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WHETHER TO GRANT AN INDIVIDUAL CHAPTER 11 DEBTOR AN “EARLY” DISCHARGE

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ABSTRACT

This Article provides a framework for determining whether to grant an “early” discharge to an individual chapter 11 debtor. An early discharge permits such a debtor to receive a discharge before making all payments under the confirmed plan. Part I begins with a review of the legislative history of § 1141(d)(5) of the Bankruptcy Code, which sets forth the requirements for an early discharge. Part II then analyzes discharge at confirmation of the plan, including the circumstances that do, or do not, warrant issuing such an early discharge, and what information ought to be included in the disclosure statement, plan, and notice of confirmation hearing. Part III examines discharge after confirmation before completion of plan payments as well as the alternatives of case dismissal or conversion to another chapter. The Article concludes that an individual chapter 11 debtor may obtain a discharge: (1) upon confirmation of a reorganization plan where the debtor has paid specified amounts to unsecured creditors before confirmation, or where necessary to keep important customers or to obtain financing to pay unsecured creditors under the confirmed plan; or (2) after plan confirmation but before plan payments are finished if the unsecured creditors have received the required distribution and the debtor no longer has sufficient income to both meet living expenses and to make the payments required under the confirmed plan.

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INTRODUCTION

An individual debtor may file for relief under chapter 11 of the Bankruptcy Code (the “Code”). Such a debtor generally may receive a discharge of her dischargeable debts if: (1) a plan is confirmed; (2) neither the plan nor the confirmation order provides otherwise; and (3) the debtor does not waive discharge. As under chapter 13, the discharge of an individual chapter 11 debtor will ordinarily be postponed until completion of plan payments—typically years after plan confirmation. However, an individual chapter 11 debtor may seek a discharge before making all of the payments under the confirmed plan. This is an “early” discharge and may occur either at plan confirmation or some time thereafter. The requirements for such an early discharge are set forth in § 1141(d)(5) of the Code, which was added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”).

The object of this Article is to provide a framework for deciding whether to grant an early discharge to an individual chapter 11 debtor. Part I describes the legislative history of § 1141(d)(5) of the Code. Part II analyzes discharge at confirmation of the plan, including the circumstances that do, or do not, warrant issuing such an early discharge, and what information ought to be included in the disclosure statement, plan, and notice of confirmation hearing.

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2 See §§ 523(a), 1141(d). Confirmation of a chapter 11 plan does not discharge a debtor if the plan provides for liquidation of substantially all property of the estate, the debtor does not engage in business after consummation of the plan, and the debtor would be denied a discharge under § 727(a) if the case had been filed under chapter 7 of the Code. See id. § 1141(d)(3); Williams v. United States (In re Williams), 227 B.R. 589, 593 (D.R.I. 1998).


4 See 11 U.S.C. § 1141(d)(5); H.R. REP. NO. 109-31, at 82 (2005), as reprinted in 2005 U.S.C.C.A.N. 88, 147; see also Torrington Livestock Cattle Co. v. Berg (In re Berg), 423 B.R. 671, 676 (B.A.P. 10th Cir. 2010) (stating that the bankruptcy court generally may not discharge an individual debtor until the debtor has completed all payments required under a confirmed plan); Shotkoski v. Fokkema (In re Shotkoski), 420 B.R. 479, 482 (B.A.P. 8th Cir. 2009) (“[Section] 1141(d)(5) provides that confirmation of the plan does not discharge an individual debtor until the court grants a discharge upon completion of all payments under the plan.”); In re Detweiler, No. 09-63377, 2012 WL 5935343, at *1 (Bankr. N.D. Ohio Nov. 27, 2012); In re Burgueno, 451 B.R. 1, n.1 (Bankr. D. Ariz. 2011).


Part III examines discharge after confirmation before completion of plan payments as well as the alternatives of case dismissal or conversion to another chapter. Part IV concludes that an individual chapter 11 debtor may obtain a discharge: (1) upon confirmation of a reorganization plan where the debtor has paid specified amounts to unsecured creditors before confirmation, or where necessary to keep important customers or to obtain financing to pay unsecured creditors under the confirmed plan; or (2) after plan confirmation but before plan payments are finished if the unsecured creditors have received the required distribution and the debtor no longer has sufficient income to both meet living expenses and to make the payments required under the confirmed plan.

I. THE LEGISLATIVE HISTORY OF CODE SECTION 1141(D)(5)

Before BAPCPA was enacted there was no separate provision stating the conditions for granting a discharge to an individual chapter 11 debtor. Also, discharge was entirely a function of confirming a plan: plan confirmation equated with discharge unless the plan or the confirmation order provided otherwise.7 The first bill that would have provided new conditions for discharging an individual chapter 11 debtor was a House bill amended by the United States Senate in 2000.8 Section 321(d) of this bill would have severed the notion of discharge from confirmation of a plan.9 It also said that, except as otherwise ordered by the court for cause shown, discharge was not effective until plan payments were completed and that after confirmation the court could grant a discharge to an individual debtor that had not completed plan payments only if unsecured creditors had already received as much as what they would have received if the debtor’s property had been liquidated in a chapter 7 case and modification of the confirmed plan was not practicable (hereinafter together “the two requirements”).10 But this bill was never enacted into law.

In 2002, another measure was introduced that included slightly different language.11 This bill indicated that confirmation of the plan would not discharge any debt provided for in the plan unless the court ordered otherwise and prohibited the court from granting a discharge after confirmation unless

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9 See id. § 321(d).
10 Id.
the two requirements above were satisfied. This measure also did not pass Congress.

During the following year, yet another bill was introduced dealing with discharge of an individual chapter 11 debtor. This bill, as amended, provided the bankruptcy court with the authority to grant a discharge after confirmation where the two requirements were satisfied. This same language was included in § 321(d) of BAPCPA that added § 1141(d) in 2005. After BAPCPA, § 1141(d)(5) provides as follows. First, confirmation of the plan is no longer the key to obtaining a discharge for an individual debtor; a discharge may be issued at confirmation only if the court orders a discharge for cause after notice and hearing. Second, if an individual debtor seeks a discharge after confirmation but before plan payments are completed, the debtor must at least satisfy the two requirements of § 1141(d)(5)(B). Third, inasmuch as § 1141(d)(5)(C) and (6) both say that the court may grant a discharge if certain conditions are met, the court has discretion whether to grant an early discharge.

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12 See id. § 321(d).
14 See id. § 321(d).
17 11 U.S.C. § 1141(d)(5) (2012). A discharge is still tied to confirmation of a chapter 11 plan for a non-individual debtor such as a corporation. See id. § 1141(d)(1), (6).
18 Section 1141(d)(5) was also amended by the Bankruptcy Technical Corrections Act of 2010. These amendments clarified that the court could only grant an early discharge, either at confirmation or before completion of plan payments, to an individual chapter 11 debtor who satisfies subparagraph (C) thereof, to wit: a discharge will be delayed unless the court determines, after notice and hearing held not more than ten days before discharge is entered, that there is no reasonable cause to believe that (1) the debtor has elected a homestead exemption that exceeds $155,675; (2) and there is a pending proceeding in which the debtor may be:

(a) convicted of a specified felony that, under the circumstances, demonstrates that the filing of the bankruptcy case was an abuse of the Bankruptcy Code; or

(b) found liable for a debt arising from:

(i) any violation of federal or state securities laws, or any regulation or order issued thereunder;

(ii) fraud, deceit or manipulation in a fiduciary capacity or in connection with purchase or sale of any registered security;

(iii) any civil remedy under 18 U.S.C. § 1964 (dealing with civil remedies under RICO); or
II. DISCHARGE AT CONFIRMATION

A. Establishing Cause to Grant a Discharge at Confirmation

This Part II will define “cause” and argue that several opinions have not utilized this definition in their determinations of cause, or have mistakenly applied the requirements for an early discharge at confirmation to cases arising postconfirmation. It will demonstrate that there is probably no federal income tax reason to discharge a debtor at confirmation, and will provide examples of cause to issue a discharge upon confirmation of the chapter 11 plan. Lastly, Part II will recommend language to be included in the disclosure statement, plan, and notice of confirmation hearing if the debtor seeks a discharge when the plan is to be confirmed.

