

SMALL BUSINESS AND THE 2005 BANKRUPTCY LAW: SHOULD MOM AND APPLE PIE BE WORRIED?

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I. INTRODUCTION

In addition to Mom and apple pie, there was always at least one other subject that members of Congress would support and that was small business. The 2005 bankruptcy law,¹ however, was affirmatively hostile to small business, making it more difficult for small businesses and their owners to get bankruptcy relief. Although Congress passes many laws that advantage large business, often at the expense of the large businesses' smaller counterparts, the 2005 bankruptcy law is the only example of which this author knows that expressly singles out small business for harsher treatment than a similar large business. Perhaps Mom and apple pie need to hire a lobbyist to prevent the same from happening to them.

How we got to this state is a fair question. The credit industry sold the 2005 law as mainly about consumer bankruptcy. The reality is different. Of the statute's 512 pages, 159 (a little under one-third of the statute) dealt with business matters large and small, from assumption of executory leases to financial contract netting provisions. The proportion of the statute devoted to business matters would be even larger if one counted the new chapter 15 about transnational insolvency as mainly a business issue. Among the business provisions were seventeen sections—subtitle B of title IV of the statute—devoted to small business. A careful read of these provisions will reveal Congress' not-so-careful drafting. Among the "small business" provisions is a section for plan administrators of an employee benefit plan² and another section dealing with chapter 11 committees for retired employees.³ Neither of these provisions is likely to arise very often in a small business bankruptcy.

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1. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 436(b), 119 Stat. 23. This article will reference either "the 2005 law," "the 2005 bankruptcy law," "the 2005 bankruptcy amendments," or a similar locution.
2. § 446, 119 Stat. at 118 (amending 11 U.S.C.A. §§ 521, 704, 1106 (West Supp. 2006)).
3. *Id.* § 447, 119 Stat. at 118 (amending 11 U.S.C.A. § 1114 (West Supp. 2006)).

Thus, part of the answer to how we ended up with a statute that treated small business so harshly was a lack of attention. Congress debated and debated the consumer issues in the statute, and these issues occupied the attention of the press. The small business provisions simply did not matter to the major players in the lawmaking process for the 2005 bankruptcy law.

Still, these provisions had to matter to someone, or they would have not made it into the bankruptcy law. It is difficult to unravel the special interests that stood to gain and hence pushed for the inclusion of the small business provisions. Instead, it is much easier to trace the genesis of these provisions. In their own article shortly after the passage of the 2005 bankruptcy law, Judge Thomas Carlson and Ms. Jennifer Frasier Hayes convincingly traced the origin of the small business provisions to the 1997 report of the National Bankruptcy Review Commission (“NBRC”).⁴ Judge Carlson identified himself as an informal advisor to the NBRC on small business issues, and Ms. Hayes identified herself as a staff attorney for the NBRC.⁵

The NBRC report had fixated on the low confirmation rates of small businesses in chapter 11.⁶ It further claimed that small businesses lingered under bankruptcy protection for years. As evidence that small businesses spent too much time in chapter 11, the report cited studies of time to confirmation. Average time to confirmation was two and half to three years in the cited studies.⁷ Of course, the NBRC’s claim did not address whether this time was too long. Rather than ask merely how long chapter 11s lasted, the NBRC should have asked whether businesses linger in chapter 11 when they should have exited. In fact, a study that appeared only recently found that 91% of small businesses that shut down in chapter 11 did so within one year but that firms that reorganized in chapter 11 took a median time of 21 months to do so.⁸ The pre-2005 version of chapter 11 appears to have been doing a good job of sorting viable and nonviable firms in a timely manner. Indeed, two members of the NBRC dissented from the small business recommendations on the

4. Thomas E. Carlson & Jennifer Frasier Hayes, *The Small Business Provisions of the 2005 Bankruptcy Amendments*, 79 AM. BANKR. L.J. 645, 647 (2005). The National Bankruptcy Review Commission was created by the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 603, 108 Stat. 4107, 4147, to study the bankruptcy laws and recommend improvements. Its report is now available over the Internet. NATIONAL BANKR. REVIEW COMM’N, 1 BANKRUPTCY: THE NEXT TWENTY YEARS (1997) (available at <http://govinfo.library.unt.edu/nbrc/reportcont.html>) (last visited Feb. 12, 2007).

5. See Carlson & Hayes, *supra* note 4, at 647 & n.8.

6. See NATIONAL BANKR. REVIEW COMM’N, *supra* note 4, at 610-13.

7. *Id.* at 613-14.

8. See Edward R. Morrison, Working Paper, *Bankruptcy Decisionmaking: An Empirical Study of Continuation Bias in Small Business Bankruptcy* (Jan. 25, 2006) (available at <http://ssrn.com/abstract=880101>) (last visited Feb. 12, 2007).

grounds that whatever evidence existed regarding the state of small business bankruptcy suggested the need for local flexibility rather than new hurdles.⁹

Although the NBRC did not have all the facts at the time it acted and later studies suggested it may have had the wrong facts, a majority voted for strong recommendations to restrict small business debtors in bankruptcy, to allow for easier dismissal, to require more disclosure, and to get small business debtors out of bankruptcy court more quickly. These NBRC recommendation largely formed the basis for the small business provisions in the 2005 bankruptcy law. Congress certainly did not accept all the findings of the NBRC on other topics, especially its consumer bankruptcy recommendation. Although one can trace the genesis of the small business amendments of the 2005 bankruptcy law to the NBRC report, that description is incomplete. The next step in the causal chain, how the NBRC's recommendations on small business became important enough to the political actors who controlled the 2005 law, is still a secret of the legislative process.

This article is unapologetically doctrinal. Its main goal is to dissect the small business provisions of the 2005 bankruptcy law to explain how they disadvantage small business in chapter 11 at almost every turn. The next section continues with a discussion of the various provisions in the 2005 law that affected small business or small business owners. It also discusses one statutory development since the 2005 law that will have an adverse affect on small business owners in chapter 13. The final part of the article offers some predictions and suggests some issues for empirical study related to small business bankruptcies.

II. PROVISIONS RELATING TO SMALL BUSINESS

As it relates to small business, the biggest feature of the 2005 bankruptcy law is that the status of being a "small business debtor" is no longer elective. Instead, this status now comes with a set of burdens and requirements that the debtor cannot avoid. It is thus best to begin with an exploration of the statutory definition for what qualifies a bankruptcy filer for small business status.

9. See NATIONAL BANKR. REV. COMM'N, *supra* note 4, at 1031–33 (Chapter 5: Individual Commissioner Views, Babette Ceccotti and the Honorable Robert Ginsberg: Dissent from Recommendation Regarding Small Business Chapter 11 Cases).

A. Debtors, Cases, and Definitions

1. “Small Business Debtor”

The new law works off two statutory definitions—a “small business debtor”¹⁰ and a “small business case.”¹¹ On their face, the two terms would seem only to distinguish between the legal proceeding itself (a “case”) and the person subject to the proceeding (a “debtor”). Whether Congress cast any particular rule to apply to the proceeding or to the person, one might expect the same practical outcome to occur. The rule would still apply. There is a very fine technical difference between the two terms, however, such that Congress appears to have intended difference consequences for “cases” versus “debtors.” To understand the difference requires an examination of the details of each term.

A “small business debtor” is first any person engaged in commercial or business activities.¹² Because the definition of a person includes individuals,¹³ a small business debtor would include sole proprietors who file bankruptcy. The statute does not provide us with a definition of what it means to engage “in commercial or business activity,” but it clearly does not require that the commercial or business activity be substantial. Under its plain language, the statute thus could sweep even individuals with a small amount of self employment income. A day laborer mowing lawns or shoveling snow on the weekend to earn a little extra cash might be said to be engaged in “commercial or business activity.”¹⁴ A better result, of course, would be to read the statute to have an implicit requirement that the commercial or business activity be substantial as compared to the debtor’s other income-producing activities. The word “substantial” does not appear in the statute, however, and an aggressive creditor could deploy the statutory plain language to argue that an individual should be labeled a “small business debtor” and hence subject to the new reporting requirements discussed below.

Once we have decided that a particular debtor is engaged in a “commercial or business activity,” the statute next asks whether the debtor has

10. See 11 U.S.C.A. § 101(51D) (West Supp. 2006).

11. See § 101(51C).

12. § 101(51D).

