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# Chapter 11 Bankruptcy: Is a Consumer Debtor Eligible?

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# Chapter 11 Bankruptcy: Is a Consumer Debtor Eligible?

## I. INTRODUCTION

In the 1970s, Congress revised and amended the United States bankruptcy laws resulting in the promulgation of the Bankruptcy Code of 1978.[1] Chapter 11 of the bankruptcy code, entitled "Reorganization,"[2] is widely used for the reorganization of debtor businesses unable to meet their obligations to creditors. The purpose of the chapter is to allow a struggling business to remain intact, continuing to contribute to the economy, while at the same time protecting the interests of the creditors.[3]

Although chapter 11 was intended primarily for use by businesses, some consumer debtors (individuals not engaged in business of any kind) have filed for chapter 11. The courts have split on the question of whether chapter 11 is available to consumer debtors. Some courts have found that both the statute's express language and its legislative history allow consumer debtors recourse under chapter 11.[4] Other courts have read the legislative history to require the existence of an ongoing business in order to file for chapter 11.[5]

This comment will attempt to present both the arguments for and against consumer debtor eligibility under chapter 11. The comment will focus on the language of the statute, the relevant legislative history and the recent case law regarding chapter 11, and will suggest some policy considerations. Finally, the comment concludes that the sounder position allows consumer debtors to file for chapter 11.

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1. 11 U.S.C. §§ 101-1330 (1988).

2. 11 U.S.C. §§ 1101-1174 (1988).

3. *In re* Ponn Realty Trust, 4 Bankr. 226, 230 (Bankr. D. Mass. 1980).

4. *E.g.*, *In re* Moog, 774 F.2d 1073 (11th Cir. 1985); *In re* Cook, 98 Bankr. 624 (Bankr. D. Mass. 1989); *In re* McStay, 82 Bankr. 763 (Bankr. E.D. Pa. 1988).

5. *E.g.*, Wamsganz v. Boatmen's Bank of DeSoto, 804 F.2d 503 (8th Cir. 1986); *In re* Winshall Settlor's Trust, 758 F.2d 1136 (6th Cir. 1985); *In re* Ponn Realty Trust, 4 Bankr. 226 (Bankr. D. Mass. 1980); *In re* Roland, 77 Bankr. 265 (Bankr. D. Mont. 1987).

## II. The Bankruptcy Laws

### A. *The Language of the Statute*

Any inquiry into statutory construction must begin with the express language of the relevant statute.[6] The language of the bankruptcy code gives no explicit indication of an ongoing business requirement that would prevent a consumer debtor from filing chapter 11. The language allows anyone qualifying for chapter 7 except a stockbroker or a commodity broker to be a debtor under chapter 11.[7] Chapter 7 unquestionably allows both consumer and business debtors the opportunity to file with some few exceptions.[8] If the language of chapter 11 alone is conclusive, consumer debtors are eligible for chapter 11, and the inquiry is ended.

The courts, however, may appropriately look beyond the language of the statute to the intent of the legislators in some cases. The United States Supreme Court has noted,

> Where the literal reading of a statutory term would "compel an odd result," we must search for other evidence of congressional intent to lend the term its proper scope. "The circumstances of the enactment of particular legislation," for example, "may persuade a court that Congress did not intend words of common meaning to have their literal effect. . . . Looking beyond the naked text for guidance is perfectly proper

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6. The United States Supreme Court has stated that " '[t]he starting point in every case involving construction of a statute is the language itself.' " Watt v. Alaska, 451 U.S. 259, 265 (1981) (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring)); *see also* Public Citizen v. U.S. Dep't of Justice, 109 S. Ct. 2558, 2574 (1989) (Kennedy, J., concurring) ("There is a starting point, which ought to serve also as a sufficient stopping point, for this kind of analysis: the plain language of the statute.").

7. 11 U.S.C. §109(d) (1988): "Only a person that may be a debtor under chapter 7 of this title, except a stockbroker or a commodity broker, and a railroad may be a debtor under chapter 11 of this title."

8. 11 U.S.C. § 109(b) (1988):

> (b) A person may be a debtor under chapter 7 of this title only if such person is not—
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> (1) a railroad;
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> (2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)); or
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> (3) a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, or credit union, engaged in such business in the United States.

> when the result it apparently decrees is difficult to fathom or where it seems inconsistent with Congress' intention . . . .[9]

The Court recognizes the "traditional canon of statutory construction: '[A] thing may be within the letter of the statute and yet not within the statute, because [it is] not within its spirit, nor within the intention of its makers.' "[10] In a bankruptcy context, the Court has held, "even when the plain meaning did not produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words."[11]

Many courts, apparently finding the literal language of the Bankruptcy Act which would allow consumer debtor eligibility unreasonable, have looked to the legislative history for guidance.[12] Furthermore, an understanding of the Bankruptcy Code as a whole, and not merely chapter 11, is central to determining whether chapter 11 should be available to consumer debtors.[13]

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9. Public Citizen v. United States Dep't of Justice, 109 S. Ct. 2558, 2566 (1989) (citations omitted) (quoting Watt v. Alaska, 451 U.S. 259, 266 (1981)).