1. “Cause” Defined

To grant an individual debtor a discharge at confirmation the court must find “cause.”19 According to leading dictionaries20 covering the year 2000 when the distinct conditions for discharging an individual chapter 11 debtor were first introduced in Congress,21 “cause” as it is used in § 1141(d)(5)(A) should be defined as “a reason for action or condition . . . ,”22 “a reason, motive, or ground for some action . . . ; esp[ecially], sufficient reason,”23 or “the reason or motive for some human action.”24 In other words, to issue a discharge at confirmation the court should find a reason to do so. Unfortunately, virtually all of the courts that have discussed early discharge at confirmation have not utilized this definition.

WEBSTER’S NEW WORLD COLLEGE DICTIONARY 223 (3d ed. 1996).
2. “Cause” Is Not a Function of the Probability that the Unsecured Creditors Will Be Paid as Provided in the Confirmed Plan

Some of the published opinions have analyzed cause in terms of the likelihood that unsecured creditors will receive the amounts promised them in the plan. One opinion said the following factors were persuasive in determining cause: (1) the likelihood the debtors will make all of their plan payments and (2) the assurance, in the form of collateral, that creditors will receive the amount they have been promised even if the plan payments are not made. This is the only reported decision that has granted a discharge at confirmation. The reliability of the debtor’s income as a construction law attorney together with the equity in property securing a junior deed of trust in favor of the class of unsecured creditors gave the court the confidence to allow a discharge upon confirmation of the plan.

A different opinion denied the request for an early discharge because the debtor failed to convince the court that he would make all future payments with a high degree of certainty. Similarly, another opinion said that in general cause must be determined based on the totality of circumstances, but “that at minimum, a debtor must show the ability to make plan payments with a ‘high degree of certainty.’” However, none of these opinions actually address the definition of cause stated above. Cause should not be a function of the probability that the debtor will be able to make plan payments after confirmation, as the court must already find that the plan is feasible before confirming the plan. Moreover, ordinarily the debtor should be required to actually begin making payments after plan confirmation before receiving a discharge. The court must instead find a reason to enter a discharge upon confirmation.

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26 Id.
28 In re Grogan, No. 11-65409, 2013 WL 4854313, at *9 (Bankr. D. Or. Sept. 10, 2013); see also In re Detweiler, No. 09-63377, 2012 WL 5935343, at *3 (Bankr. N.D. Ohio Nov. 27, 2012) (noting that the “court cannot conclude that an ability to make payments, on its own, constitutes cause for entry of an early discharge”).
3. “Cause” Is Not Determined by Substantial Consummation of a Confirmed Plan

Other courts have refused to find cause because substantial consummation was not shown. One opinion stated that “[c]ause must be determined based upon the facts and circumstances of each case,” and that substantial consummation may constitute cause.\(^{30}\) Similarly, another decision denied the debtor’s request for discharge at confirmation in part because the debtor had not substantially consummated the plan.\(^{31}\) Yet a different opinion denied an early discharge because the debtor did not show “more than just substantial consummation.”\(^{32}\) But “substantial consummation” is not present in § 1141(d);\(^{33}\) it is only mentioned in §§ 1101, 1112, and 1127.\(^{34}\) These sections, which define substantial consummation, provide that a confirmed plan for a non-individual can be modified only before substantial consummation, and state that an inability to effectuate substantial consummation of a confirmed plan is a ground to dismiss the case or convert it to chapter 7.\(^{35}\) Also, since the definition of substantial consummation requires that distributions under the plan have begun,\(^{36}\) the term does not apply before a chapter 11 plan has been confirmed. Thus, whether or not there has been substantial consummation ought not be part of a court’s determination of cause to grant an individual debtor a discharge at confirmation of the plan.\(^{37}\)

4. “Cause” Is Irrelevant to Determining Whether to Grant an Early Discharge After Plan Confirmation

Some courts have mistakenly analyzed whether an individual chapter 11 debtor showed cause after the plan was confirmed. One court noted that the debtor did not “allege[] any cause for entering a discharge despite [] failure” to

\(^{30}\) Detweiler, 2012 WL 5935343, at *5.

\(^{31}\) In re Draiman, 450 B.R. 777, 824 (Bankr. N.D. Ill. 2011).

\(^{32}\) Beyer, 433 B.R. 888.

\(^{33}\) 11 U.S.C. § 1141(d).

\(^{34}\) Id. §§ 1101, 1112, 1127.

\(^{35}\) See id. §§ 1101(2), 1112(b)(4)(M), 1127(b), (e).

\(^{36}\) Id. § 1101(2)(C).

\(^{37}\) However, whether the debtor will engage in business after “consummation” of the plan will be relevant if the plan provides for liquidation of at least substantially all estate property. If the plan so provides and the debtor will not engage in business following the plan’s consummation, the debtor must not be discharged at confirmation if the debtor would not be entitled to a discharge under chapter 7. This could occur, for example, where the debtor received a discharge in a previous chapter 7 or 11 case filed within eight years before the pending chapter 11 case was filed or if the debtor received a discharge in a chapter 12 or 13 case filed within six years before the pending chapter 11 case was filed. See id. §§ 1101(2)(C), 727(a)(8), (9).
complete plan payments. Another court denied the debtors’ motion for final decree because the debtors did not establish cause for entry of discharge before completing plan payments. A third court did not believe there was sufficient cause to enter a discharge where the plan was confirmed only six months earlier. The plan contemplated a relatively short duration based upon an orderly liquidation of assets, the sole property remaining to be sold should have been sold in the then-near future, and the only cause stated was to avoid further payments to the United States Trustee along with the burden of filing postconfirmation reports. A fourth court observed that finding cause to enter a discharge after payment of sixty payments to unsecured creditors with dischargeable claims but before completion of payments due on educational loans or the debtors’ long term mortgage obligations would be consistent with the intent of § 1141(d)(5)(A). Finally, a fifth court confirmed a debtor’s plan without a discharge, but declared that the debtor could renew his request for an early discharge based upon cause after confirmation before the completion of payments.

All of these decisions relied on subparagraph (A), instead of subparagraph (B) of § 1141(d)(5), which ought to govern discharge after confirmation, but before plan payments have been completed. The language of subparagraph (A)—which includes the cause requirement—only deals with whether confirmation works a discharge. Subparagraph (B) specifically treats the conditions under which a discharge can be granted after confirmation but before plan payments are finished. If subparagraph (A) were to apply

40 In re Ball, No. 06-1002, 2008 WL 2223865, at *4 (Bankr. N.D. W. Va. May 23, 2008); see also In re Belcher, 410 B.R. 206, 217 (Bankr. W.D. Va. 2009) (observing that Congress cannot have intended for “cause” to be relieving debtors from having to pay regular fees to the United States Trustee).
41 Belcher, 410 B.R. at 218; see also In re Brown, No. 07-00148, 2008 WL 4817505, at *1 (Bankr. D.D.C. Oct. 29, 2008) (stating that cause for ordering a discharge may exist where the debtor has not completed all future regular monthly mortgage payments).

In a case in which the debtor is an individual . . . unless after notice and a hearing the court orders otherwise for cause, confirmation of the plan does not discharge any debt provided for in the plan until the court grants a discharge on completion of all payments under the plan.

Id. (emphasis added).