13. See § 101(41).

14. As will be discussed just below, *see infra* notes 24–30 and accompanying text, because of the statute’s language, some of the “small business” requirements could apply to debtors filing chapter 7 or chapter 13. Although the hypothetical day laborer in the text might not file chapter 11, the small business debtor definition could have consequences in the day laborer’s chapter 7 or chapter 13 case.

more than \$2,000,000 in noncontingent liquidated secured and unsecured debt.¹⁵ If the debt falls below that amount, the debtor is a small business debtor. Debts owed to affiliates or insiders are not counted.¹⁶ Empirical studies of business bankruptcies suggest this definition will cover most business filers.¹⁷ Thus, small business debtors will not be an exception, but the rule under the Code. Essentially, chapter 11 has become a small business chapter with exceptions for companies that are not small businesses.

The statutory definition of a “small business debtor” then continues with a number of exclusions. First, it excludes any “person whose primary activity is the business of owning or operating real property or activities incidental thereto.”¹⁸ This exception is apparently meant to dovetail with the statutory definition of “single asset real estate” and make single asset real estate cases mutually exclusive from small business bankruptcies.¹⁹ Like many pieces of the 2005 bankruptcy law, this change almost accomplishes its objective but not quite completely. A “single asset real estate” case is one involving

real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental.²⁰

One can quickly think of several gaps between the exclusion in the definition of small business debtor and the definition of a single asset real estate case. For example, reading the plain language of the statute, a real estate developer or an apartment company manager would not be a small business debtor because their primary activity is the business of “owning or operating real property.” At the same time, their activities would not qualify as a “single

15. See 11 U.S.C.A. § 101(51D)(A) (West Supp. 2006).

16. See *id.* (containing language “excluding debts owed to 1 or more insiders” from counting toward debt cap for “small business debtors”).

17. See Elizabeth Warren & Jay Lawrence Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 AM. BANKR. L.J. 499, 500, 519–21 (reporting more than 90% of businesses filing bankruptcy in 1994 study had less than \$2,000,000 in debt).

18. See § 101(51D)(A).

19. § 101(51B). A bankruptcy judge who was involved in the small business provisions of the National Bankruptcy Review Commission (“NBRC”) describes the small business provisions of the 2005 bankruptcy law as “adopted largely intact” from the Commission’s proposals. Carlson & Hayes, *supra* note 4, at 647. He describes the NBRC’s intention that single-asset real estate cases be excluded entirely from the statutory definition of small business debtors. Carlson & Hayes, *supra* note 4, at 653. Of course, the words that Congress passed are what counts rather than the NBRC’s intentions.

20. 11 U.S.C.A. § 101(51B). The primary consequence of being a single-asset real estate case is to apply the requirements in § 362(d)(3) providing grounds for relief from the automatic stay unless the debtor begins making interest payments or proposes a plan of reorganization within 90 days of filing.

asset real estate” case because real estate developers and apartment company managers typically do not limit their activities to a “single property or project.”

These sorts of gaps between the exclusions for a small business debtor and a single asset real estate case existed under the previous law, but they did not have the same consequences. The previous definition was a small business *election* that the debtor could make, but the current definition is mandatory and imposes extra requirements on small business debtors. Where the previous law merely may have left some debtors without the ability to make a small business election that was rarely made anyway because it carried few benefits, the new law allows some debtors to slip through a loophole to evade the new requirements.

The real-estate exclusion is only the first exclusion, however, from the definition of a “small business debtor.” The statute also excludes cases for which the U.S. Trustee has appointed a committee of unsecured creditors or, for cases where a committee of unsecured creditors has been appointed, if the committee is not “sufficiently active and representative to provide effective oversight of the debtor.”²¹ Here, this statutory language also raises practical concerns in its operation because it does not provide any guidance on how a court is to determine whether an unsecured creditors committee is “sufficiently active and representative.” Because the U.S. Trustee has the power to appoint committees in chapter 11,²² the U.S. Trustee will have the power to nullify this exclusion for any particular debtor simply by declining to appoint a committee. Also, the language appears to contemplate that debtors can fall in and out of the statutory definition. In a case where a committee of unsecured creditors had been appointed, a later court finding that the committee had become inactive would mean a debtor could revert to small business status. Notably, such a move could subject a debtor suddenly to the more restrictive exclusivity provisions for small businesses discussed later.²³

2. “Small Business Case”

In a puzzling statutory move, the new law does not stop with the definition of “small business debtor.” It then creates a second definition for a “small business case,” which is a small business debtor in chapter 11.²⁴ The

21. § 101(51D)(A).

22. § 1102.

23. See *infra* Part II.D.

24. See § 101(51C).

clear effect of this second statutory definition is to create a subset of small business debtors. All small business *cases* in chapter 11 will involve a small business *debtor*, but small business *debtors* in chapter 7, 12,²⁵ or 13 will not be a small business *case*.

The distinction would not matter if chapter 11 contained all of the small business provisions, but one new section applies to all small business debtors in all chapters of the Bankruptcy Code. As discussed more fully below,²⁶ section 308 will require all small business debtors to file periodic financial reports. Because a small business debtor need not be in chapter 11 and because section 308 applies to all chapters,²⁷ these reporting requirements apply, on their face, to any debtor who meets the definition. Thus, a chapter 7, 12, or 13 debtor who qualified as a small business debtor would be subject to these new reporting requirements.

Many more bankruptcies could be subject to these reporting requirements than may at first appear. An individual debtor who operates a small business for a little side income arguably fits the definition of a small business case.²⁸ An individual debtor who operates a small business as her full-time self employment clearly falls within the definition's plain language. Moreover, there are many more self-employed persons filing bankruptcy than the official statistics from the Administrative Office of United States Courts suggest. Perhaps seven times as many self-employed persons were filing bankruptcy under the old law than the government's count of business filers would imply.²⁹ Extrapolating from filing levels for the most recently available statistics, there might be approximately 92,000 to 135,000 debtors per year with self-employment that could qualify them for the section 308 reporting requirements.³⁰ The broad reach of section 308 is hardly harmless. Creditors

25. Family farmers enjoy special advantages under chapter 12, and these advantages are extended throughout the Bankruptcy Code. For example, farmers are excluded from the definition of "single asset real estate" in § 101(51C). There is no indication in the Code, however, that farmers are to be excluded from the definition of a "small business debtor."

26. See *infra* notes 39–40 and accompanying text (including discussion of future effective date for section 308).

27. See 11 U.S.C.A. § 103(a) (West Supp. 2006).

28. See *supra* notes 12–14 and accompanying text.

29. See Robert M. Lawless & Elizabeth Warren, *The Myth of the Disappearing Business Bankruptcy*, 93 CAL. L. REV. 743, 745 (2005).

30. The Administrative Office of U.S. Courts reported 98,824 chapter 7 and 73,052 chapter 13 "nonbusiness" filings for the three months ended December 31, 2006. See Administrative Office of U.S. Courts, *News Release: Bankruptcy Filings Plunge in Calendar Year 2006*, http://www.uscourts.gov/Press_Releases/bankruptcyfilings041607.html (last visited Apr. 25, 2007). In a blog post, I cited more recent data for the first three months of 2007 that showed filing trends that might push total filing figures for 2007 to close to 1,000,000. See Bob Lawless, *U.S. Bankruptcy Filings Back Over 1,000,000?*, http://www.creditslips.org/creditslips/2007/04/us_bankruptcy_f.html

could sandbag debtors who do not suspect the need to file such forms. Alternatively, debtors could defensively file section 308 reports, adding to the already increased expenses and hassles created by the 2005 amendments.

Judge Thomas Carlson, who was heavily involved in both the National Bankruptcy Review Commission's examination of small business bankruptcy, as well as the congressional drafting of the small business provisions, claims that section 308 will apply only to chapter 11 proceedings.³¹ In fact, in an overview of the small business provisions for the *American Bankruptcy Law Journal*, Judge Carlson relegated his discussion of the issue to a footnote.³² But Judge Carlson's conclusion seems to be wishful thinking by someone closely attached to these provisions. If the parties responsible for section 308 wanted it applied only to chapter 11 cases, then they should not have put it in chapter 3, which is clearly applicable to all cases under the Bankruptcy Code.³³ Section 308 serves as another example of the sloppy drafting that plagues the 2005 bankruptcy amendments.