10. United Hous. Found., Inc. v. Forman, 421 U.S. 837, 849 (1975) (quoting Church of the Holy Trinity v. United States, 143 U.S. 457, 459 (1892)).

11. Perry v. Commerce Loan Co., 383 U.S. 392, 400 (1966) (quoting United States v. American Trucking Ass'ns, 310 U.S. 534, 543 (1940)); *see also Public Citizen*, 109 S. Ct. at 2566 n.9 (Court expressly rejects notion that result from the literal language must be "absurd" before resorting to the legislative history.). *But see id.* at 2574 (Kennedy, J., concurring) (finding courts should "not intrude upon the lawmaking powers of Congress" by departing from the literal language unless the plain language would result in "patently absurd consequences"); *In re* Martin-Amirault, 115 Bankr. 10, 11 (Bankr. D.N.H. 1990) (faced with the issue of consumer debtor eligibility for chapter 11 bankruptcy, court found "[t]he start, and in this case the end, of our inquiry is with the statutory language").

12. One court, faced with a debtor seeking to adjust a mortgage on a single-family residence by filing chapter 11, found such a use unreasonable and felt compelled to look to the legislative history of the Bankruptcy Reform Act. That court stated, "[t]he court not only may, but must, look to the legislative history of the Bankruptcy Reform Act to determine whether the case currently before the court is within the intended purpose of Chapter 11." *In re* Ponn Realty Trust, 4 Bankr. 226, 229-30 (Bankr. D. Mass. 1980).

Another court, however, rejected resort to the legislative history. In *In re* Martin-Amirault, 115 Bankr. 10 (Bankr. D.N.H. 1990), the court noted that the "plain meaning rule" prevails in recent United States Supreme Court decisions, and the question of consumer debtor eligibility for chapter 11 is answered solely by resort to the language of the bankruptcy code. *Id.* at 11. Looking to the language of the statute, the court found a consumer debtor eligible for chapter 11 bankruptcy. Such a result was in no way unreasonable and, therefore, the court found the legislative history irrelevant. *Id.* at 11-13.

13. Wamsganz v. Boatmen's Bank of De Soto, 804 F.2d 503, 505 (8th Cir. 1986) ("The legislative history of the Bankruptcy Code, taken as a whole, shows that Congress meant for chapter 11 to be available to businesses and persons engaged in business, and not to consumer debtors.").

### *B. The Legislative History*

The Bankruptcy Code allows a debtor to file for relief under chapters 7, 9, 11, 12 or 13. Chapter 7 bankruptcy, entitled "Liquidation,"[14] which is unquestionably available to business or consumer debtors,[15] provides for the liquidation of the debtor's assets to pay its creditors, and also discharges the unpayable debt under most circumstances. Chapter 9 bankruptcy provides for adjustments of debts of a municipality.[16] Chapter 12 provides debtor relief for a family farmer.[17] The chapters most relevant to discussion of consumer debtors are chapters 13 and 11.

#### *1. Chapter 13: a chapter for consumer debtors*

Chapter 13, entitled "Adjustment of Debts of An Individual With Regular Income,"[18] provides specific bankruptcy relief for consumer debtors or small sole proprietorships[19] who meet certain requirements.[20] The pre-1979 chapter 13 was viewed as "overly stringent and formalized" and inadequate to meet the needs of consumer debtors.[21] The House Report on the new chapter 13 explains that the new law

> [f]irst, . . . simplifies, expands, and makes more flexible wage earner plans . . . . Second, many of the provisions in the [pre-1979] bankruptcy law that enable private action to undo the beneficial effects of bankruptcy are changed. Third, the debtor

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14. 11 U.S.C. §§ 701-766 (1988).

15. H.R. Rep. No. 595, 95th Cong., 1st Sess., *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 5968 [hereinafter House Report].

16. 11 U.S.C. §§ 901-946 (1988).

17. 11 U.S.C. §§ 1201-1231 (1988). Chapter 12 is repealed effective October 1, 1993. *Id.*

18. 11 U.S.C. §§ 1301-1330 (1988).

19. 11 U.S.C. § 1304 (1988) (provides for self-employed debtors, engaged in business); House Report, *supra* note 15, at 5968 ("Chapter 13 . . . is limited exclusively to individuals, but permits small sole proprietorships to use the chapter.").

20. The qualifications for chapter 13 are given in 11 U.S.C. §109(e) (1988):

> Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $100,000 and noncontingent, liquidated, secured debts of less than $350,000, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $100,000 and noncontingent, liquidated, secured debts of less than $350,000 may be a debtor under chapter 13 of this title.

The debt limit in chapter 13 is to ensure that sole proprietors with large businesses will not qualify. House Report, *supra* note 15, at 6080.