44 Id. § 1141(d)(5)(B). “In a case in which the debtor is an individual . . . at any time after the confirmation of the plan, and after notice and a hearing, the court may grant a discharge to the debtor who has not completed payments under the plan . . . .” Id. (emphasis added).
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5. Exclusion of Cancellation of Indebtedness Income Is Usually Not “Cause” to Issue a Discharge at Plan Confirmation

In In re Beyer, an individual chapter 11 debtor requested the court to issue an early discharge because, if the debtor had to pay additional tax arising from cancellation of indebtedness income (“COD”), he would be unable to pay his unsecured creditors under his confirmed plan.\textsuperscript{45} The confirmed plan provided that surrender of a property by the debtor either by deed-in-lieu or voluntary foreclosure would be in full satisfaction of the particular secured claim.\textsuperscript{46} The debtor had not commenced payments\textsuperscript{47} to unsecured creditors and he did not know which properties he would retain and which he would surrender.\textsuperscript{48} The court concluded that “[f]ear of potential forgiveness of debt income alone is not sufficient cause to justify an early discharge under Section 1141(d)(5)(A).”\textsuperscript{49} But, whether the debtor obtained an early discharge, a discharge upon completion of plan payments, or no discharge at all, probably would not have mattered. One reason is that the bankruptcy exclusion for cancellation of indebtedness income from taxable income is predicated upon the cancellation of indebtedness occurring in a bankruptcy case in which the taxpayer is under the court’s jurisdiction and the cancellation of indebtedness is granted by the court or pursuant to a plan approved by the court.\textsuperscript{50} As long as the confirmed plan remains in effect and the case has not been closed, any cancellation of indebtedness income arising from surrender of property to a secured creditor in full satisfaction of such creditor’s claim pursuant to the confirmed plan should be excluded from the debtor’s taxable income.

For the same reason, a discharge granted at confirmation is not likely to trigger cancellation of indebtedness income arising from the plan’s treatment

\textsuperscript{45} 433 B.R. 884, 887 (Bankr. M.D. Fla. 2009).
\textsuperscript{46} Id. at 886, 889.
\textsuperscript{47} Failure to commence payments should result in denial of a request for an early discharge after confirmation because a debtor who has not begun payments should not be deemed to have failed to complete payments. If payments have not even begun, the debtor may not be able to show that payments have not been completed. See In re Marrero, 7 B.R. 589, 590 (Bankr. D.P.R. 1980) (construing identical language in § 1328(b) of the Code).
\textsuperscript{48} Beyer, 433 B.R. at 888.
\textsuperscript{49} Id. at 888, 889.
\textsuperscript{50} 26 U.S.C. § 108(a)(1)(A), (d)(2) (2012). While the “insolvency exclusion” might also apply on these facts, such an alternative exclusion is not available if this bankruptcy exclusion applies. Id. § 108(a)(2).
of unsecured claims. But there is a second reason why a discharge at confirmation would be unnecessary. In most instances, there will be deemed a taxable exchange of the unsecured creditors’ debt instruments for their plan treatment on the effective date of the confirmed plan. A typical chapter 11 plan proposed by an individual debtor provides for repayment of a small percentage, such as 1%, of general unsecured claims over a period of years. Under the applicable IRS regulation, a “significant modification” of a debt instrument is a taxable event, to wit: the old debt instrument is considered to be exchanged for a new debt instrument. A “modification” is generally any alteration of a legal right or obligation of the issuer or of the holder of the instrument that does not occur by operation of the terms of the instrument. Ordinarily a modification is “significant” if the legal rights or obligations that are altered and the degree to which they are altered are economically significant. For specified types of debt instruments, a change in yield is “significant” if the change exceeds the greater of 25 basis points or 5% of the original yield (the “yield test”). For example, if the debtor previously executed a qualifying debt instrument with an annual interest rate of 6% and the confirmed plan effectively reduces this to 4%, there would be a significant modification because the change of 200 basis points exceeds both 25 basis points and the product of 5% multiplied by the original yield of 6% (30 basis points).

Similarly, a modification that changes the timing of payments due under a debt instrument is “significant” if it results in a material deferral of scheduled payments. However, deferral of one or more payments within a defined “safe-harbor” period is not a material deferral where the deferred payments are unconditionally payable by the end of such period. The safe-harbor period begins on the original due date of the first postponed payment and extends

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51 A “debt instrument” is generally defined in one part of the Internal Revenue Code as “a bond, debenture, note or certificate or other evidence of indebtedness.” Id. § 1275(a)(1)(A). A Treasury Regulation promulgated under this same section of the Internal Revenue Code states that a “debt instrument” is ordinarily defined as an “instrument or contractual arrangement . . . constitut[ing] indebtedness under general principles of Federal income tax law.” Treas. Reg § 1.1275-1(d) (as amended in 2002).
53 See id. § 1.1001-3(c)(1)(I).
54 Id. § 1.1001-3(c)(2).
55 See id. § 1.1001-3(e)(1).
56 Id. § 1.1001-3(e)(2).
57 Id. § 1.1001-3(e)(3).
58 See id. § 1.1001-3(e)(3).
until the lesser of 5 years or 50% of the original term of the instrument.\textsuperscript{59} For example, assume that the debtor executes a debt instrument on April 1, 2014 with a maturity date of April 1, 2016. If the debtor’s confirmed plan extends this maturity date to April 1, 2018 there would be a significant modification because this new maturity date, while it would postpone the due date less than five years, would be more than 50% of the original term of two years. Also note that a deferral of payments that changes the yield of a fixed rate debt instrument must satisfy both the yield test and the safe-harbor period in order not to be deemed a “significant modification.”\textsuperscript{60}

If indebtedness is “significantly modified” as discussed above, the debtor is deemed to have exchanged a new debt instrument for the old debt instrument. Under Internal Revenue Code § 108(e)(10)(A), the debtor is deemed to have satisfied the old debt instrument “with an amount of money equal to the issue price of [the new debt instrument].”\textsuperscript{61} For example, if the old debt is $10,000 and the issue price of the new debt is $7,000, the difference of $3,000 is COD. This COD is excludable from income if the debtor is in a bankruptcy proceeding and the cancellation is granted by the court or pursuant to a plan approved by the court.

What, then, is the “issue price” of the new debt instrument? The Internal Revenue Code provides two sets of rules that generally apply in this situation. If the aggregate amount of payments due under the new debt instrument exceeds $250,000, the “issue price” is determined under Internal Revenue Code § 1274.\textsuperscript{62} These rules are very complex and beyond the scope of this Article. Suffice it to say that in most bankruptcy situations the issue price determined under § 1274 will be less than the amount of the old debt, resulting in the realization of COD that is then excluded from income under the bankruptcy exclusion of Internal Revenue Code § 108(a)(1)(A).\textsuperscript{63}

If the aggregate amount of payments due under a new debt instrument is $250,000 or less, the issue price of the new debt is its stated redemption price at maturity.\textsuperscript{64} Stated redemption price at maturity is defined to include all payments of both principal and interest other than interest that is

\begin{itemize}
\item \textsuperscript{59} Id.
\item \textsuperscript{60} Id. § 1.1001-3(f)(1).
\item \textsuperscript{61} 26 U.S.C. § 108(e)(10)(A) (2012).
\item \textsuperscript{62} Id. § 1274(e), (c)(3)(C).
\item \textsuperscript{63} Id. § 108(a)(1)(A).
\item \textsuperscript{64} Id. § 1273(b)(4).
\end{itemize}
unconditionally payable at least annually at a single fixed rate.\textsuperscript{65} Internal Revenue Code § 108(e)(10)(B) provides that stated redemption price at maturity is reduced by amounts treated by tax law as interest, so in effect the issue price of the new debt instrument in this situation will be limited to its principal amount.\textsuperscript{66} The upshot of all this is that if the aggregate amount of payments due under a new debt instrument is $250,000 or less, tax law will treat the old debt as having been satisfied with an amount of money equal to the principal amount of the new debt. Once again, it is likely in a bankruptcy setting that the principal amount of the new debt will be less than the amount of the old debt, so COD is realized but will be excluded from income if the bankruptcy exclusion applies.

Does the elimination of a discharge or its postponement beyond the plan’s effective date alter these results? Although the matter is not entirely free from doubt, it appears highly probable that the bankruptcy exclusion will apply to the COD realized on the plan effective date under the rules discussed above irrespective of when or whether the debtor receives a discharge from the bankruptcy court. The Internal Revenue Code uses the word “discharge” to encompass not only the discharge granted by a bankruptcy court but also a cancellation of debt by a creditor and constructive cancellations occurring under Internal Revenue Code § 108(e)(10) (as well as under other provisions in § 108). It could not plausibly be contended, for example, that COD arising under § 108(e)(10) is not eligible for exclusion under the insolvency exclusion because there is no “discharge.” In sum, the constructive cancellation of debt under § 108(e)(10) occurs pursuant to a chapter 11 plan approved by the bankruptcy court, and therefore the bankruptcy exclusion ought to apply.

