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NINTH CIRCUIT RULES THAT THE ABSOLUTE PRIORITY RULE APPLIES TO INDIVIDUAL CHAPTER 11s

By Micaela Rustia Moore

The Ninth Circuit ruled Thursday that the absolute priority rule still applies to individual Chapter 11 reorganizations after the Bankruptcy Code was amended in 2005, overruling a previous decision from the circuit's Bankruptcy Appellate Panel and a 2010 decision by the Nevada Bankruptcy Court.

Under the absolute priority rule in 11 U.S.C. § 1129(b)(2)(B)(ii), debtors seeking to prove a Chapter 11 reorganization plan is fair and equitable to dissenting unsecured creditors have to pay those creditors in full before any junior class can receive property. The rule was amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), allowing individual Chapter 11 debtors to retain property included in Section 1115, which expanded the definition of a debtor's estate to include property acquired after the start of bankruptcy proceedings. Following the amendment, courts were split as to a narrow or broad interpretation of BAPCPA. The Nevada Bankruptcy Court in *In re Shat*, 424 B.R. 854 (Bankr. D. Nev. 2010), concluded that the broader interpretation was proper and individual Chapter 11 debtors were able to retain most prepetition and postpetition property and nonetheless cram down plans rejected by a class of unsecured creditors and did not pay such creditors in full.

In *Zachary v. Cal. Bank & Trust*, the debtors, David K. Zachary and Annmarie S. Snorsky, filed a plan

allowing them to retain their home in Carnelian Bay and a rental property in Lake Tahoe but only proposing to pay California Bank & Trust \$5,000 on its nearly \$2 million claim. California Bank & Trust objected to the plan, saying it violated the absolute priority rule. In declining to follow the Ninth Circuit Bankruptcy Appellate Panel's broad interpretation of the absolute priority rule amendment in *In re Friedman*, 466 B.R. 471 (B.A.P. 9th Cir. 2012), the bankruptcy judge agreed that the plan violated the absolute priority rule. The debtors directly appealed the decision to the Ninth Circuit, which rejected the broad interpretation of the BAPCPA amendment to the absolute priority rule and adopted the narrow view that individual Chapter 11 debtors may only cram down a plan that allows the debtor to retain postpetition property only. *Zachary v. Cal. Bank & Trust*, Case No. 13-16402 (9th Cir. Jan. 28, 2016).

This decision may effectively mean that individual debtors cannot confirm Chapter 11 plans if they do not pay their unsecured creditors in full.

For more information on this alert, please contact Micaela Rustia Moore at 702.699.5911 or mmoore@foxrothschild.com or any member of the firm's Financial Restructuring & Bankruptcy Department.

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