21. House Report, *supra* note 15, at 6077-78.

> is given adequate exemptions and other protections to ensure that bankruptcy will provide a fresh start. Fourth, the bankruptcy system is modified to eliminate the close relationship between a bankruptcy judge and a trustee that often works to the consumer debtor's detriment.[22]

The House Report makes clear that either the new, expanded chapter 13 or chapter 7 was intended to be used in consumer debtor cases:

> The premises of the bill with respect to consumer bankruptcy are that use of the bankruptcy law should be a last resort; that if it is used, debtors should attempt repayment under chapter 13, Adjustment of Debts of an Individual with Regular Income; and finally, whether the debtor uses chapter 7, Liquidation, or chapter 13, Adjustment of Debts of an Individual, bankruptcy relief should be effective, and should provide the debtor with a fresh start.[23]

Significantly, the legislative history of the Bankruptcy Reform Act of 1978 in the section dealing with consumer bankruptcy does not mention chapter 11 as a possibility for consumer debtors.

A second passage in the same report, however, directly refutes the proposition that Congress did not intend to allow consumer debtor eligibility for chapter 11. The passage states: "The distinction between a barber, grocer, or worm digger who is self-employed from one who is an employee is slight. H.R. 8200 [the bill amending the Bankruptcy Code] eliminates the distinction, in order to afford small sole proprietors as well as wage earners an alternative to chapter 11."[24] This passage, explaining that chapter 13 was broadened to allow small businesses to file chapter 13, strongly suggests that chapter 11 is an alternative to wage earners who are neither businesses nor individuals engaged in business (i.e., consumer debtors).

### 2. *Chapter 11: business reorganization*

Chapter 11, entitled "Reorganizations," was amended to simplify bankruptcy procedures for business reorganizations. The Senate Report characterizes the new chapter 11 as "[a] single chapter for all business reorganizations" which "will elimi-

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22. *Id.* at 6078.
23. *Id.*
24. *Id.* at 6079.

nate unprofitable litigation over the preliminary issue as to which of the [old] chapters apply."[25] The report states that "[c]hapter 11 deals with the reorganization of a financially distressed business enterprise, providing for its rehabilitation by adjustment of its debt obligations and equity interests."[26]

The House Report also explains the purpose of chapter 11 in terms of business revitalization:

> The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. . . . It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets.[27]

Both the Senate and House Reports indicate that chapter 11 is designed for use in a business and not a consumer context. The Senate Report reads: "Chapter 11, Reorganization, is primarily designed for businesses, although individuals are eligible for relief under the chapter. The procedures of chapter 11, however, are sufficiently complex that they will be used only in a business case and not in the consumer context."[28] The House Report is similar: "Chapter 11, Reorganization, is primarily designed for businesses, but permits individuals to use the chapter. The procedures of chapter 11, however, are sufficiently burdensome that their use will only make sense in the business context, and not in the consumer context."[29] Both reports make it clear that individuals are eligible for chapter 11, but individual debtors are not necessarily synonymous with consumer debtors.[30]

Professor Michael J. Herbert, a proponent of consumer eligibility for chapter 11, acknowledges that the legislative history of chapter 11 indicates that "it is of course possible—indeed probable—that Congress never seriously considered the hypothetical of a consumer Chapter 11 . . . ."[31]

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25. S. Rep. No. 989, 95th Cong., 2d Sess. 9, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5795 [hereinafter Senate Report].

26. *Id.*

27. House Report, *supra* note 15, at 6179.

28. Senate Report, *supra* note 25, at 5789.

29. House Report, *supra* note 15, at 5968.

30. *See infra* note 40 and accompanying text.

31. Herbert, *Consumer Chapter 11 Proceedings: Abuse or Alternative?*, 91 COM. L.J. 234, 238 (1986).

## III. Exploring the Conflict Among the Circuits

Congress' intent that chapter 13 be used for consumer debtors and small sole proprietorships and that chapter 11 be used for business reorganization is beyond dispute, but it does not necessarily follow that chapter 11 cannot be used by a consumer debtor in all circumstances. After all, silence in the code is not a prohibition.

### *A. The Leading Cases for Chapter 11 Consumer Debtors*

The courts have split on the question of consumer debtor eligibility under chapter 11. One leading case allowing consumer debtors to file chapter 11 is *In re Moog*.[32] In *Moog*, the debtor housewife, with no regular income and consumer debts totaling $7,000, filed under chapter 11. Moog's only significant assets were a home, valued at $269,000 subject to mortgages, and furniture.[33] The bankruptcy court dismissed the suit, viewing it "as an abuse of Chapter 11 since Ms. Moog had 'no business, no employees, and no known shareholders,' " and the district court affirmed.[34] The Eleventh Circuit reversed, noting that the language of the Act does not disqualify a consumer debtor.[35] Further, the court read the legislative history to indicate that consumer debtors might file chapter 11 bankruptcy under certain circumstances.[36] Because Moog did not have a regular income and was therefore ineligible for chapter 13, and the only other alternative would have been chapter 7 liquidation and probable loss of the debtor's home, the court found chapter 11 available in this fact situation.[37]

The Eleventh Circuit in *Moog* relied on three aspects of the legislative history to support consumer debtor eligibility. First, the court cited the passage from the Senate Report that, "[c]hapter 11, Reorganization is primarily designed for businesses, although individuals are eligible for relief under the chapter. The procedures of chapter 11, however, are sufficiently complex that they will be used only in a business case and not in

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32. 774 F.2d 1073 (11th Cir. 1985).
33. *Id.* at 1074.
34. *Id.* (quoting *In re* Moog, 46 Bankr. 466 (N.D. Ga. 1985)).
35. *Id.* at 1075.
36. *Id.* at 1074-75.
37. *Id.*

the consumer context."[38] The court concluded that this passage shows Congress' intent to allow consumer debtors to file chapter 11 under certain circumstances.[39] Opponents of consumer debtor eligibility freely admit that this passage evidences congressional intent that chapter 11 is available to individuals and not only to business entities. The issue is whether any individual is eligible or only individuals with business assets or who are engaged in business.[40] The second half of this passage, while not expressly prohibiting consumer debtors from filing under chapter 11, suggests that Congress did not consider chapter 11 appropriate in a purely consumer context.