A final question is whether the possibility that the debtor may never receive a bankruptcy discharge somehow affects the calculation of the issue price of the new debt as of the plan effective date. For example, if the debtor defaults under the plan and no discharge is ever granted, the debt that was believed at the time the plan was confirmed to be slated for discharge again becomes payable by the debtor. How would tax law treat this outcome?

The additional payments that will become due if no chapter 11 discharge is ever granted are best viewed for tax law purposes as contingent payments (i.e., contingent on a bankruptcy discharge not being granted). If the new debt instrument is $250,000 or less and therefore its issue price is its principal

\textsuperscript{65} Id. § 1273(a)(2); see Treas. Reg. § 1.1273-1(b), (c) (as amended in 2013).

amount (as discussed above), the contingent payment(s) that would become due if no discharge is ever granted should not be taken into account in determining the issue price of the new debt instrument. 67 If the new debt instrument is more than $250,000 and therefore its issue price is determined under Internal Revenue Code § 1274 (as discussed above), the debtor would be deemed for tax law purposes to have issued new debt instruments to his or her creditors when it becomes clear that no chapter 11 discharge will be granted. 68 Assuming this occurs in a tax year subsequent to the tax year in which the plan became effective, the tax benefit rule may apply in the debtor’s favor and conceivably could restore tax attributes lost because of the application of the bankruptcy exclusion. However, this should not affect the calculation of the issue price of the new debt instruments issued on the plan’s effective date because each tax year stands on its own. If it becomes clear in the tax year in which the effective date falls that the debtor will not be receiving a discharge, the debtor likely would be able to take this into account and report the transactions as if no COD arose.

In sum, if an individual debtor’s confirmed chapter 11 plan “significantly modifies” secured or unsecured claims, a taxable exchange would occur “pursuant to the plan” such that any resulting cancellation of indebtedness income would be exempt income regardless of whether or not the debtor then obtained a discharge under § 1141(d). 69 This means that there is likely to be no federal tax reason that would constitute cause to have an individual chapter 11 debtor’s discharge entered upon confirmation of the plan.

6. Examples of “Cause” to Discharge an Individual Debtor Upon Plan Confirmation

While establishing cause to obtain a discharge at confirmation may in most instances be difficult, cause should be shown where the entry of discharge at confirmation would enable the debtor to obtain financing necessary to make all of the payments contemplated by the plan. This was suggested in a law review article published in 1996 70 and considered by the National Bankruptcy Review

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67 Treas. Reg. § 1.1275-4(a)(2) (stating that contingent payment rules do not apply to debt instruments whose issue price is determined under Internal Revenue Code § 1273(b)(4)).
68 Id. § 1.1275-4(c)(7), Example 2 (ii).
69 If the income arising from a significant modification is not cancellation of indebtedness income, it will not be excluded by the bankruptcy exception regardless when the bankruptcy court discharges the debtor.
70 See Alan M. Ahart & Lisa Elaine Meadows, Deferring Discharge in Chapter 11, 70 AM. BANKR. L.J. 127, 155 (1996). If discharge is postponed beyond confirmation “[n]ot only would the debtor’s ability to repay new debt be impaired by the existence of the old debt, but also a new lender may not be willing to extend
Commission the following year.\textsuperscript{71} To establish this cause the debtor should provide evidence that, in the absence of such financing, the debtor would be unable to pay one or more classes of creditors the amount(s) required to confirm a chapter 11 plan. Similarly, cause could be shown by proving that the debtor’s major customer(s) have threatened to cease doing business with the debtor if the debtor’s discharge is delayed beyond confirmation of the plan.

Cause should also include situations where the plan satisfies all requirements for confirmation and the debtor has already paid specified amounts to unsecured creditors. For example, if the debtor has sold property and unsecured creditors—including priority creditors—have already received, at present value, the entire amounts that would be due them under the confirmed plan, the debtor’s discharge ought to be entered at confirmation.\textsuperscript{72} Or, if these same unsecured creditors have received at least as much as they would have received if the case had been a chapter 7 case, and the plan, as confirmed, will not provide any further distributions to these creditors, cause should be shown warranting discharge of the debtor upon confirmation of the plan.

Notwithstanding the foregoing, if the plan provides for liquidation of substantially all estate property, the debtor will not engage in business after the plan is consummated, and the debtor would be denied a discharge if the case were a chapter 7 case, § 1141(d)(3) will prevent the debtor from receiving a discharge upon confirmation of the plan.\textsuperscript{73}

\textsuperscript{71} The National Bankruptcy Review Commission considered whether discharge should be deferred in all business cases under chapter 11, but noted “that a deferred discharge might make it hard for some debtors to obtain financing during the gap between confirmation and plan consummation.” Nat’l Bankr. Review Comm’n, Final Report, Bankruptcy: The Next Twenty Years, Chapter 2: Business Bankruptcy 617 (1997), available at http://govinfo.library.unt.edu/nbrc/.

\textsuperscript{72} This would be a prepayment of all amounts due to unsecured creditors. Of course, if the debtor completes payments under the plan after confirmation and the debtor is otherwise eligible, the debtor will receive a discharge. See 11 U.S.C. § 1141(d)(2), (3), (5) (2012).

\textsuperscript{73} See id. § 1141(d)(3).
B. Preparing the Plan, Disclosure Statement, and Notice of the Confirmation Hearing Where an Early Discharge Is Sought

1. Drafting the Disclosure Statement and Plan

If any class of claims will be impaired by the plan, such a class will be entitled to vote on the plan. Except in a small business case in which the court determines that the plan itself provides adequate information, each creditor in such class must receive a disclosure statement approved by the court before the creditor votes on the plan. This disclosure statement must contain information adequate for a hypothetical member of such a class to make an informed judgment about the plan. Since the court cannot order discharge at confirmation unless cause is shown, the disclosure statement ought to describe this cause. And, since the debtor is seeking a discharge upon confirmation, the disclosure statement and plan must state the debtor will be discharged at confirmation. Also, Federal Rule of Bankruptcy Procedure 3016(c) mandates that, if the plan provides for an injunction against conduct not otherwise enjoined by the Code, the disclosure statement and plan must describe in specific and conspicuous language all acts to be enjoined and identify the entities that would be subject to the injunction.

One of the primary effects of a discharge is to enjoin creditors from collecting their prepetition claims from the debtor. Because a discharge for an individual chapter 11 debtor is ordinarily not granted at confirmation, it appears that entry of discharge at confirmation would enjoin acts not otherwise enjoined by the Code on the date the plan is confirmed. Consequently, the disclosure statement and plan ought to also specifically state in bold, italic, or underlined text how creditors’ acts will be enjoined by entry of the discharge.

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74 See id. §§ 1126(a), (f), 1129(a)(10).
75 See id. § 1125(b), (f).
76 See id. § 1125(a)(1).
77 See id. § 1141(d)(5)(A).
79 See id.
82 The following is suggested language for the plan and disclosure statement:
It is recommended that this language appear on the first page of both the disclosure statement and the plan.83

2. Drafting Notice of the Confirmation Hearing

Notice of the hearing on approval of the disclosure statement will be sent to all creditors, but only those creditors who request in writing a copy of the plan and disclosure statement will be entitled to receive these along with the notice of hearing.84 After the court approves the disclosure statement as containing adequate information, the plan (or a court-approved summary thereof), the disclosure statement, and notice of the time fixed for filing objections and of hearing on confirmation of the plan must be mailed to all creditors who hold claims that are impaired under the plan.85 A class of claims is generally impaired under a plan unless the plan “leaves unaltered the legal, equitable and contractual rights” of each claim within the class.86 Unless the plan will pay all unsecured creditors in full, including interest and all other accrued charges, by the plan’s effective date, the plan will impair the claims of unsecured creditors. Moreover, if the plan provides for the debtor’s discharge at confirmation, all classes of unsecured creditors may be impaired by this provision alone. Thus, for nearly every individual chapter 11 plan providing for discharge upon confirmation of the plan, all holders of unsecured claims are entitled to receive the disclosure statement, the plan, and notice of the hearing on confirmation of the plan.