In any event, an argument that section 308 does not apply outside chapter 11 would seem to run straight into the reasoning of the Supreme Court in *Lamie v. United States Trustee*.³⁴ In that case, the Supreme Court had to decide what Congress meant when it deleted the words "debtor's attorney" from the list of professional persons in section 330 who could be paid from the bankruptcy estate. The deletion had been created by an apparent drafting error.³⁵ Although the language was a mistake and "awkward and ungrammatical,"³⁶ the Court held the language was clear. Debtor's attorneys could not be compensated from the bankruptcy estate, with the primary effect of the opinion coming to rest on the lawyers for chapter 7 consumer debtors. Similarly, the general application of section 308 may have been a mistake, but the plain language of the Bankruptcy Code indicates its application outside the chapter 11 context.

(last visited Apr. 25, 2007) By annualizing these figures and then assuming that 13.5% of these persons have self-employment, *see* Lawless & Warren, *supra* note 29, at 781–83, one arrives at a figure of between 92,183 and 135,000 bankruptcy cases involving persons with self-employment in the 2007 calendar year.

31. *See* Carlson & Hayes, *supra* note 4, at 680, n.187. The Advisory Committee for the Federal Rules of Bankruptcy Procedure has issued a proposed rule for public comment that would require the section 308 reports only in small business cases, i.e. only in chapter 11. *See* Fed. R. Bankr. P. 2016(a)(6) (proposed Aug. 2006) (http://www.uscourts.gov/rules/Excerpt_BK_Report_Pub.pdf#page=72) (last visited Feb. 11, 2007).

32. *Id.*

33. *See* 11 U.S.C.A. § 103(a) (West Supp. 2006).

34. 540 U.S. 526 (2004).

35. *Id.* at 533–34.

36. *Id.* at 534.

Even beyond *Lamie*, there are several other textual reasons directing a court to apply section 308 outside of the chapter 11 context. First, section 362(n) applies to small business *cases*,³⁷ making the argument that section 308's broader application to small business *debtors* seem less accidental. Also, if section 308 does not apply to small business debtors in any chapter, there would have been no reason for Congress to have distinguished between cases in section 101(51C) and debtors in section 101(51D). Given the plain language evidence integrating many different sections of the Code and the Supreme Court precedent, it will be difficult for a court to come to a conclusion other than that section 308 applies broadly to any bankruptcy case. Such a result may be an unwise policy decision, but the text is very compelling.

To top things off and for those who still read legislative history, the House Report draws the same dichotomy as the statute, talking about "small business debtors" covered by section 308 and one sentence later talking about "small business cases" covered by other provisions in the 2005 law.³⁸ Indeed, reading the House Report gives the distinct impression that perhaps the result was intentional and not just sloppy drafting when one considers that the report was likely drafted by the same congressional staffers who would have been heavily involved in initially drafting the legislation.

The consequences of a broad application of section 308 may be mitigated by two factors. First, outside of chapter 11,³⁹ there is no specific sanction for failing to file the reports mandated by section 308. Presumably, the sanction would be the same for failing to file information with the court generally. Although that could include dismissal of the bankruptcy case, presumably bankruptcy courts could use their discretion to ameliorate section 308's potentially harsh effects outside of chapter 11. Second, section 308 will not go into effect until sixty days after rules are prescribed for forms to use.⁴⁰ As of this article's writing, section 308 would not take effect until February 1, 2009—an almost four-year delay from the enactment of the 2005 amendments. If Congress is able to muster support for a technical corrections bill—a minor achievement but an achievement for which political will has been lacking—it

37. See 11 U.S.C.A. § 362(n) (West Supp. 2006) (imposing new serial filer rulers against small business debtors).

38. H.R. REP. NO. 109-31, pt. 1, at 91 (2005).

39. See *infra* Part II.C.4 (discussing new reach of new dismissal rules in section 1112 for chapter 11, including possible dismissal for failure to file technical reports).

40. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 436(b), 119 Stat. 23, 112.

would be an easy matter to clarify the reach of section 308 before it goes into effect.

3. *The “When” Question & New FRBP 1020*

The statutory definitions themselves present puzzling questions, but even beyond the question of the definitions’ statutory ambiguity, it is unclear how the court is to proceed when the parties dispute the definitions’ application. The question is one of timing, created by the definitions’ operation. Under the old law, the small business definition triggered an election that came into play at the time of disclosure statement approval and confirmation.⁴¹ In controversial cases, there was plenty of time for the court to consider whether the debtor qualified for the election. Because the new small business provisions are mandatory and impose immediate reporting consequences,⁴² new grounds for relief from the automatic stay,⁴³ and shorter deadlines,⁴⁴ not only will the issue of whether the debtor is a “small business debtor” need to be resolved sooner in the case, it also can be expected that debtors will resist its application.

To address these issues, the Advisory Committee for the Federal Rules of Bankruptcy Procedure has released a new version of rule 1020 for public comment.⁴⁵ If the rule meets no objections from the Judicial Conference, the Supreme Court, or Congress, it will take effect on December 1, 2008. Until the proposed rule becomes final, an interim rule has been issued that is virtually identical to the proposed rule.⁴⁶

Under the proposed and interim rule 1020, the debtor states in the petition whether it qualifies for the “small business” designation. This designation would then stand until the court entered an order finding it incorrect. Parties wanting to object to the debtor’s designation would have thirty days from the meeting of creditors to do so. Consistent with the statutory definition, the new rule also would provide that a debtor would cease to be designated a small

41. See 11 U.S.C. § 1125(f) (2000) (allowing court to combine hearing on approval of disclosure statement and confirmation of the plan if debtor made a small business election).

42. See *infra* Parts II.C.1–II.C.2.

43. See *infra* Part II.B.

44. See *infra* Part II.D.

45. See FED. R. BANKR. P. 1020 (proposed Aug. 2006), http://www.uscourts.gov/rules/Excerpt_BK_Report_Pub.pdf#page=42 (last visited Feb. 11, 2007).

46. See Advisory Committee on Bankruptcy Rules and the Committee on Rules of Practice and Procedure, *Interim Rules and Official Forms Implementing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, <http://www.uscourts.gov/rules/interim.html> (last visited Feb. 12, 2007).

business if the U.S. Trustee appoints a committee of unsecured creditors. Disputes over whether a debtor is a small business debtor will be treated as contested matters under Federal Rule of Bankruptcy Procedure 9014. By giving the debtor's initial designation a presumption of correctness and by requiring parties to object within thirty days, the rule goes a long way toward clearing up some of the timing ambiguities that the 2005 amendments created.

B. "Small Business Only" Serial Filer Rules in § 362(n)

Congress singled out small business debtors for restrictive rules against serial bankruptcy filers, denying them the protections of the automatic stay in some instances. A small business debtor loses the protection of the automatic stay (1) if it is a debtor in a pending small business case, (2) if it was a debtor in a small business case that was dismissed in the previous two years, or (3) if it was a debtor in a small business case that was confirmed in the previous two years.⁴⁷ The automatic stay is also denied to any entity that acquired all or substantially all of the assets or business of a small business debtor that meets one of these three criteria.⁴⁸ Because the language clearly specifies that the previous proceeding must have been a small business *case*, it clearly contemplates only a second filing followed by a previous chapter 11.⁴⁹ But, because the statute specifies small business *debtors* lose the protections of the automatic stay, the second filing may be in any chapter.⁵⁰

There are two exceptions to the loss of the automatic stay for a serially filing small business debtor. The first exception is if the second case is an involuntary bankruptcy case.⁵¹ The second exception applies if the debtor establishes by a preponderance of the evidence that the second filing was due to circumstances that were not foreseeable at the time of the first filing. Also, the debtor must establish that it is more likely than not the court will be able to confirm a feasible plan within a reasonable time (but not a liquidating plan).⁵²

It is not clear why Congress would have singled out small business debtors in these serial filing provisions. By lifting the automatic stay, Congress appears to be expressing its displeasure that a business would need

47. 11 U.S.C.A. § 362(n)(1) (West Supp. 2006).

48. § 362(n)(1)(D).

49. *See supra* Part II.A.2.

50. *See supra* notes 24–26 and accompanying text (discussing statutory difference between a small business debtor and a small business case).

51. § 362(n)(2)(A).