Second, the court in *Moog* noted that the chapters replaced by the current chapter 11 permitted individuals to file, and the debtor would have been eligible under the old bankruptcy chapter 11 equivalent.[41] Congress did not express any intent for the new chapter 11 to have a more limited scope.

The court in *Moog*, however, did not consider the new chapter 11 in context with the new chapter 13. Under the old bankruptcy act, chapter XIII, the chapter most adept for consumer relief (next to liquidation) was "one of the least understood and most erratically applied of all federal statutes dealing with bankruptcy or social welfare."[42] Consumer relief under chapter XIII was difficult and inadequate.[43] The new chapter 13 was designed

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38. *Id.* at 1074 (citing Senate Report, *supra* note 25, at 5787).

39. *Moog*, 774 F.2d at 1074-75. Other courts have found this same passage to indicate Congress' intent to limit Chapter 11 solely to businesses and individuals with business assets to the exclusion of consumer debtors. *See, e.g., In re* Ponn Realty Trust, 4 Bankr. 227, 230 (Bankr. D. Mass. 1980); *In re* Dolton Lodge Trust No. 35188, 22 Bankr. 918, 922 (Bankr. N.D. Ill. 1982) (Citing this same passage from the Senate Report, the court found congressional intent of an ongoing business requirement disqualified a land trust holding title to property under chapter 11.).

40. *See, e.g.*, Wamsganz v. Boatmen's Bank of De Soto, 804 F.2d 503, 505 (8th Cir. 1986) ("Congress meant for chapter 11 to be available to businesses and persons engaged in business, and not to consumer debtors."). For an example of an individual debtor engaged in business, see *In re* Van Dyke, 95 Bankr. 636, 638 (Bankr. N.D. Iowa 1988).

41. *Moog*, 774 F.2d at 1075. No case or authority is cited for this proposition. The proposition may, however, be true. Chapter 11 replaced the reorganization chapters X, XI, and XII. *See, e.g.*, 124 CONG. REC. 32403-04 (1978) (statement of Rep. Edwards). Professor Herbert says that only Chapter X was clearly unavailable to consumers, while "Chapter XI was almost certainly available to consumers (although rarely, if ever, used by them)," and Chapter XII was indisputably available to consumers. Herbert, *supra* note 31, at 241-42. Rep. Edwards confirms that under the old bankruptcy code individuals could file under chapter XI, or under certain circumstances, chapter XII. 124 CONG. REC. 32403-04 (1978).

42. Senate Report, *supra* note 25, at 5798.

43. House Report, *supra* note 15, at 6077.

for consumer debtor relief and to alleviate the problems found in the old code. Congress intended that when a consumer debtor filed bankruptcy, chapter 13 should be used.[44] Congress may not have had that same express intention under the old bankruptcy laws, but the legislative history of the new bankruptcy laws expresses that intent.

Third, the court in *Moog* cited Bankruptcy Rule 1007(b)[45] which states:

> The debtor in a chapter 7 liquidation case or chapter 11 reorganization case shall file with the court schedules of assets and liabilities, a statement of financial affairs, and a statement of executory contracts, prepared as prescribed by Official Forms No. 6 and either No. 7 or No. 8, whichever is appropriate, unless the court orders otherwise.[46]

Official Form No. 7 is entitled "Statement of Financial Affairs For Debtor Not Engaged in Business," and Official Form No. 8 is entitled "Statement of Financial Affairs For Debtor Engaged in Business."[47] The court read Rule 1007 (b) as evidence that chapter 11 is available to a debtor not engaged in business, apparently on the theory that a debtor may file either Form No. 7 or No. 8 for chapter 11.[48] However, an equally legitimate reading of the rule is that Form No. 7 is never appropriate for chapter 11, while either Form No. 7 or Form No. 8 is obviously appropriate for chapter 7.[49] The rule may simply be one way of saying, for chapter 7, the debtor will file Form No. 6 and Form No. 7 or No. 8 (since either may be appropriate), while for chapter 11, the debtor will file Form No. 6 and No. 8 (because No. 8 is appropriate, and No. 7 is not). Because Congress did not appear to have contemplated the use of chapter 11 in a consumer setting,[50] there was no reason to write the rule in a longer, but possibly clearer form.

Finally, in *Moog*, one of the three judges concurred in the judgment and agreed that chapter 11 was available to consumer

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44. *See supra* note 25 and accompanying text.

45. *In re* Moog, 774 F.2d 1073, 1075 (11th Cir. 1985).