In addition, § 1141(d)(5)(A) states that the court may order a discharge at confirmation after “notice and a hearing.”87 The phrase “after notice and a hearing” is defined in the Code to mean both notice and an opportunity for a

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A discharge will be entered when the plan is confirmed. All creditors with dischargeable claims will be enjoined from taking any action to: (1) collect, recover, or offset any dischargeable debt as a personal liability of the debtor, and [if the debtor is married and lives in a community property state] (2) collect, recover from or offset against community property of the debtor acquired postpetition on account of a community claim except a community claim that is, or would be, excepted from discharge in a case concerning the debtor’s spouse commenced on the same date the debtor’s bankruptcy case was commenced.


83 If there will be no disclosure statement separate from the plan, then this language ought to appear on the first page of the plan or combined disclosure statement and plan.


85 See id. 3017(d).


87 Id. § 1141(d)(5)(A).
hearing appropriate in the particular circumstances.\textsuperscript{88} Although this phrase does not require an actual hearing if notice is properly given and a hearing is not timely requested by a party in interest,\textsuperscript{89} as noted above, all creditors who hold impaired claims should receive notice of the confirmation hearing.\textsuperscript{90} Three cases have said that creditors must be given actual notice that a discharge prior to completion of plan payments is being requested,\textsuperscript{91} and one case has declared that the notice “must include some identification of the cause” to grant an early discharge.\textsuperscript{92} Consequently, the notice of confirmation hearing should also state that an early discharge is being sought at confirmation and the cause therefor.\textsuperscript{93} Nevertheless, the courts are split as to whether conspicuous notice in the disclosure statement and notice of a confirmation hearing will suffice.\textsuperscript{94}

III. DISCHARGE AFTER CONFIRMATION BUT BEFORE COMPLETION OF PLAN PAYMENTS

This Part III will analyze the requirements for obtaining a discharge after confirmation without completing plan payments. It will discuss the procedure to procure such a discharge, including the two requirements. It will also discuss the debtor’s options if the debtor is unable to get a discharge without

\textsuperscript{88} Id. § 102(1)(A).
\textsuperscript{89} See id. § 102(1)(B).
\textsuperscript{90} See supra note 85 and accompanying text.
\textsuperscript{91} In re Drainman, 450 B.R. 777, 823 (Bankr. N.D. Ill. 2011); In re Kirkbride, No. 08-00120-8-JRL, 2010 WL 4809334, at *3 (Bankr. E.D.N.C. Nov. 19, 2010); In re Sheridan, 391 B.R. 287, 290 (Bankr. E.D.N.C. 2008).
\textsuperscript{92} See In re Detweiler, No. 09-63377, 2012 WL 5935343, at *3 (Bankr. N.D. Ohio Nov. 27, 2012).
\textsuperscript{93} Two decisions have said that notice of discharge at confirmation must be separate from notice of the confirmation hearing. Id. at *2; see In re Brown, No. 07-00148, 2008 WL 4817505, at *2 (Bankr. D.D.C. Oct. 29, 2008). However, if the notice of hearing clearly states that the debtor is requesting discharge upon confirmation of the plan, a separate notice to this effect should not be required.
\textsuperscript{94} See Detweiler, 2012 WL 5935343, at *3 (concluding that conspicuous notice in a disclosure statement and notice of a confirmation hearing does not satisfy the notice and hearing requirement); Brown, 2008 WL 4817505, at *1 ( intimating that a separate motion and notice of motion must be served with the proposed plan and disclosure statement); Drainman, 450 B.R. at 824 (notice and a hearing requirement was complied with where the plan specifically provided for debtor’s discharge upon the effective date, the disclosure statement stated that debtor was seeking a discharge upon confirmation and the debtor testified at the confirmation hearing that he was seeking such a discharge); Kirkbride, 2010 WL 4809334, at *3 (stating that the notice requirement was satisfied where there was a conspicuous statement in the disclosure statement and a statement of notice during the confirmation hearing); Sheridan, 391 B.R. at 290–91 (remarking that the notice requirement was fulfilled by a notice in bold and capital letters on the first page of the disclosure statement and by language in the notice of the confirmation hearing sent to all creditors).
completing payments under the confirmed plan, to wit: dismissal and re-filing
a case or conversion of the case to chapter 12, 13, or 7.

A. Giving Notice and Making a Motion

As is the case for discharge upon confirmation of a plan, a discharge
granted after confirmation to a debtor who has not completed plan payments
must be after notice and a hearing. The debtor should file and serve notice
and a motion on all creditors and the United States Trustee. The notice ought
to give these parties in interest an opportunity to object and request a hearing
or should set forth the date of any scheduled hearing. Evidence supporting the
motion must show that the plan has been confirmed, that the debtor has not
completed payments under the plan, that unsecured creditors with allowed
claims have received, at present value, at least as much as they would have
received if the debtor’s estate had been liquidated under chapter 7 and that
modification of the plan is not practicable. Unlike chapter 13, there is no
need to demonstrate that failure to complete plan payments is due to
circumstances for which the debtor should not justly be held accountable.

B. The Two Requirements

If payments under the confirmed plan have not been completed, the
debtor must prove that unsecured creditors with allowed claims have already
received at least as much as what they would have received if the debtor’s
estate had been liquidated under chapter 7. This requirement would be
satisfied, for example, if these creditors would have received nothing under
chapter 7. But if they would have received some dividend under chapter 7, they
must have received at least this much, at present value, as of the effective date

Nov. 27, 2012) (stating that if a debtor requests an early discharge after the plan is confirmed, the “debtor has
no choice but to provide separate notice and hearing for the request”).
96 Sheridan, 391 B.R. at 291 n.3.
97 See In re Necaise, 443 B.R. 483, 488 (Bankr. S.D. Miss. 2010); In re Belcher, 410 B.R. 206, 212
§ 1328(b)(1). But see In re Burgueno, 451 B.R. 1, 2 n.5 (Bankr. D. Ariz. 2011) (noting that it is unclear
whether early discharge after confirmation of a chapter 11 plan “requires a showing of cause or hardship as
does the similar provision” of chapter 13).
98 If payments have not even begun, the debtor may not be able to show that payments have not been
completed. See In re Marrero, 7 B.R. 589, 590 (Bankr. D.P.R. 1980) (construing identical language in
§ 1328(b)).
100 See 11 U.S.C. § 1141(d)(5)(B)(i); Necaise, 443 B.R. at 488 (citation omitted).
of the confirmed chapter 11 plan. A bankruptcy court found that the debtor had not satisfied this requirement where certain property under the confirmed plan remained to be distributed.101

The debtor must also show that modification of the confirmed plan under § 1127 is not practicable.102 One decision concluded that the debtor had not shown that modification was impracticable where the confirmed plan contemplated distribution of additional proceeds of sales of debtor’s properties.103 According to the legislative history of the parallel provision of chapter 13, where a natural disaster, a long-term layoff, or family illness or accidents are severe enough, modification is impracticable.104 The focus should simply be: can the plan be modified so that the debtor could continue making plan payments? If the debtor’s income is no longer adequate to pay ongoing living expenses, let alone plan payments, this requirement should be met. This could occur, for example, where the debtor dies and no longer has any income. Modification generally should be impracticable where the period for repaying unsecured creditors has expired or is about to expire. Otherwise, unlike chapter 13 where the duration of a plan generally cannot exceed five years, payments under a confirmed chapter 11 plan would not end so long as the debtor has any income above current living expenses to pay to creditors. If an individual chapter 11 debtor could be compelled to make payments against his or her will, there may be involuntary servitude barred by Amendment XIII to the United States Constitution.105 This situation would be especially detrimental for a debtor with a confirmed plan that followed filing of an involuntary chapter 11 petition against the debtor and the plan confirmed by the court was a creditor’s plan. On the other hand, if the court would confirm a modified plan pursuant to §1127 such that no further payments would be mandated—and thereby entitle the debtor to request a discharge following completion of plan payments—the court should conclude that modification is not practicable. The debtor would then be eligible to receive an early discharge that has the same scope as a discharge following completion of payments under the confirmed chapter 11 plan.