52. *See* § 362(n)(2)(B).

to refile within two years of a previous bankruptcy, as if the short period of time elapsed speaks for itself as evidence of abuse of the system. Whether that is true may be dubious, but it certainly seems no less true for small business debtors than for large corporate debtors. Why is not the refiling of a large business debtor within two years similarly abusive and worthy of punitive measures in regards to the automatic stay? By denying the automatic stay only to small businesses filing a second chapter 11, Congress expressed hostility to small businesses reorganization alone.

Beyond Congress' questionable policy choice of treating small businesses differently from large businesses, the serial filer provisions again raise a few technical doctrinal issues. The statute speaks of a previous small business case, but such a term did not exist in the statute before the 2005 amendments. Does the serial filer provision apply if the previous case was filed before the 2005 amendments? The statute is completely silent on its retroactive application. Also, the running of the two-year period to capture a second, serial filing, runs from the date of confirmation or dismissal of the previous small business chapter 11. Thus, the running of the two-year period would be triggered by cases pending at the time of the October 2005 effective date of the 2005 law but not reaching confirmation or dismissal until much later.

The statute does not specify the mechanism for deciding whether the serial filer provisions apply in a particular case. The bankruptcy petition requires the debtor to identify all bankruptcy cases within the previous eight years and the date of filing,⁵³ which will put other parties on notice of the previous bankruptcy. Although the statute directs that the automatic stay will not apply in the event of a serially filing small business, creditors would be well advised to seek court approval before acting against the debtor's property. The mere existence of a previous case, however, does not mean the serial filer provisions apply. The previous case must have been a "small business case." Presumably, a creditor could file a motion asking the court to find the serial filer provisions applicable.

Another technical issue with the serial filer provisions arises because of the possibility that debtors can fall in and out of the statutory definition of "small business debtor."⁵⁴ If a debtor begins as a small business debtor in chapter 11 (and hence also as a small business case), but the U.S. Trustee appoints an unsecured creditors' committee, the debtor loses the small business designation,⁵⁵ but the serial filing provisions apply if the debtor was

53. See Official Bankruptcy Form 1, Voluntary Petition, at 2.

54. See *supra* Parts II.A.1; II.A.3.

55. See 11 U.S.C.A. § 101(51C) (West Supp. 2006).

a debtor “in a small business case” that was dismissed or confirmed in the previous two years. Thus, on its face, the statute leaves open the question of what happens if a debtor is a small business in chapter 11 but by the time of confirmation or dismissal has lost that designation. Was such a debtor “in a small business case?” The statute does not resolve the issue, but because the serial provisions have punitive effects that single out only one category of debtors, a better reading would impose a temporal requirement, holding that for the serial filing rule to apply, debtor had to have the small business designation at the time of confirmation or dismissal, so as to narrow the statute’s reach.

C. Small Business Reporting Requirements

The 2005 law imposes substantial new duties on small business debtors. Most, but not all, of these new duties involve new disclosures that small business debtors must make after filing a bankruptcy case. Although this article has earlier explored the consequences of the new section 308 reporting requirements outside the chapter 11 context,⁵⁶ in this part it focuses on the substance of the section 308 reporting requirements as well as requirements in section 1116 and an uncodified provision of the 2005 law.

1. Section 308 Financial Reports

Turning to section 308, it requires the filing of financial and other reports disclosing the following information about the debtor:

- Profitability
- Reasonable approximations of projected cash receipts and disbursements
- Comparisons of actual cash receipts and disbursements with projections from prior reports
- Compliance with all material requirements of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure
- Timely filing of tax returns, timely filing of required government filings, payment of taxes, and payment of administrative expenses
- If not in compliance on tax or regulatory filings, how the debtor intends to come into compliance⁵⁷

56. See *supra* Part II.A.2.

57. 11 U.S.C.A. § 308 (West Supp. 2006).

The section concludes with a catch-all, requiring disclosure of “such other matters as are in the best interests of the debtor and creditors.”⁵⁸

The 2005 bankruptcy law directs that these reporting requirements are not to go into effect until sixty days after forms are produced for reporting the information. As of this article’s writing, that would mean the section 308 reporting requirements will not go into effect until February 1, 2009.⁵⁹

To implement the reporting requirements, the Advisory Committee on Bankruptcy Rules has proposed an Official Form 25C, Small Business Monthly Operating Report. The form itself is four pages long, but it will be much lengthier once the small business debtor completes the information required by the form. A small business debtor is required to file this form monthly. It begins with seventeen yes/no questions asking about the state of the debtor’s business, compliance with taxing and regulatory requirements, and major financial changes like sales of assets. The small business debtor is then to list its income and its expenses, with the expenses being itemized. The small business debtor then must list its accounts payable and receivable and provide statements for all its bank accounts. Information about the number of employees must be provided. Also, the small business debtor must provide information about professional fees paid during the month, although that information could be gathered from other records in the bankruptcy case. Finally, the form concludes by demanding that the small business debtor compare its income and expenses to the projections provided for the first 180 days of the case.

It is difficult to argue against disclosure. There is no doubt that more disclosure can help creditors and bankruptcy courts make better decisions about the viability of the business. The information required by section 308 and the new form implementing its provisions, however, is overkill. It appears to be designed to increase the hassle, and thereby the cost, for a small business seeking bankruptcy protection. Few small businesses keep detailed records that would make the information demanded easily available. Moreover, the report must be filed monthly. Having the debtor state each month that it is still in compliance with applicable taxing and other governmental requirements provides little information for creditors but does create another opportunity for a creditor to object that the debtor has mischaracterized some event.

58. § 308(b)(4)(C).

59. See *supra* notes 39–40 and accompanying text.

A comparison of the section 308 reporting requirements for small businesses can be made to the reporting requirements of large publicly traded corporations. Outside of bankruptcy, publicly traded corporations file statements on a quarterly, not monthly basis.⁶⁰ Also, publicly traded companies in bankruptcy can be excused from the normal reporting requirements.⁶¹ Small businesses in bankruptcy get new reporting requirements, but large corporations get fewer reporting requirements once they file bankruptcy. The reporting provisions are another example where Congress singled out small businesses for harsher treatment than their larger counterparts.

2. Section 1116 Duties for Chapter 11 Trustees

In addition to new reporting requirements in section 308, section 1116 imposes other new disclosure requirements in small business cases as well as new substantive duties. Section 1116 begins by imposing its duties on a trustee *or a debtor in possession*,⁶² a completely unnecessary duplication because the Bankruptcy Code already imposes most every duty of a chapter 11 trustee on the debtor in possession.⁶³ The duplication is harmless, but it again reinforces the notion that the 2005 bankruptcy amendments do not reflect expert drafting skill with the Bankruptcy Code.

Section 1116 imposes five new disclosure requirements on the debtor:

- Appending to the petition the most recent balance sheet, statement of operations, cash-flow statement, and Federal income tax return (or a statement that these documents were not prepared or filed)
- Timely filing schedules and statements of financial affairs
- Filing of all postpetition financial and other reports required by the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure, a local court rule, or an order of the court
- Timely filing of tax returns
- Allowing the U.S. Trustee to inspect the business premises, books, and records

60. See 15 U.S.C. § 78m (2000) (requiring “such quarterly reports” as the SEC may prescribe); 17 C.F.R. § 240.13a–13 (2005) (prescribing quarterly reports for publicly traded companies).

61. See Securities Exchange Comm’n, Staff Legal Bulletin No. 2 (Apr. 15, 1997) (outlining steps publicly traded companies should take to request a “no action” letter from the SEC if they are unable to file reports while in bankruptcy).

62. 11 U.S.C.A § 1116 (West Supp. 2006).

63. See § 1107.

Actually, some of these disclosure requirements are not so new. Debtors always had to file the schedules and statements of financial affairs. And what does it add to the statute requiring the debtor to follow an order of the court? The real importance of section 1116 is not that it adds new disclosure requirements. Rather, the not-so-new disclosure requirements now provide a statutory basis for the information so as to set up grounds for dismissal of the small business case.⁶⁴

Section 1116 also imposes new substantive duties on a small business debtor in chapter 11:

- Senior management attendance at meetings scheduled by the U.S. Trustee or the court
- Maintenance of insurance customary and appropriate to the debtor's industry
- Timely payment of all taxes entitled to administrative expense priority

Again, these new substantive duties are not as new as they appear. The debtor certainly had no excuse not to appear at meetings scheduled by the court. Failure to maintain insurance could be grounds for lifting the automatic stay. Section 1116 now makes these duties express, again possibly providing grounds for dismissal of the case.