46. 11 U.S.C. Rule 1007(b) (Supp. IV 1986).

47. 11 U.S.C., Official Forms No. 7 and No. 8 (1988).

48. *Moog*, 774 F.2d at 1075.

49. Chapter 7 is available to both business and consumer debtors, i.e., individuals engaged in business and individuals not engaged in business. *See supra* note 15 and accompanying text.

50. *See supra* note 31 and accompanying text.

debtors but expressed the view that in this fact situation, chapter 11 was probably not desirable, and he "seriously doubt[ed] that a bankruptcy judge [could] effectively deal with the petitioner and her creditors under Chapter 11."[51] The concurring judge's skepticism is well-founded. If the consumer debtor cannot satisfy the requirements for chapter 13 or show that he or she is engaged in business, chapter 11 will probably not be a useful remedy anyway because of the unlikelihood of being able to effectuate a legitimate reorganization plan.

Nevertheless, many courts have accepted *Moog*'s analysis and have found consumer debtors eligible for chapter 11.[52] In *In re McStay*,[53] the court, looking to the language of the code, the legislative history, and policy considerations, determined that chapter 11 was available to consumer debtors. The court commented that Congress was capable of limiting chapter 11 relief to businesses and individuals engaged in business but had failed to do so.[54] The court overlooked the possibility that Congress did not seriously consider the possibility of consumer debtors using chapter 11.[55] It is unreasonable for a court to require Congress to expressly negate a proposition which it considered totally unrealistic or did not consider at all.[56]

*McStay* recognized the additional burdens chapter 11 places upon a consumer over and above chapter 13 requirements: higher fees, a disclosure statement, possible creditor voting on the reorganization plan, creditors offering competing plans, and a more limited discharge.[57] The court also noted that the debtor

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51. *Moog*, 774 F.2d at 1077 (Hill, J., concurring).

52. *E.g.*, *In re* Cook, 98 Bankr. 624 (Bankr. D. Mass. 1989); *In re* McStay, 82 Bankr. 763 (Bankr. E.D. Pa. 1988); Grundy Nat'l Bank v. Shortt, 80 Bankr. 802 (W.D. Va. 1987); *In re* Greene, 57 Bankr. 272 (Bankr. S.D.N.Y. 1986); *In re* Martin, 51 Bankr. 490 (Bankr. M.D. Fla. 1985) (prior to *Moog*, but same holding).

53. 82 Bankr. 763, 765 (Bankr. E.D. Pa. 1988).

54. *Id.* at 766.

55. *See* Herbert, *supra* note 31, at 238 ("Silence may mean nothing at all, since it is of course possible—indeed probable—that Congress never seriously considered the hypothetical of a consumer Chapter 11, and thus never even thought about extending or restricting its availability to non-business debtors. This, indeed, is what the legislative history indicates.").

56. Senate Report, *supra* note 25, at 5789 ("The procedures of chapter 11, however, are sufficiently complex that they will be used *only* in a business case and *not* in the consumer context.") (emphasis added); House Report, *supra* note 15, at 5968 ("The procedures of chapter 11, however, are sufficiently burdensome that their use will *only* make sense in the business context, and *not* in the consumer context.") (emphasis added). Clearly, Congress did not consider consumer use of chapter 11 a viable possibility.

57. *McStay*, 82 Bankr. at 767.

in that case appeared to be eligible for chapter 13 relief but considered the possibility of relief under chapter 13 irrelevant.[58]

Another court, following the approach in *Moog*, argued in *In re Cook*, that courts reading into chapter 11 an ongoing business requirement are infringing on the legislative branch and overstepping their judicial role.[59] Another court, in *Grundy National Bank v. Shortt*, was faced with a fact situation of a debtor with debts exceeding the chapter 13 limits, but the bankruptcy court found that the debtor was engaged in business and eligible for chapter 11.[60] The district court, following the *Moog* analysis, held that a consumer debtor was eligible for chapter 11 without reaching the question of whether the debtor was engaged in business.[61]

The courts arguing for consumer debtor eligibility have a strong argument in light of the language of the statute. These courts do not argue that chapter 11 is a wise remedy for consumers or that at later stages in the litigation the plan may not fail; they simply argue that status as a consumer debtor does not automatically disqualify a debtor from filing under chapter 11. Other courts, however, have not been so willing to tolerate what they consider an abuse of chapter 11.

### *B. The Leading Cases Against Chapter 11 Consumer Debtors*

One leading case arguing against consumer debtor eligibility under chapter 11 is *In re Ponn Realty Trust*.[62] In *Ponn*, the debtor was a business trust with a house as its sole asset.[63] The creditors argued that the business trust was not a debtor for the purposes of chapter 11 and should be dismissed. The court

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58. *Id.* at 767 n.10.

59. 98 Bankr. 624, 626 (Bankr. D. Mass. 1989).

60. 80 Bankr. 802 (W.D. Va. 1987).

61. *Id.* at 803.

62. 4 Bankr. 226 (Bankr. D. Mass. 1980).