101 Necaise, 443 B.R. at 492. The debtor had already paid over $200,000 to unsecured creditors, but it appears that three assets remained to be liquidated for the benefit of unsecured creditors. Id. at 485, 492.
103 Necaise, 443 B.R. at 492.
105 U.S. CONST. amend. XIII, § 1 (”Neither slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States, or any place subject to their jurisdiction.”).
C. Dismissal of the Case

When deciding whether to grant an early discharge after confirmation, the court should keep in mind what would likely occur if the motion were denied and the debtor sought a discharge under a different chapter of the Code. Ordinarily, the court shall dismiss the case if the debtor is in material default with respect to the confirmed plan. Also, if the case is converted to chapter 7 but the debtor fails the “means test,” the case will be dismissed. Dismissal would provide no relief for the debtor, as it generally restores the debtor to the status quo ante. Consequently, to obtain a discharge after dismissal the debtor would have to commence a new bankruptcy case. Depending upon the particular chapter of the Code under which the debtor would file, all of the same considerations discussed below would be present.

D. Conversion to Chapter 12 or 13

Where the request for an early discharge following confirmation is denied, it is unlikely an individual chapter 11 debtor would seek to convert the case to chapter 12 or 13. If the debtor were eligible for relief under either chapter when the chapter 11 petition was filed, the debtor probably would have proceeded under chapter 12 or 13 in the first place. The court may, nonetheless, convert the case to chapter 12 or 13 if the debtor requests

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See infra text accompanying note 130. 


107 See infra text accompanying note 130. 

108 See 11 U.S.C. § 349(b). Dismissal will vacate certain orders and reinstate specified transfers and liens avoided or “stripped” during the case. See id. § 349(b)(1), (2). Dismissal will terminate the automatic stay. See In re Weston, 100 B.R. 452, 456–57 (E.D. Cal. 1989), aff’d, 967 F.2d 596 (9th Cir. 1985) (citing In re Nash, 765 F.2d 1410, 1412–13 (9th Cir. 1985)). If an individual chapter 11 debtor with a confirmed plan is treated in the same manner as a chapter 13 debtor, dismissal of the case would also effectively vacate the confirmed plan. In re Sanitate, 415 B.R. 98, 104 (E.D. Pa. 2009); Elliott v. ITT Corp., 150 B.R. 36, 40 (N.D. Ill. 1992). Dismissal will also terminate the separate taxable bankruptcy estate that arose when the chapter 11 case was commenced. See 26 U.S.C. § 1399(a)(1), (b)(1), (c)(1). In fact, upon dismissal the Internal Revenue Service says that “the debtor is treated as if the bankruptcy case had never been filed and as if no bankruptcy estate had been created.” I.R.S. Notice 2006-83, 2006-40 I.R.B. 596 § 2.12, 2006-2 C.B. 596. Thus, if the chapter 11 case was pending beyond one taxable year, and the bankruptcy estate had gross income and deductions in those taxable years, and the case was subsequently dismissed, then the debtor must file amended returns to report the gross income and deductions of the estate [on the debtor’s amended returns]. Furthermore, if the bankruptcy estate had filed an income tax return and paid any taxes, the debtor would be entitled to a refund of the tax paid by the estate. C. RICHARD MCQUEEN & JACK F. WILLIAMS, TAX ASPECTS OF BANKRUPTCY LAW § 13:8 (3d ed. 2013). 

109 See infra text accompanying notes 110–54.
conversion and the debtor has not been discharged in the chapter 11 case.\textsuperscript{110} If the chapter 11 case were converted to chapter 12 or 13, the debtor would have to get the plan confirmed before requesting a discharge.\textsuperscript{111} If the debtor then sought a discharge before completing plan payments under chapter 12 or 13, the debtor would not only have to satisfy the same requirements as for an early chapter 11 \textit{postconfirmation} discharge, but also would have to demonstrate that the debtor’s failure to complete plan payments was due to circumstances for which the debtor should not justly be held accountable.\textsuperscript{112}

There do not appear to be any reported cases that deal with the effect of conversion of the case to chapter 12 or 13 upon a confirmed chapter 11 plan. Section 348, which is entitled “Effect of conversion,” does not address this issue. Generally, the provisions of a confirmed chapter 11 plan bind the debtor and each creditor and, except as otherwise provided in the plan or confirmation order, the property dealt with by the plan is free and clear of all claims and interests of creditors.\textsuperscript{113} Therefore, conversion of the case to chapter 12 or 13 ordinarily would not vacate a confirmed chapter 11 plan.

Upon confirmation of the chapter 11 plan, property of the estate would have vested in the debtor unless the plan or confirmation order provided otherwise.\textsuperscript{114} In an individual chapter 11 case as well as in a chapter 12 or chapter 13 case, property of the estate would include most property acquired postpetition but before the case is closed, dismissed, or converted to chapter 7.\textsuperscript{115} Thus, if the case is converted to chapter 12 or 13 after confirmation of a chapter 11 plan, the chapter 12 or 13 estate would likely only contain this postpetition property. This would be especially true if conversion did not vacate the confirmed chapter 11 plan.

\textsuperscript{110} See 11 U.S.C. § 1112(d). To convert the case to chapter 12, the court would have to also find that such conversion is equitable. See id.

\textsuperscript{111} See id. §§ 1228(a), (b), 1328(a), (b).

\textsuperscript{112} See id. §§ 1228(b)(1), 1328(b)(1). If the debtor requested a discharge before completing payments under a confirmed chapter 13 plan, a creditor that asserts a claim for nondischargeability under § 523(a)(6) would have a second opportunity to file a complaint to except this claim from discharge. See \textit{FED. R. BANKR. P. 4007(d)}.

\textsuperscript{113} See 11 U.S.C. § 1141(a), (c). The only exceptions are for a debtor who is not entitled to a discharge at confirmation and for nondischargeable claims against the debtor. See id. § 1141(d)(2), (3).

\textsuperscript{114} Id. § 1141(b); \textit{In re K & M Printing, Inc.}, 210 B.R. 583, 584 (Bankr. D. Ariz. 1997). But see \textit{In re Smith}, 201 B.R. 267, 272–75 (D. Nev. 1996), \textit{aff’d}, 141 F.3d 1179 (9th Cir. 1998) (providing that, if plan confirmation vested all property in the debtor, “there would be no way to enforce a confirmed plan under Chapter 11”).

\textsuperscript{115} See 11 U.S.C. §§ 1115(a), 1207(a), 1306(a).
Upon conversion to chapter 12 or 13, the codebtor stay would arise. The debtor would have to attend another meeting of creditors. Parties in interest may have another opportunity to object to the debtor’s claimed exemptions. If the case were converted to chapter 12, the debtor usually would have to file a plan within ninety days. If the case were converted to chapter 13, the debtor must file a plan within fourteen days unless the court extends this period for cause shown. The debtor would ordinarily be required to complete a personal financial course to obtain a discharge in a chapter 13 case.

Conversion of the case to either chapter 12 or 13 would terminate the service of any chapter 11 trustee serving in the case and the bankruptcy estate as a separate taxable entity would end for purpose of the federal income tax. The debtor should also inform the IRS service center where any short year Form 1040 tax return was filed that the case has been converted to chapter 12 or 13.