The U.S. Trustee also picked up new powers in a small business case under chapter 11. Before the first meeting of creditors, the U.S. Trustee must conduct an initial interview with the debtor.⁶⁵ The U.S. Trustee is to inquire about the debtor's viability and business plan, explain the debtor's obligations to file reports, and attempt to develop an agreed scheduling order.⁶⁶ The U.S. Trustee is to monitor the debtor and identify "as promptly as possible" whether the debtor will be unable to confirm a plan.⁶⁷ The statute does not specify what happens if the U.S. Trustee decides the debtor will be unable to confirm a plan. Presumably, the U.S. Trustee could use this information to move for dismissal or conversion of the chapter 11 case under section 1112. The new disclosure requirements and the statutory directive to determine the viability of the debtor's business give the U.S. Trustee a tremendously powerful gatekeeping function for small business bankruptcies.

64. See *infra* Part II.C.4.

65. 28 U.S.C. § 586(a)(7)(A) (2000). The meeting of creditors authorized by 11 U.S.C. § 341 (2000) must take place within 20 to 40 days of the filing of a chapter 11 case. See FED. R. BANKR. P. 2003(a).

66. See 28 U.S.C. § 586(a)(7)(A) (2000).

67. See § 586(a)(7)(C).

3. *Uncodified Reporting of Ownership in Closely Held Businesses*

In an uncodified section from the 2005 bankruptcy amendments, Congress directed that the Judicial Conference produce a new form to provide “more complete information regarding assets of the estate.”⁶⁸ It is not all estate assets about which Congress was concerned. Rather, the new form is to provide information about “the value, operations, and profitability of any closely held corporation, partnership, or of any other entity in which the debtor holds a substantial or controlling interest.” This section applies only to chapter 11 filers and will affect the owners of closely held businesses rather than the businesses themselves.

To implement this uncodified section, the Advisory Committee on Bankruptcy Rules has proposed a rule⁶⁹ and an official form.⁷⁰ Like the other small business rules and forms, this rule and form have just been released for public comment and would take effect on December 1, 2008, at the earliest. The Advisory Committee did not release an interim rule to implement this provision.

The information required by this section is not likely to be readily available for the business owners who will have to file them. Unlike the constant marketplace valuation of publicly traded corporations, there is no running assessment regarding the value of any closely held corporation. Also, while most closely held businesses may keep track of their business affairs and produce reports appropriate for internal decision making, few regularly produce the elaborate financial statements the form and rules contemplate.

The proposed official form runs nine pages with exhibits and has seven pages of instruction. A separate form will need to be filed for each closely held entity that the debtor controls. The form begins with a requirement that the debtor produce an estimate of the entity’s value, using a valuation that is not more than two years old. Apparently, if a more recent valuation is not available, one will need to be prepared as an expense of the estate. Next comes a balance sheet, an income statement, a statement of cash flows, and a statement of owners’ equity. The form contemplates very detailed statements. For example, on the sample balance sheet, the instructions have thirty-five

68. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109–8, § 419(a), 119 Stat. 23, 109.

69. See FED. R. BANKR. P. 2013.5 (proposed Aug. 2006) (*available at* http://www.uscourts.gov/rules/Excerpt_BK_Report_Pub.pdf#page=72) (last visited Feb. 12, 2007).

70. See Official Form 26, Periodic Report Regarding Value, Operations and Profitability of Entities in Which the Estate of [Name of Debtor] Holds a Substantial or Controlling Interest (proposed Aug. 2006) (*available at* http://www.uscourts.gov/rules/BK_Forms_08_Official/Form_26_1208_Combined.pdf) (last visited Feb. 12, 2007).

separate line entries. Finally, the report must conclude with a description of the entity's operations for which the instructions identify thirteen separate matters that must be addressed.

The burden created by this uncodified reporting requirement could be potentially a huge expense if the information was not already regularly produced by the debtor. The proposed interim rule alleviates some of this burden by allowing the court to modify the reporting requirement if the debtor is not able to comply in good faith or if the information is not publicly available.⁷¹ The uncodified section, form, and rule suggest a paradigm case of a nonbankrupt, wholly-owned subsidiary of a large corporation in chapter 11. A large business organization would be much more likely to regularly produce the information requested by the form. The bankruptcy courts could alleviate the burden on small business owners who find themselves in chapter 11 by liberally exercising the exemptive authority allowed under the rule.

The proposed rule also clears up a statutory ambiguity by establishing a rebuttable presumption of 20% as the threshold for the ownership at which an interest would be considered "controlling or substantial" to trigger the reporting requirement.⁷² Parties can file motions to rebut this presumption.

4. *Why It Matters—Putting It Together with the Dismissal Rule*

The expanded reporting requirements are onerous and many are unnecessary. For small businesses trying to reorganize, these requirements will add extra expense both in terms of out-of-pocket costs and in time devoted to the paperwork needed to comply. Indeed, the opportunity cost of management's time while they are trying to reorganize a business may be the biggest impediment imposed by the new reporting requirements. Congressional hostility to small business reorganization did not stop at the added costs. What makes the expanded disclosure requirements perhaps most worrisome is that each becomes grounds to seek possible dismissal of a chapter 11 case.

In the 2005 bankruptcy laws, Congress expanded the grounds for dismissal or conversion of a chapter 11 case. There are now sixteen enumerated grounds for dismissal or conversion.⁷³ Among these new grounds

71. See FED. R. BANKR. P. 2013.5(d) (proposed Aug. 2006) (available at http://www.uscourts.gov/rules/Excerpt_BK_Report_Pub.pdf#page=72) (last visited Feb. 12, 2007).

72. See *id.*

73. 11 U.S.C.A. § 1112(b)(4) (West Supp. 2006).

are two provisions directed specifically at the failure to meet disclosure requirements:

- Unexcused failure to satisfy timely *any* filing or reporting requirement established by the Bankruptcy Code or Federal Rules of Bankruptcy Procedure⁷⁴
- Failure timely to provide information or attend meetings reasonably requested by the United States trustee⁷⁵

Neither provision is limited by any materiality requirement. The slightest omission could produce a motion to dismiss. Failure to file a form required by section 308, to append forms at the time of the bankruptcy filing, or to prepare an elaborate financial statement mandated by the uncodified section can become grounds for dismissal of a small business case. Although the dismissal rules apply to all chapter 11 cases, they will hit small businesses the hardest because these businesses now have the most disclosure requirements in chapter 11 and the fewest resources with which to deal with them.

Moreover, once grounds have been established to dismiss a case, Congress changed the statutory language to state that the court *shall* (rather than “may”) dismiss the chapter 11 case.⁷⁶ In convoluted language, the court still has discretion to deny dismissal if it can specifically identify unusual circumstances that dismissal would not be in the best interests of creditors.⁷⁷ To invoke this discretion, however, the court must find that there is a reasonable likelihood that a plan will be confirmed and that there was reasonable justification for any omission that created the grounds for dismissal.⁷⁸ Under the new dismissal rules, establishing a ground for dismissal essentially establishes a presumption that dismissal will be granted. The court must make very specific factual findings to overcome the presumption. Again, the burdens will fall specifically on smaller businesses because the reporting requirements give them more potential exit points from the chapter 11 process.

One of the few small business cases to result in a reported opinion since the enactment of the 2005 bankruptcy law illustrates how the disclosure provisions and dismissal rules can interact to produce pernicious effects for

74. § 1112(b)(4)(F) (emphasis added).

75. § 1112(b)(4)(H).

76. Compare 11 U.S.C. § 1112(b) (2000) (court “may” dismiss) with 11 U.S.C.A. § 1112(b)(1) (West Supp. 2006) (court “shall” dismiss).