63. *Id.* at 228. While a business trust is obviously not a consumer debtor, they are factually indistinguishable. The trustee in *Ponn* lived continuously in the house from the time the trust acquired the property, and all the shares of the trust were owned by the trustee's son. The only creditors involved were creditors claiming under the mortgages on the property. *Id.* Essentially, the purpose of filing chapter 11 was to save a consumer debtor's house from foreclosure.

Furthermore, an individual engaged in business may file chapter 11 just as a trust or business which is engaged in business. Similarly, the argument goes, a trust or business not engaged in business is as ineligible as an individual not engaged in business (a consumer debtor).

noted that a business trust could be a chapter 11 debtor under the proper circumstances but that the trust in this case was not a proper debtor for chapter 11.[64] The court recognized that the express language of the code did not expressly preclude the debtor's eligibility. However, the court felt compelled to look beyond the language of the statute to the legislative intent and purpose of the bankruptcy laws. The court, after reviewing the legislative history of the Bankruptcy Reform Act, concluded that "[c]ertainly the legislative history can leave no doubt that Chapter 11 of the Bankruptcy Code was intended for utilization solely in the business setting and not in a consumer context."[65] The court seemed especially influenced by what it viewed as the purpose of chapter 11 as evidenced in the legislative history. The purpose of the chapter, the court explained, is to protect struggling businesses in order to protect public investors and to allow businesses to survive so they can continue to contribute to the economy and provide jobs.[66] These concerns, which motivated the passage and revision of chapter 11, are not present in a consumer debtor context because, in the consumer context, no investors are protected, no jobs are saved, and no business operation is allowed to continue.

The court in *Ponn* also noted that language in the Bankruptcy Code supported the view that chapter 11 was intended exclusively for business use.[67] The provision instructing a committee of creditors to investigate the condition of the debtor's business seems to indicate that Congress expected the debtor using chapter 11 to have a business.[68] Finally, the *Ponn* court

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64. *Id.* at 229.

65. *Id.* at 231.

66. *Id.* at 230-31; *see, e.g.*, *In re* Winshall Settlor's Trust, 758 F.2d 1136, 1137 (6th Cir. 1985); *In re* Dolton Lodge Trust No. 35188, 22 Bankr. 918, 922 (Bankr. N.D. Ill. 1982).

67. *Ponn*, 4 Bankr. at 231.

68. Section 1103 of the bankruptcy code states:

> (c) A committee appointed under section 1102 of this title may—
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> . . .
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> (2) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan; . . . .

11 U.S.C. § 1103(c) (1988).

Section 1108 in chapter 11, entitled "Authorization to operate business," suggests the same conclusion: "Unless the court, on request of a party in interest and after notice and a hearing, orders otherwise, the trustee may operate the debtor's business." 11 U.S.C. § 1108 (1988).

found congressional intent in chapter 13 to indicate that consumer debtors should not be allowed to adjust the mortgage debt on a residence.[69]

Critics of *Ponn*'s application to the question of consumer debtor eligibility assert that, in fact, *Ponn*'s only relevance is to a debtor trying to adjust a mortgage under chapter 11.[70] Such a narrow interpretation is unreasonable in view of the emphatic language of the opinion condemning use of chapter 11 in a consumer setting and recognizing the similarities between a trust not engaged in business and an individual not engaged in business.

The Eighth Circuit in *Wamsganz v. Boatmen's Bank of De Soto*[71] followed the analysis in *Ponn* in finding a consumer debtor ineligible for chapter 11. In *Wamsganz*, the debtors filed first for chapter 13 but were denied relief.[72] The debtors then filed under chapter 11 to prevent the scheduled foreclosure on their non-residential real estate.[73] The Eighth Circuit found that "[t]he legislative history is replete with references to chapter 11's intended application to business, and chapter 11's provisions are more consistent with application to business enterprises than to individual consumers."[74] The court first noted the language in the legislative history indicating chapter 11's business purpose. Furthermore, the chapter in the House Report covering consumer debtors gives "no indication that chapter 11 is to be available to nonbusinesses,"[75] although "the chapter notes that some chapter 13 proceedings by individuals engaged

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A comparison of these sections with chapter 7, however, quickly points out the folly of this argument. Chapter 7, which is indisputably available to both business debtors and consumer debtors, *see supra* notes 8 & 15 and accompanying text, contains similar language. Section 704 of chapter 7 states: "The trustee shall— . . . (8) if the business of the debtor is authorized to be operated, file with the court . . . reports and summaries of the operation of such business . . . ." 11 U.S.C. § 704 (1988). Chapter 7 also contains a section entitled "Authorization to operate business." 11 U.S.C. § 721 (1988). Thus, chapter 7 uses in these examples the same affirmative business language that chapter 11 uses. The only distinction, in addition to the legislative history that chapter 7 is available to consumer debtors, is that chapter 7 contains along with the business language, references to consumer debts and individual debtors as well. *See* 11 U.S.C. §§ 722, 728 (1988).

69. *Ponn*, 4 Bankr. at 231.

70. Note, *Individual Consumer Debtors Are Eligible for Chapter 11 Relief*, 1988 U. ILL. L. REV. 785, 796-97.

71. 804 F.2d 503 (8th Cir. 1986).

72. *Id.* at 504.

73. *Id.*

74. *Id.* at 504-05 (citation omitted).