If the case were converted to chapter 12 or 13 and the debtor were actually to receive a discharge, generally fewer types of debts would be discharged than if the debtor had obtained a chapter 11 discharge. However, the debtor in such a chapter 12 or 13 case could thereafter get a discharge in a new chapter 7

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116 See id. §§ 1201(a), 1301(a).
117 See id. §§ 341(a), 343, 348(a).
118 See Fed. R. Bankr. P. 4003(b)(1). However, it seems that a party in interest would not have another chance to ask the bankruptcy court to declare a particular debt nondischargeable under §523(a)(2) or (4); cf. In re Schupbach, 473 B.R. 423, 426–28 (D. Kan. 2012) (holding that creditor’s complaint requesting that a § 523(a)(2) debt not be discharged was not timely even though the complaint was filed within sixty days after the first date of the creditors’ meeting in a chapter 11 case that had been converted from chapter 13).
121 See 11 U.S.C. § 1328(g).
122 See id. § 343(e).
123 See 26 U.S.C. § 1398 (2012); 11 Collier on Bankruptcy ¶ 3.02[1][b] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010). It is also possible that the bankruptcy taxable estate ended when the chapter 11 plan was confirmed. See Benton v. Comm’r, 122 T.C. 353 (2004).
125 Unlike a chapter 11 debtor, a chapter 12 debtor cannot discharge specified long-term secured or unsecured debts provided for in the confirmed chapter 12 plan. Similarly, a chapter 13 debtor cannot discharge certain long-term debts whose defaults are being cured under a confirmed chapter 13 plan and certain postpetition debts. However, a chapter 13 debtor who completes payments under a confirmed chapter 13 plan can also discharge § 523(a)(7) and § 523 (a)(10)–(19) debts—none of which could be discharged by a chapter 11 debtor unless the confirmed chapter 11 plan or the order confirming the chapter 11 plan so provides. Compare 11 U.S.C. § 1141(d)(1), (5), with id. §§ 1222(b)(5), (9), 1228(a), (c), 1322(b)(5), 1325(a), (b), (c), (d). But, if the case is converted to chapter 12 or 13, an unsecured claim that arises after conversion probably will be discharged if the confirmed chapter 12 or 13 plan provides for the claim. See id. §§ 1228(a), (b), (c), 1305 (a)(2), 1328(a), (b), (c).
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case sooner than if the debtor had obtained a chapter 11 discharge and then wished to file a new chapter 7 case to procure a new discharge.126

The bottom line is that conversion to chapter 12 or 13 may not be available to the debtor, would be costly for the debtor, would create uncertainty as to whether the confirmed chapter 11 plan remains in effect and whether the individual debtor would ultimately obtain a discharge, and would only provide the debtor with a broader discharge if the debtor were able to confirm a chapter 13 plan and complete the plan payments thereunder.

E. Conversion to Chapter 7

Where the request for an early discharge after confirmation is denied, most often an individual chapter 11 debtor will want to convert the case to chapter 7. Generally, a chapter 11 debtor has a right to convert the case to chapter 7.127 But, if a chapter 11 trustee is serving in the case, the case was commenced as an involuntary case, or if the case was previously converted to chapter 11 not at the debtor’s request, cause must be shown for the court to order the case converted to chapter 7.128 Furthermore, if the debtor has acted in bad faith, the court will not convert the case to chapter 7.129 Also, if the debtor has primarily consumer debts and an annualized current monthly income higher than the median income for a household of the same size in the debtor’s home state, and the debtor is subjected to the means test in the converted chapter 7 case, the case may be dismissed if the debtor’s income, reduced by allowable expenses, would enable the debtor to pay the lesser of $12,475 or 25% of the debtor’s unsecured, nonpriority debts, but at least $7,475.130

The case law indicates that conversion of a chapter 11 case to chapter 7 after confirmation of a chapter 11 plan does not vacate the plan.131 However,

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126 If the case is converted to chapter 12 or chapter 13, the debtor could file the chapter 7 case not more than six years after the current case was filed instead of waiting the required eight years if an early discharge is granted in the pending chapter 11 case. See id. § 727(a)(8), (9).
127 See id. § 1112(a).
128 See id. § 1112(a), (b). If the debtor is a farmer, the case can be converted to chapter 7 only if the debtor requests conversion. See id. § 1112(c).
some of these decisions rely on the fact that a discharge was granted upon confirmation of the plan. With an individual chapter 11 debtor now ordinarily being discharged after confirmation as is the case for an individual chapter 13 debtor, this case law may no longer be valid precedent. Instead, the chapter 13 case law which states that conversion of a chapter 13 case postconfirmation vacates the confirmed plan should now also apply to individual chapter 11 debtors.

While the scope of a chapter 7 discharge following conversion of the case from chapter 11 is potentially broader than the scope of a chapter 11 discharge, a chapter 11 debtor who is otherwise qualified for an early chapter 11 discharge but received a discharge in a previous chapter 7, 11, 12, or 13 case may not be eligible for a chapter 7 discharge. For example, if the debtor received a discharge in a chapter 7 or 11 case filed within eight years before the current chapter 11 petition was filed, the debtor would generally be eligible for an early chapter 11 discharge but could not obtain a chapter 7 discharge if the case were converted to chapter 7. Similarly, if the debtor were discharged in a previous chapter 12 or 13 case commenced within six years before the current chapter 11 petition was filed, the debtor generally would be eligible for a chapter 11 early discharge but would only get a discharge in a case converted to chapter 7 if the debtor had paid at least a 70% dividend to unsecured creditors in the prior chapter 12 or 13 case. Moreover,


133 See Hutchinson v. Delaware Savs. Bank, FSB, 410 F. Supp. 2d 374, 380 (D.N.J. 2006); In re Okositi, 451 B.R. 90, 100 (Bankr. D. Nev. 2011); see also Harris v. Viegelahn, 135 S.Ct. 1829, 1838 (stating that a confirmed chapter 13 plan was no longer binding when the case was converted to chapter 7).

134 Compare 11 U.S.C. § 1141(d), with id. § 348(d), and id. § 727(a), (b). Except as otherwise provided in the confirmed plan or confirmation order, a chapter 11 discharge will apparently release an individual debtor from either all dischargeable preconfirmation debts or from dischargeable debts provided for in the plan. A discharge in a chapter 7 case converted from chapter 11 will release the debtor from all dischargeable debts arising before conversion—which would include even postconfirmation debts—and may release the debtor from otherwise dischargeable debts that were specified in the confirmed plan or confirmation order as nondischargeable.

135 See 11 U.S.C. §§ 348(d), 727(a)(8). However, if the confirmed chapter 11 plan provides for liquidation of at least substantially all estate property and the debtor will not engage in business after consummation of the plan, the debtor would not be eligible to receive an early discharge upon confirmation of the chapter 11 plan.

136 See id. § 727(a)(9). The debtor would also have to show that the earlier chapter 12 or 13 plan was proposed in good faith and was her best effort or simply that 100% of the allowed unsecured claims were paid. See id.
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if an individual debtor gets an (early) chapter 11 discharge, the debtor will be eligible for a discharge in a subsequent chapter 11 reorganization or chapter 12 case without any time restriction,137 or in a subsequent case filed under chapter 13 more than four years after the chapter 11 case was filed.138

Upon confirmation of a chapter 11 plan, property of the estate vests in the debtor unless the plan or confirmation order provides otherwise.139 Consequently, if the case is converted after confirmation to chapter 7, the estate will ordinarily contain no property140—except perhaps property acquired postconfirmation.141 The debtor is mandated to turnover this property of the estate and recorded information pertaining thereto to the chapter 7 trustee.142 The debtor must attend another meeting of creditors.143 The debtor ordinarily must complete a personal financial management course to obtain a discharge in