77. See 11 U.S.C.A. § 1112(b)(2) (West Supp. 2006).

78. See § 1112(b)(2)(A)–(B).

small business. In a case called *In re Franmar, Inc.*, the chapter 11 debtor conceded it fit within the definition of a “small business case” and hence was subject to the new and expanded disclosure requirements.⁷⁹ It had filed the case to prevent a judgment creditor from perfecting a judicial lien.⁸⁰ The debtor operated in a remote area of Colorado, and the debtor used one of the few accountants in the region, a small accounting firm with a few employees. Unfortunately, the debtor’s accountant was busy with tax season, and the debtor did not have the documents required by the new reporting provisions ready at hand.⁸¹ Consequently, the debtor filed its bankruptcy petition but did not append a balance sheet, statement of operations, cash flow statement, or federal income tax return as now required by section 1116.⁸² Instead, the debtor sought an extension of time to file these documents. The U.S. Trustee responded with a motion to dismiss the case, taking the position that the failure to file the small business documents at the time of filing fatally doomed the chapter 11 case and could not be cured by a later filing.⁸³

The bankruptcy court rejected the U.S. Trustee’s arguments. The court reasoned that Congress clearly had made the failure to meet filing requirements in section 109 (certificate of credit counseling) and section 521 (schedules and statement of financial affairs) mandatory grounds for dismissal. Because Congress had not done so with section 1116, the debtor’s failure to file the documents required by that section was not automatically fatal.⁸⁴ Still, failure to file might constitute “cause” if the failure was unexcused. On the facts presented in this case, the court found that the debtor’s reasons were excused.⁸⁵

Although the small business debtor in the *Franmar* case was able to stay in chapter 11, the next bankruptcy court to consider the issue may exercise its discretion in a different manner. Even debtors who successfully fend off motions to dismiss still face the expense, time, and uncertainty of the litigation. In *Franmar*, the U.S. Trustee signaled its willingness to apply the small business disclosure provisions strictly. Together, the new disclosure provisions and the tighter dismissal rules make chapter 11 much more hostile to reorganizing small businesses than the pre-2005 law.

79. *In re Franmar, Inc.*, 361 B.R. 170 (Bankr. D. Colo. 2006).

80. *Id.* at 175.

81. *Id.*

82. *See supra* Part II.C.2.

83. *Franmar*, 361 B.R. at 176.

84. *See id.* at 177-78.

85. *See id.* at 178.

D. Fast Track to Confirmation

The 2005 bankruptcy amendments also put small business cases on a fast track to confirmation. Section 1121(e) expands the period of exclusivity for small business cases to 180 days, rather than the 120 days for all other cases.⁸⁶ Of course, because small businesses numerically predominate larger businesses in bankruptcy court, the apparently “special” 180-day exception for small businesses will be the de facto norm, and the 120-day rule will be the de facto exception. After a plan of reorganization is filed in a small business case, the court must confirm the plan within forty-five days.⁸⁷

The generosity of the expanded exclusivity period is immediately taken away with an absolute deadline of 300 days for the filing of any plan and disclosure statement in a small business case.⁸⁸ This new provision does not merely end exclusivity but is a filing deadline. Failure to file a plan or disclosure statement by the statutory deadline may be a ground to dismiss the chapter 11 case.⁸⁹ There are very limited grounds under which the court may extend the 300-day deadline, but the court must act before the expiration of the deadline.⁹⁰ For the court to extend the deadline, it must find that the debtor has demonstrated by a preponderance of the evidence that the court will confirm a plan within a reasonable time.⁹¹ One wonders what sort of circumstances could lead a small business debtor to be able to demonstrate it can confirm a plan within a reasonable time but not be able to file a plan and proceed to confirmation. The exception seems most likely to be invoked in cases where the debtor will be able to propose a plan in a short amount of time and probably will provide little practical relief for debtors who are unable to meet the statutory deadline.

The only reported decision to consider the tightened plan confirmation deadlines is *In re Florida Coastal Airlines*.⁹² The court attempted to alleviate the debtor of the harsh results of the 300-day deadline, but in its rush to do so, the court stormed past the plain language of the statute. The debtor was a

86. Compare 11 U.S.C. § 1121(e) (2000) (180 day exclusivity period for small business cases) with 11 U.S.C.A. § 1121(b) (West Supp. 2006) (general rule of 120 day exclusivity period).

87. See 11 U.S.C.A. § 1129(e) (West Supp. 2006).

88. See § 1121(e)(2).

89. See § 1112(b)(4)(J); see also *supra* Part II.C.4 (discussing new dismissal rules).

90. See § 1121(e)(3)(C). These same rules apply to a possible extension of the 45-day requirement for the court to rule on confirmation of a small business debtor’s chapter 11 plan. 11 U.S.C. § 1129(e) (2000).

91. See § 1121(e)(3)(A).

92. 361 B.R. 286 (Bankr. S.D. Fla. 2007).

nonoperating airline with serious regulatory issues that threatened its operating authority.⁹³ The debtor had filed a plan within the 300-day deadline, but the IRS objected to the plan.⁹⁴ At the same time, a potential acquirer emerged for the debtor's assets. Negotiations broke down with the acquirer, which then purchased a claim against the debtor so it could propose a competing plan that contemplated the acquisition of the debtor.⁹⁵

The debtor filed an amended plan 309 days after the bankruptcy filing, and the thwarted acquirer filed a competing plan 317 days after the bankruptcy filing.⁹⁶ Missing the irony, each claimed the other's plan could not be filed because of the new statutory 300-day deadline.

The court dealt first with the debtor's plan. It found the 300-day deadline "akin to a statute of limitations."⁹⁷ Therefore, the court reasoned that the debtor's amended plan could relate back to the time of the filing of its original plan, which was within the statutory deadline. The court analogized to civil procedure rules that allowed an amended complaint to an original complaint and so as to satisfy statute of limitations deadlines.⁹⁸ Recognizing that Federal Rule of Bankruptcy Procedure 7015 governing the relation back of complaints was specifically limited in scope, the court fell back on its general powers under section 105 to interpret section 1121 to allow the relation back of amended plans.

But section 105 is not a free-floating power for the court to do what it believes is right. It certainly is not a power to change normal rules of statutory interpretation. Rather, section 105 only specifies that a court may issue "order, process or judgment" necessary to carry out the provisions of the Bankruptcy Code. The court's opinion seemed more to stem from a passage of the opinion where it declared itself "highly reorganization minded."⁹⁹ The court might have found a different way to its desired conclusion without having to make

93. *See id.* at 288-89.

94. *Id.* at 289.

95. *Id.*

96. *Id.*

97. *Id.* at 290.

98. *Id.*

99. In its recitation of the facts, the court stated:

As a Westlaw or Lexis search will reveal, I was involved in a number of airline reorganizations as a practicing lawyer. Like most bankruptcy judges, I am highly reorganization minded and will endeavor to confirm chapter 11 plans whenever the requirements of the Bankruptcy Code are met. I would like nothing better than to have this case become successful. Having said that, I can only act on the facts and law that are before me. I am duty bound, and will, honestly apply the facts presented to the law as I can best understand it.

Id.

section 105 do such heavy lifting. Section 1121(e) specifies a 300-day deadline for filing of the plan, but it does not specify the consequences for failure to meet that deadline. Rather, those consequences come from section 1112 and are possible dismissal or conversion.¹⁰⁰ For dismissal or conversion to occur, however, the statute specifies it must occur “on request of a party in interest.”¹⁰¹ Here, there was no request for dismissal of the case—both the debtor and its primary creditor saw the chapter 11 process as their best hope. Without a motion for dismissal, the court could proceed with the case. Moreover, if the creditor had asked for dismissal, then the court’s description of the case suggests it could have made the requisite finding that there was a reasonable likelihood that a plan would be confirmed within a reasonable time and there was reasonable justification for the debtor’s delay. Indeed, plans already had been proposed, and the court indicated it would approve the debtor’s disclosure statement.¹⁰² These are precisely the grounds for a court to exercise its discretion to deny dismissal of a chapter 11 case even if filing deadlines are missed.¹⁰³

After ruling it could consider the debtor’s plan, the next question for the court was whether it could consider the creditor’s plan filed 317 days after the bankruptcy filing. The court found the 300-day statutory deadline applicable only to plans filed by a debtor.¹⁰⁴ The statute clearly specifies that a court can extend the statutory deadline if *the debtor* is able to prove by a preponderance of the evidence that the court will confirm a plan within a reasonable period of time.¹⁰⁵ If the deadline applied to creditor-proposed plans, the statute would put the fate of the creditor’s plan in the hands of the debtor—an absurd result that Congress could not have intended.¹⁰⁶ The statute also states the filing of *the* plan must be filed by the 300-day deadline.¹⁰⁷ The court reasoned that the use of the definite article “the” referred back to the immediately preceding clause giving the debtor (but not the creditor) a 180-day exclusivity period in which to file a plan.¹⁰⁸ The court’s reading of the statutory language here is persuasive. The result, however, could lead to the anomalous situation where,

100. See *supra* Part II.C.4 (discussing new dismissal rules).

101. See 11 U.S.C.A. § 1112(b)(1) (West Supp. 2006).

102. *Fla. Coastal Airlines*, 361 B.R. at 289.