75. *Id.*

in business would be more appropriate under chapter 11."[76] The court also noted that the chapter on reorganization speaks exclusively of business reorganization, not consumer debtor reorganization.[77] The *Wamsganz* court recognized that the language of the code did not exclude consumer debtors and acknowledged authority holding consumer debtors eligible, but concluded that "[t]he legislative history of the Bankruptcy Code, taken as a whole," excludes consumer debtors from chapter 11 relief.[78] As a result, the court affirmed the dismissal of the chapter 11 action.

*Wamsganz* cites two important cases which, while not addressing the question of consumer eligibility directly, are certainly relevant to the inquiry and seem to suggest consumer debtor ineligibility for chapter 11. In *In re Winshall Settlor's Trust*,[79] the Sixth Circuit held that a trust which had neither assets nor an ongoing business to protect was ineligible for chapter 11. The court emphasized that the purpose of chapter 11 is to "assist financially distressed business enterprises by providing them with breathing space in which to return to a viable state."[80]

The court recognized that although there was no explicit ongoing business requirement in chapter 11, there is an inherent ongoing business requirement:[81] "[I]f there is not a potentially viable business in place worthy of protection and rehabilitation, the chapter 11 effort has lost its *raison d'etre* . . . ."[82] While the *Winshall* court was not faced with the question of consumer debtor eligibility, the court's finding of an inherent ongoing business requirement in chapter 11 is not consistent with consumer debtor eligibility because consumer debtors, by definition, cannot satisfy this requirement. With a consumer debtor, there is no viable business to protect or rehabilitate, no employees' jobs to protect, and no investors at risk.

In addition to chapter 11's purpose as set forth above by the *Winshall* court, the inherent ongoing business requirement is implied in 11 U.S.C. section 1112 (b), which allows conversion to

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76. *Id.*
77. *Id.*
78. *Id.* at 505.
79. 758 F.2d 1136 (6th Cir. 1985).
80. *Id.* at 1137; *see also*, *In re* Dolton Lodge Trust No. 35188, 22 Bankr. 918, 922-24 (Bankr. N.D. Ill. 1982) (chapter 11's purpose is business reorganization; without an ongoing business to protect, debtor is not eligible for chapter 11).
81. *Winshall*, 758 F.2d at 1137.
82. *Id.* (quoting *In re* Ironsides, Inc., 34 Bankr. 337, 339 (Bankr. W.D. Ky. 1983)).

chapter 7 or dismissal for inability to effectuate a plan, and in the implicit requirement of "good faith" on the part of the debtor.[83] This is because the court's "good faith analysis" requires consideration of "whether the debtor had any assets, whether the debtor had an ongoing business to reorganize, and whether there was a reasonable probability of a plan being proposed and confirmed."[84] While the good faith requirement has an ongoing business element, it is distinct from the threshold requirement of an ongoing business but almost inevitably has the same result of disallowing a debtor without an ongoing business from succeeding under chapter 11.[85] If an ongoing business requirement is part of chapter 11 and the debtor does not have an ongoing business, the issue of good faith is never reached. *Winshall*, however, after finding an ongoing business essential to the purpose of chapter 11, continued its analysis to show that the debtor also failed the good faith inquiry.[86]

The second key case cited by *Wamsganz* is *In re Little Creek Development Co.*[87] In *Little Creek*, the court stated that where a debtor corporation had only one asset—a piece of real estate—"[r]esort to the protection of the bankruptcy laws is not proper . . . because there is no going concern to preserve, there are no employees to protect, and there is no hope of rehabilitation, except according to the debtor's 'terminal euphoria.' "[88] The court recognized that the purpose of chapter 11 is to protect ongoing businesses, and without an ongoing business, chapter 11

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83. *Winshall*, 758 F.2d at 1137.

84. *Id.*

85. A court in the Ninth Circuit found significance in the fact that *Winshall*'s good faith test is stated in the conjunctive which suggests that a finding of no ongoing business alone is enough to end the inquiry; once a court establishes that there is no ongoing business, it need not proceed to inquire into the possibility of effectuating a plan. *In re* Roland, 77 Bankr. 265, 268 (Bankr. D. Mont. 1987) (the court continued, however, to show that no feasible plan was possible anyway).

86. *Winshall*, 758 F.2d at 1137. At least one court has recognized these two distinct issues— 1) an ongoing business requirement and 2) a good faith requirement with an ongoing business element—and has read *Winshall* as denying an individual debtor without an ongoing business eligibility under chapter 11. *In re* Lange, 75 Bankr. 154, 156-57 (Bankr. N.D. Ohio 1987); *see also, e.g., In re* Bendig, 47 Bankr. 74 (Bankr. D. Conn. 1987) (reading *Winshall* as holding debtor without an ongoing business ineligible for chapter 11). Another court, however, has read the *Winshall* ongoing business requirement as merely a "shorthand expression for the requirement of being able to repay debts and to effectuate a plan." *In re* Markunes, 78 Bankr. 875, 879 (Bankr. S.D. Ohio 1987). The court found an individual debtor could be eligible for chapter 11 if the debtor had significant assets to protect and the possibility of effectuating a plan. *Id.*

87. 779 F.2d 1068 (5th Cir. 1986).