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137 See id. §§ 1141(d), 1228.
138 See id. § 1328(f).
139 Id. § 1141(b); In re K. & M Printing, Inc., 210 B.R. 583, 584 (Bankr. D. Ariz. 1997). But see In re Smith, 201 B.R. 267, 272–75 (D. Nev. 1996), aff’d, 141 F.3d 1179 (9th Cir. 1998) (providing that, if plan confirmation vested all property in the debtor, “there would be no way to enforce a confirmed plan under Chapter 11”).
140 See In re Bell, 225 F.3d 203, 216 (2d Cir. 2000); In re Sundale, Ltd., 471 B.R. 300, 306 (Bankr. S.D. Fla. 2012); Carter v. Peoples Bank & Trust Co. (In re BNW, Inc.), 201 B.R. 838, 848–49 (Bankr. S.D. Ala. 1996); In re Winom Tool & Die, Inc., 173 B.R. 613, 621 (Bankr. E.D. Mich. 1994) (citations omitted); In re TSP Indus., 117 B.R. 375, 377–78 (Bankr. N.D. Ill. 1990). But see Smith, 201 B.R. at 274 (noting that, when a chapter 11 case is converted to chapter 7 after confirmation of a plan, property of the chapter 7 estate consists only of property of the estate as of the date the case was commenced under chapter 11); Carey v. Flintridge Lumber Sales, Inc. (In re RJW Lumber Co.), 262 B.R. 91, 95 (Bankr. N.D. Cal. 2001) (stating that, “upon conversion [of a chapter 11 case postconfirmation] the chapter 7 estate consists of all remaining assets held for the benefit of creditors” including the right to recover a preference under § 547); In re Calania Corp., 188 B.R. 41, 43 (Bankr. M.D. Fla. 1995) (stating that only “properties in which the Debtor had a cognizable legal or equitable ownership interest on the date of confirmation will be properties of the estate in a Chapter 7 case”).
141 See In re Hoyle, No. 10-01484-TLM, 2013 WL 3294273, at *5–7 (Bankr. D. Idaho June 28, 2013) (earnings from personal services in accounts when case was converted from chapter 11 to chapter 7 are property of the chapter 7 estate); Pergament v. Pagano (In re Tolkin), No. 809-8311-reg., 2011 WL 1302191, at *10 (Bankr. E.D.N.Y. Apr. 5, 2011), aff’d, No. 11-CV-2630 (SJF), 2012 WL 1828854 (E.D.N.Y. May 16, 2012) (property acquired and earnings from personal services while the case was pending under chapter 11 remain property of the estate even after conversion of the case to chapter 7); Bezner v. United Jersey Bank (In re Midway, Inc.), 166 B.R. 585, 590 (Bankr. D.N.J. 1994) (stating that property of the estate in the converted case “consists of the debtor’s interests in property, including the accounts receivable [generated postconfirmation], on the date the case was converted to chapter 7”); see also 11 U.S.C. § 1115(a). But see In re Markosian, 506 B.R. 273 (B.A.P. 9th Cir. 2014) (concluding that an individual chapter 11 debtor’s postpetition earnings are excluded from property of the chapter 7 estate); In re Evans, 464 B.R. 429, 439–41 (Bankr. D. Colo. 2011); see also Calania Corp., 188 B.R. at 43 (“properties . . . clearly acquired by the Debtor post-confirmation will not be subject to administration by the Chapter 7 trustee.”).
the chapter 7 case. Unless the court orders otherwise, the debtor must file a final report and account and various schedules pertaining to postpetition debts, property, executory contracts, and unexpired leases. The debtor may also have to file any missing inventories, schedules and statements of financial affairs, and a Statement of Intention regarding secured consumer debts. Conversion to chapter 7 also terminates the service of any chapter 11 trustee serving in the case. However, a new trustee will be appointed under chapter 7 and this trustee may be the person who was serving as the chapter 11 trustee.

To the extent that nonexempt equity is created in the debtor’s real property acquired postconfirmation by virtue of the debtor’s payments on liens during the chapter 11 case, upon conversion to chapter 7 the trustee should be able to sell the property to realize this equity for the benefit of creditors. Similarly, the chapter 7 estate ought to benefit from an increase in equity in such property due to appreciation occurring after confirmation while the case was pending under chapter 11.

When a chapter 11 case is converted to chapter 7, new time periods ordinarily arise for parties in interest to file a motion to dismiss, a proof of claim, an objection to discharge, and a complaint to determine nondischargeability of a particular debt. Similarly, unless the case is converted to chapter 7 more than one year after the chapter 11 plan was first

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144 See 11 U.S.C. § 727(a)(11); Fed. R. Bankr. P. 1007(b)(7). An individual chapter 11 debtor does not have to complete such a course unless the confirmed plan provides for liquidating at least substantially all estate property, the debtor does not engage in business after consummation of the plan, and the debtor would be denied a discharge under § 727(a) if the case were a chapter 7 case. See 11 U.S.C. § 1141(d)(3); Fed. R. Bankr. P. 1007(b)(7); In re Sheridan, 391 B.R. 287, 291–92 n.5 (Bankr. E.D.N.C. 2008).

145 If a chapter 11 trustee is serving in the case, the trustee must file and transmit to the United States trustee the final report and account and must file the schedule of unpaid debts incurred postpetition but before conversion. See Fed. R. Bankr. P. 1019(5)(A).

146 See id. 1019(5)(A), (C).

147 See id. 1019(1)(A), (B).


149 Id. § 701(e). The creditors may also elect a trustee at the § 341(a) meeting of creditors. Id. § 702.

150 3 Collier on Bankruptcy, supra note 123, ¶ 348.06[1].


152 Id.; cf. In re Evenson, No. 05-37920-SVK, 2010 WL 4622188, at *4, *5 (Bankr. E.D. Wis. Nov. 3, 2010) (concluding that postpetition appreciation of debtors’ farm, which they owned when their chapter 12 case was filed and when the case was converted to chapter 7, remained property of the estate and inured to the benefit of creditors, subject to the debtors’ claimed exemption).

153 See Fed. R. Bankr. P. 1019(2)(A). New periods for these matters will not arise, however, if the case was previously converted to chapter 11 from chapter 7 and these time periods expired in the original chapter 7 case. Id.
confirmed, or unless the case was previously pending under chapter 7 and the deadline for objecting to exemptions expired therein, parties in interest will have another opportunity to object to the exemptions claimed by the debtor.154

None of these time periods would arise if the debtor simply sought an early discharge in the chapter 11 case. Consequently, a chapter 11 debtor who is denied an early discharge may be detrimentally affected even if the debtor is eligible to receive a discharge in a case converted to chapter 7. It appears there is only one situation in which a chapter 11 individual debtor with a confirmed plan would prefer to convert the case to chapter 7: where it is certain that a discharge will actually be entered following conversion of the case to chapter 7 and the debtor has postconfirmation, preconversion unsecured debts that the debtor desires to discharge.

CONCLUSION

An individual debtor who satisfies § 1141(d)(5)(C) is eligible for a chapter 11 discharge.155 An early discharge is available to such a debtor either at confirmation or thereafter before plan payments have been completed. If the debtor seeks a discharge upon confirmation, the debtor must establish cause, i.e., a reason for the court to grant a discharge earlier than normal.

The necessity of keeping important customers or obtaining financing to make payments to unsecured creditors under the confirmed plan may be cause to discharge an individual debtor at confirmation. In addition, if the debtor pays all unsecured creditors: (1) all amounts that would be due to them under the confirmed plan; or (2) at least as much as they would have received if the case had been a chapter 7 case and they would receive no further payments under the confirmed plan, a discharge may be entered upon confirmation of the plan. However, if the debtor would be denied a discharge in a chapter 7 case, the plan provides for liquidation of substantially all property of the estate, and the debtor will not engage in business after the plan is consummated, under no circumstances can the debtor receive a discharge when the plan is confirmed.

After confirmation, if the debtor has commenced making plan payments but has not completed these payments, the debtor must demonstrate that the holders of allowed unsecured claims have received, at present value, at least as much as they would have received if the debtor’s non-exempt property had

154 Id. 1019(2)(B).
155 See supra note 18.
been liquidated under chapter 7 on the effective date of the confirmed plan and that plan modification is not practicable, to wit: the debtor no longer has sufficient income to meet living expenses and to make the payments required by the confirmed plan. When deciding whether to grant the request for a discharge after confirmation before plan payments are concluded, the court should keep in mind that if the request is denied, the debtor’s means of obtaining a discharge would be to convert the case to chapter 7, 12, or 13, or to get the case dismissed and then commence a new bankruptcy case. In either event, the debtor would suffer significant additional expense, including possible payment to unsecured creditors of amounts in excess of what they would have been paid if the debtor had simply filed a chapter 7 case in the first place. An early chapter 11 discharge after confirmation will be in the debtor’s best interest unless the benefit of discharging postconfirmation debt outweighs the additional cost of conversion or of dismissal and filing of a new case under the Code.