103. See § 1112(b)(2); see also *supra* notes 77–79 and accompanying text (discussing the circumstances under which a court may exercise its discretion on motions to dismiss or convert a chapter 11 case).

104. See *Fla. Coastal Airlines*, 361 B.R. at 291. Because the court found it could consider both the debtor’s and creditor’s plans, it ordered further proceedings in the case. *Id.* at 292.

105. 11 U.S.C.A. § 1121(e)(3) (West Supp. 2006).

106. See *Fla. Coastal Airlines*, 361 B.R. at 291.

107. § 1121(e)(2).

108. See § 1121(e)(1); *Fla. Coastal Airlines*, 361 B.R. at 291.

after the expiration of the 300-day deadline, a creditor could have the power to propose a plan, but a small business debtor would not.

E. Standard Form Disclosure Statements and Reorganization Plans

Although the 2005 bankruptcy amendments generally make it more difficult for small businesses to navigate the chapter 11 process, the changes to the disclosure statement and reorganization plan could provide some new flexibility and perhaps cost savings that were not previously present. First turning to disclosure statements, section 1125(f) now allows a court to conditionally approve a disclosure statement and allow creditor voting with the effect that the confirmation hearing will be a hearing both on confirmation and the disclosure statement, to accept disclosure statements on a standard form, or to waive the requirement of a disclosure statement altogether if the plan contains adequate information. The 2005 bankruptcy amendments also directed the Advisory Committee on Bankruptcy Rules to promulgate standard form disclosure statements and plans of reorganization for small business cases.¹⁰⁹

There is no requirement that the standard forms be used. Rather, use of the standard forms provides the debtor with a safe harbor under section 1125(f).¹¹⁰ The standard forms, therefore, undoubtedly will become the baseline against which courts will measure the adequacy of disclosure in small business cases. For that reason, an assessment of the new small business disclosure statement and confirmation rules must begin with an examination of these forms.¹¹¹ The Advisory Committee on Bankruptcy Rules has

109. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 433, 119 Stat. 23, 110-11.

110. See 11 U.S.C.A. § 1125(f)(2) (West Supp. 2006).

111. Judge Bruce Markell summarized the potential effect of these the standard form disclosure statements and reorganization plans:

The provisions of the 2005 Act which direct the National Bankruptcy Rules Committee to draft and promulgate guidelines on disclosure represent a new direction, and a direction that is somewhat contrary to the legislative history for that original Code. That history indicates only a limited role for the National Bankruptcy Rules Committee in specifying adequate information in particular cases. Moreover, the drafting of such guidelines, particularly for small business, may prove difficult. As *Collier on Bankruptcy* states for smaller cases, "the disclosure statement must clearly and succinctly inform the average unsecured creditor what it is going to get, when it is going to get it, and what contingencies there are to getting its distribution." Forced compliance with the longer lists, the treatise surmises, "would all but doom the small and medium size businesses which might have been able to make use of the old Chapter XI."

proposed an official form that will take effect on December 1, 2008, assuming that the Judicial Conference or Congress does not object.¹¹²

The first thing one notices about the proposed official form disclosure statement is that it runs twenty-six pages just in its blank state. Completed disclosure statements for small business cases will be even longer than twenty-six pages. There is no doubt that the form will be of some benefit to small business debtors who will be able to simply copy the boilerplate disclosures relating to descriptions of claims, voting, confirmation requirements, and the like. Overall, however, the complexity and length of the proposed form disclosure statement will swamp many small business debtors. Moreover, the proposed official committee note implies the proposed form provides a floor for adequate information, inviting small business debtors to supply additional information, but remaining silent on the possibility of providing less information.¹¹³

Section 1125(f), which governs the approval process for a disclosure statement in a small business case, does not require the use of the standard form disclosure statement, or at least does not apparently require its use. In another example of sloppy drafting, the subsection uses the conjunctive word “and” between the different processes listed in the statute:

1. Court may determine the plan itself contains adequate information and dispense with a disclosure statement;

This impact and consequences of this part of the 2005 Act will develop over time as the National Rules Committee develops and drafts its forms.

Bruce A. Markell, *Right Without a Remedy?: Individual and Small Business Chapter 11 Under the New Code*, Materials Presented to the Winter Leadership Conference of the American Bankruptcy Institute (Dec. 1–3, 2005) (available on Westlaw at 120105 ABI-CLE 195).

112. See Official Bankruptcy Form 25B, [Name of Proponent]’s Disclosure Statement, Dated, at 1 [Insert Date] (proposed Aug. 2006) (*available at* http://www.uscourts.gov/rules/BK_Forms_08_Official/Form_25B_1208_Combined.pdf) (last visited Feb. 12, 2007).

113. The proposed official committee note reads:

Because the relevant legal requirements for, and effect of, a plan’s confirmation may vary depending on the nature of the debtor and the details of the proposed plan, this form is intended to provide an illustrative format for disclosure, rather than a specific prescription for the language or content of a particular disclosure statement. The form highlights the factual and legal disclosures required for adequate disclosure under § 1125 of the Code. The form is not intended to restrict a plan proponent from providing additional information where that would be useful.

Official Bankruptcy Form 25B [Name of Proponent]’s Disclosure Statement, Dated [Insert Date] committee note, at 31 (proposed Aug. 2006) (*available at* http://www.uscourts.gov/rules/BK_Forms_08_Official/Form_25B_1208_Combined.pdf) (last visited Feb. 12, 2007).

2. Court may approve a disclosure statement submitted on standard forms; and
3. Court may conditionally approve a disclosure statement and combine final approval the disclosure statement with approval of the plan.¹¹⁴

The use of the conjunctive “and” normally would imply that a small business debtor must satisfy all three elements in the list. Nevertheless, the first alternative (allowing the reorganization plan to function as the disclosure statement) is mutually exclusive with both the second alternative (approval of a disclosure statement on the standard form) and the third alternative (conditional approval of disclosure statement). The subsection is best read in the disjunctive, meaning that use of the standard form is one of three permissible options.

One wonders, however, how realistic the other two options are in a world with form disclosure statements. If the proposed standard form becomes official in its current form, it will ask for a plethora of information. A small business debtor who provided less information in its own customized disclosure statement will have to explain to the court why its disclosure is adequate despite a form with more complete disclosures sanctioned by the Advisory Committee on Bankruptcy Rules, the Judicial Conference, and (implicitly) Congress. Also, given the amount of information in the proposed form disclosure statement, it seems unlikely that a reorganization plan would provide adequate information on its own. Although the standard form disclosure statement is only one of three options allowed under the statute, it may become a de facto requirement.

The Advisory Committee on Bankruptcy Rules also has proposed an official form reorganization plan for small business cases.¹¹⁵ Again, the official form makes useful contributions by standardizing language for items such as the assumption or rejection of executory contracts and the debtor’s discharge. In contrast to the proposed disclosure statement form, the form reorganization plan is skeletal, providing only broad outlines of what might be required. For example, one commentator suggested that the form reorganization plan could benefit small business debtors by providing standard language for retention of postconfirmation jurisdiction or standard

114. § 1125(f).

115. Official Bankruptcy Form 25A, [Name of Proponent]’s Plan of Reorganization, Dated [Insert Date], at 1 (proposed Aug. 2006) (*available at* http://www.uscourts.gov/rules/BK_Forms_08_Official/Form_25A_1208_Combined.pdf) (last visited Feb. 12, 2007).

definitions.¹¹⁶ The proposed form reorganization form does not address postconfirmation jurisdiction and merely references the statutory definitions in the Bankruptcy Code. In fact, the proposed form provides a procedure to resolve disputed claims subject to court approval without specifying that the bankruptcy court would retain jurisdiction.

Thus, the proposed official forms for the disclosure statement and reorganization plan are a mixed bag for small businesses in chapter 11. The statute does streamline the process by making it possible to combine the hearings on the disclosure statement and confirmation.¹¹⁷ Where the proposed official disclosure statement may result in a de facto standard that will swamp many small business debtors with expense and paperwork, the proposed official form reorganization plan provides only skeletal guidance to small business debtors. As this article is written, the implementation dates for the proposed forms are almost two years away. Subsequent developments may result in the forms' improvement.