88. *Id.* at 1073.

is inappropriate.[89] The court noted that allowing the chapter 11 proceedings to continue without an ongoing business at stake would not be fair to the creditors or courts who would suffer from the costs and delays of the proceedings.[90]

The courts which find an ongoing business requirement in chapter 11, despite the plain language of the statute, rely upon the purpose and legislative history to infer such a requirement. The courts arguing against an ongoing business requirement in chapter 11 do not find the purpose or legislative history to suggest such a requirement. With this uncertainty regarding the bankruptcy code's true legislative intent, policy considerations become important to determine the appropriate scope of chapter 11.

## IV. Policy Considerations

The principle consideration behind the bankruptcy laws is the need to balance the interests of debtors, who need time to fulfill their obligations or need a new start, with creditors, who have the right to collect from their debtors. The creditors also have an interest in the speedy enforcement of their rights because court delays cost creditors time and money.

A creditor will often find that lenience to a defaulting debtor is a good policy because the creditor may ultimately realize a greater return than by a harsher approach such as liquidation. Furthermore, avoiding bankruptcy altogether by permitting a delay in repayment may be cheaper than resorting to litigation to enforce the creditor's rights against the debtor. As a result, a creditor may try to work out an agreement if it appears that the debtor has the capacity to fulfill its obligations. A creditor may argue that if creditors and debtor are unable to reach agreement, a consumer debtor should not be allowed to file chapter 11. A consumer debtor should, a creditor will argue, use chapter 13 which is designed for consumer use rather than chapter 11. Chapter 13 has a shorter time table than chapter 11 and will mean a shorter delay for creditors.[91] Also, a chapter 13 plan is normally effective for up to three years or, with the court's

89. *Id.*

90. *Id.*

91. A chapter 13 plan must be filed within 15 days after filing for chapter 13, 11 U.S.C. Rule 3015 (1988), while a chapter 11 plan allows the debtor 120 days to file a plan; if the debtor fails to file within the 120 days, the creditors may propose a plan. 11 U.S.C. § 1121(b) (1988).

permission, up to a maximum of five years,[92] while chapter 11 has no such limitation on the duration of the plan.

However, if the debtor is not eligible for chapter 13, either because its debts exceed the chapter 13 limits or the debtor does not have regular income, thereby leading to its disqualification, the debtor's only option is to liquidate under chapter 7. The debt amount limit for chapter 13 does not suggest that Congress intended that consumer debtors with debts exceeding the limit be forced to liquidate under chapter 7, but instead was directed at preventing business debtors from taking advantage of more favorable provisions intended for consumer debtors.[93] Sound policy does not suggest that a consumer debtor who exceeds the limit should automatically be forced to file chapter 7 without even the opportunity to put forth a plan. Also, a consumer debtor who is disqualified from chapter 13 due to lack of regular income should be given at least the opportunity to put together a workable plan. In many cases, if the court allows a consumer debtor to use chapter 11, the likely result will be further delay as the court determines that the consumer debtor is unable to propose an acceptable plan and eventually is forced to convert the chapter 11 to a chapter 7.[94] However, in other cases, the debtor may be able to work out a plan or settle out of court with its creditors which would be preferable to liquidation under chapter 7.

Although consumer chapter 11 may cause some court delays and hinder creditors, some good faith debtors who are unable to qualify for chapter 13 may find bankruptcy relief. This opportunity should not be foreclosed for this group of debtors who cannot qualify for chapter 13. For other debtors, the courts should be able to make a quick determination of good faith and convert meritless filings seeking to delay creditors to chapter 7.

## V. Conclusion

The courts have struggled with the concept of consumer debtor eligibility under chapter 11. Many courts, probably the majority of courts directly facing the question, have found con-

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92. 11 U.S.C. § 1322(c) (1988).

93. *See* House Report, *supra* note 15, at 6080.

94. Chapter 11 allows for conversion to chapter 7 for inability to effectuate a plan, unreasonable delay by the debtor, or failure to propose a plan (there are also other grounds for dismissal). 11 U.S.C. § 1112(b)(2)-(4) (1988).

sumer debtors eligible for chapter 11 at least under certain circumstances largely because the statute does not expressly exclude consumer debtors. A significant number of courts, however, have found in both the legislative intent of the bankruptcy laws and the spirit of chapter 11 an ongoing business requirement in order to file for chapter 11.

Consumer debtors should be allowed to use chapter 11. The express language of the statute should be controlling considering the inconclusiveness of the legislative history. Because the legislative history is not clear and can be interpreted to support either allowing consumer debtor eligibility or denying consumer debtor eligibility, the legislative history cannot overcome the presumption created by the express language of the bankruptcy code. Furthermore, the debt limit which applies to chapter 13 could otherwise force certain consumer creditors to file for liquidation without any opportunity to offer a plan to recover from its debts. This conclusion does not suggest that consumer debtors will actually succeed in most cases or would even be well-advised to attempt to file under chapter 11, but does suggest that Congress has, either advertently or inadvertently, provided chapter 11 as an option for consumer debtors, and only Congress can change that policy.

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