however, a separate disclosure statement won't be necessary if the plan itself makes sufficient disclosures.*

3. How Does Chapter 11 Help Individual Debtors?

Chapter 11 bankruptcies involve the submission of a reorganization plan that is designed to *rehabilitate* the debtor. Rehabilitation means the individual is given time to restructure debts. And for small businesses with debts under \$2 million, fast track proceedings are available to expedite relief for the Chapter 11 debtor.

When a debtor has plenty of equity in real property, but a poor cash flow, then the method of funding a Chapter 11 bankruptcy can really be helpful. In general, proceeds are collected from the sale of the individual debtor's real property. This gives the debtor time to sell assets and pay down debts. In fact, the payments to creditors under the reorganization plan will ordinarily come from the sale proceeds. In some instances, the debtor will not make any payments before the court confirms the repayment plan. Even mortgage payments may be delayed!

Although the process involved with a Chapter 11 is more complicated than Chapter 7 or 13, it has the unique benefit of leaving you in charge of your business operations as a debtor-in-possession. As a Chapter 11 debtor, the petitioner continues to operate the business, manage investments, protect assets, and avoid foreclosure all at the same time.

4. Who Is a Debtor in Possession?

The Chapter 11 debtor-in-possession is really unique in bankruptcy law. 11 U.S.C. § 1101. The petitioner retains possession and control over the assets in the bankruptcy estate throughout the reorganization. There is a remote possibility that a case trustee could be appointed, but that rarely occurs. Because the petitioner remains in possession and in control of business operations, there is no need for a case trustee to be appointed. Most individuals will remain in possession until one of the following two events occurs: the case is dismissed (with the debtor having been rehabilitated) or the case is converted to a Chapter 7 Liquidation bankruptcy.

5. How Does a Court-Approved Plan Help the Debtor?

This is how a Chapter 11 is implemented. The debtor-in-possession continues to run the business, keeping operations going, and paying creditors according to a court-approved repayment plan. When important business decisions need to be made that are outside the ordinary day-to-day operations of the debtor's business (for example, whether to sell real property or not), then the bankruptcy court must grant prior approval before the debtor-in-possession can go forward.

Any debts that arose prior to the court's plan confirmation will be discharged. Of course, confirmation of the plan isn't the ultimate goal – as with a Chapter 13, the individual debtor must successfully *complete* the plan before the debts are discharged.

6. What Are the Benefits of Filing Chapter 11?

If you've been in business for any length of time, then you'll really appreciate the finer points of filing for debt relief under Chapter 11. In addition to the peace of mind that comes with knowing creditors will stop harassing you and that you'll remain in control of your business, here are some of the benefits that Chapter 11 provides:

- *You get immediate relief from obligations while the business is reorganized and restructured.*
- *Payments to creditors are made under a court-approved plan.*

- *There is no limit on the debt amount that may be repaid or discharged.*
- *As debtor-in-possession, you continue day-to-day operations without court supervision.*
- *You act in place of a trustee (fiduciary) over the bankruptcy estate.*
- *You can preserve the value of your business.*
- *You can retain a substantial percentage of the business assets.*
- *Your employees may have their pay reduced to reasonable levels.*
- *Your cash flow improves, which helps you compete in your industry.*
- *Under its cram-down power, the court may approve a plan over the objections of creditors.*
- *Creditors included in the plan receive less than what is owed to them.*
- *You still have the option of converting to a Chapter 7 liquidation.*

7. Are Debtors with Single Asset Real Estate Treated Differently?

Chapter 11 has a unique provision for “single asset real estate” (SARE) debtors. In Arizona, certain property developers, home builders, commercial landlords, and residential landlords are considered SARE debtors for purposes of Chapter 11. You have single asset real estate under 11 U.S.C. § 101(51B) if the following are true in your case:

- *The real property is a single property or project.*
- *The asset is not residential real property with fewer than four residential units.*
- *The real estate generates substantially all of your gross income.*
- *You are not a family farmer.*
- *Your business is restricted to operating this single asset.*

SARE debtors can be more vulnerable in Chapter 11 because these individuals have less time to file a reasonably confirmable plan and must start making payments to creditors to stay out of default. A bankruptcy creditor of a SARE debtor can file a motion for relief from the automatic stay which, when granted, will allow the creditor to foreclose on real property. The SARE debtor needs to take action in the form of:

1. *Filing a timely and reasonably confirmable Chapter 11 plan.*
2. *Arrange to start making interest payments within 90 days of filing the petition (in an amount equal to the non-default interest rate under the contract).*
3. *Arrange to start making interest payments within 30 days of the court’s conclusion that this is an SARE debtor (in an amount equal to the non-default interest rate under the contract).*

So long as interest in an amount equal to the underlying contract's interest rate is paid, the case will go forward without a problem for the SARE debtor.

In conclusion, filing for bankruptcy protection under Chapter 11 may not be for every debtor, but it is definitely worth exploring for many individual Arizona filers. The bankruptcy filing fee associated with a Chapter 11 (\$1,046) is certainly higher than with Chapter 7 or Chapter 13. And because they tend toward greater legal and procedural complexities, Chapter 11's typically involve more in attorneys' fees, too.

If you have minimal cash flow, but substantial assets or plenty of real estate, then keep your options open and examine all bankruptcy alternatives. Definitely take the time to meet with an experienced bankruptcy attorney on the benefits and detriments of filing a Chapter 11 in your particular circumstances.

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Lawrence 'D' Pew is an experienced tax, bankruptcy, and transactional attorney, and founder of the Pew Law Center, PLLC, a leading Arizona tax and bankruptcy law firm focused exclusively on debt relief. With offices in Mesa, the law firm serves Arizona residents in the greater Phoenix area, including Scottsdale, Mesa, Tempe, Gilbert, and Chandler. As a client-oriented law firm with a mission to always exceed client expectations, the Pew Law Center has helped over 2,000 people file for bankruptcy and eliminate over \$100 Million in debt.

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