F. Small Business Owners and the Religious Liberty and Charitable Donation Clarification Act of 2006

In late 2006, members of Congress fell all over themselves rushing to guarantee the right to tithe even if the person tithing is in bankruptcy court. Although it seems a topic unlikely to have implications for small business, the congressional action on tithing could have severe adverse consequences for small business owners who find themselves in chapter 13. The story begins with a ruling from the bankruptcy court in Albany, New York.

The case began with the chapter 13 filing of Frank and Patricia Diagostino. When asked on their Statement of Financial Affairs to list all charitable contributions made in the past year, they listed "none."¹¹⁸ In their chapter 13 plan, however, the Diagostinos proposed to make a \$100/month charitable contribution, making them not the first set of debtors to discover a sudden interest in charitable giving after filing bankruptcy. The chapter 13 trustee objected, noting that the Diagostinos' income was above their state's median and therefore they had to use the IRS Guidelines to compute their allowable expenses.¹¹⁹ Because the IRS Guidelines do not allow for charitable contributions, the chapter 13 trustee reasoned the Diagostinos could not

116. Markell, *supra* note 111.

117. See § 1125(f)(3).

118. *In re Diagostino*, 347 B.R. 116, 117 (Bankr. N.D.N.Y. 2006).

119. *Id.*

deduct charitable contributions in calculating their disposable income to devote to their chapter 13 plan.

To understand the chapter 13 trustee's argument requires a trip through the changes the 2005 bankruptcy law made to the relevant provisions governing confirmation of a chapter 13 plan. Generally stated, a debtor must devote all of his or her disposable income to payments under the chapter 13 plan.¹²⁰ Before the 2005 amendments, disposable income was income "not reasonably necessary to be expended" for (A)(i) maintenance or support of the debtor or the debtor's dependents (including alimony and child support), (ii) for charitable contributions not to exceed 15% of income, and (B) for the payment of expenditures necessary for the continuation, preservation, and operation of a business.¹²¹ (In numbering the provisions, I have used the nomenclature of the post-2005 version of the statute.). The 2005 amendments added to these requirements by stating that, for debtors above the median income for their state, amounts reasonably necessary to be expended had to be calculated under "section 707(b)(2)," the complex means test that determines eligibility for chapter 7 and that refers to IRS Guidelines to determine expenses.¹²²

The court reluctantly agreed with the chapter 13 trustee, finding the plain reading of the statute compelling.¹²³ The language, however, is ambiguous. It merely states that amounts allowable as deductions are to be calculated under "section 707(b)(2)." One could read an implied exception for the three items that Congress chose to specifically list as allowed deductions. As the court noted, its holding created an anomalous reading of the statute where below-median income debtors could deduct certain expenses but above-median income debtors could not.¹²⁴ The court might also have noted that its reading of the statute also would subject to the means test expenditures for the operation of a business. Because the IRS Guidelines do not allow for the deduction of business expenses just like charitable contributions, the court's reading would effectively mean above-median income self-employed individuals could not confirm a chapter 13 plan.

The court also was heavily influenced by the legislative provenance of the subsection under consideration. During the 2005 law's consideration, Senator Russell Feingold proposed an amendment that would have specifically

120. See 11 U.S.C.A. § 1325(b)(1)(B) (West Supp. 2006).

121. See 11 U.S.C. § 1325(b)(2) (2000).

122. See 11 U.S.C.A. § 1325(b)(3) (West Supp. 2006); see also 11 U.S.C.A. § 707(b)(2) (West Supp. 2006).

123. *Diagostino*, 347 B.R. at 120.

124. *Id.*

subjected the (A)(ii) charitable contribution expense—and only this expense—to the IRS Guidelines. The court stated, “Later, during the same Senate proceedings and debates, Senator Feingold submitted another amendment” that would have submitted all of a chapter 13 debtor’s expenses to section 707(b)(2) and the means test.¹²⁵ Apparently, the court reasoned the later proposed amendment somehow superseded the earlier amendment and was evidence of legislative intent.

The court completely misapprehended the legislative record. Senator Feingold submitted both amendments on the same day. In fact, the amendments were part of a package of fifteen amendments that Senator Feingold submitted simultaneously.¹²⁶ The two amendments were mutually exclusive; both could not have passed the Senate. Rather, they were obviously part of a set of parliamentary maneuvers by a vocal opponent of the 2005 bankruptcy law. In the end, Senator Feingold withdrew both amendments, and they never received a Senate vote.¹²⁷ Even if the amendments had gone to a vote, they never stood a chance of being accepted. Supporters of the bankruptcy legislation were able to block virtually every amendment offered in the Senate. The *Diagostino* court should have treated these proposed amendments as the political maneuvers they were rather than indicia of legislative intent.

Although the *Diagostino* decision was a plausible reading of the statute, it was not one compelled by the statute’s language. The decision created several anomalies in the statute. Most egregiously, the decision heavily relied on a legislative record about which it was completely mistaken. Nonetheless, the stage was set for a picture-perfect political moment. Senators Grassley, Hatch, and Sessions wrote a letter to the Executive of Office of U.S. Trustees asking it to reject the *Diagostino* result as a matter of administrative enforcement.¹²⁸ The political forces that arrayed to attack *Diagostino* decision were roughly the same coalition that sold a story about a bankruptcy system that was so rife with irresponsible debtors that it needed a major overhaul in 2005. But churches had to come before credit card companies.

Although Congress could not muster enough interest for a technical corrections bill to fix even obviously flawed statutory language in the 2005

125. *Diagostino*, 347 B.R. at 119.

126. 151 CONG. REC. S2134–S2138 (daily ed. Mar. 7, 2005).

127. *Id.* at S2342 (daily ed. Mar. 9, 2005) (withdrawing Senate Amendment 94); *id.* at S2462–S2463 (daily ed. Mar. 10, 2005) (withdrawing Senate Amendment 96).

128. See Press Release of Senator Hatch, September 15, 2006 at http://hatch.senate.gov/index.cfm?FuseAction=PressReleases.Detail&PressRelease_id=1654 (last visited Feb. 12, 2007).

bankruptcy law, it enthusiastically rushed to “fix” the *Diagostino* decision. Eventually, two other bankruptcy courts accepted the *Diagostino* holding, but at the time Congress initially moved to act, it was reacting to one bankruptcy court decision from upstate New York.¹²⁹ The legislation that resulted, the Religious Liberty and Charitable Donation Clarification Act of 2006,¹³⁰ added only six words to section 1325(b)(3): “except as provided in subparagraph (A)(ii).” Because 1325(b)(3) is the provision subjecting chapter 13 expenses to the means test and (A)(ii) is the charitable donation provision, the effect is to clearly allow above-median income debtors to deduct charitable donations (up to 15% of income) in determining their allowable chapter 13 expenses.

In the stampede to look good on the issue of charitable deductions, the Senate missed the fact that its actions could make it impossible for some self-employed debtors to fund chapter 13 plans. By expressly excluding charitable deductions from the chapter 13 means test, Congress has implicitly included other items—*exclusio unius est expressio alterius*. Specifically, Congress has subjected to the means test the deductions in section 1325(b)(2)(B): “expenditures necessary for the continuation, preservation, and operation of such business.”¹³¹ The end result is that an above-median income chapter 13 debtor could not deduct business expenses in calculating the “disposable income” that must be paid through the chapter 13 plan. Under such a rule, self-employed individuals would not be able to confirm a chapter 13 plan.

Courts might ameliorate the harsh, silly, and likely unintended result of the new law by simply ignoring its implications for chapter 13 business expenses. Perhaps more likely and more consistent with the judicial role, a court could read the prohibition on the deduction of business expenses as applying only to extraordinary expenses. A self-employed individual in chapter 13 still could deduct ordinary expenses to arrive at a starting point of net income to begin the calculations for confirmation of a chapter 13 plan. For example, a self-employed carpenter would be allowed to deduct the costs of material rather than reporting the gross amount of wages as income. In the end, the bankruptcy court system will adapt to the implications of the Religious Liberty and Charitable Donation Clarification Act of 2006. Still, it

129. *In re Meyer*, 2006 WL 3505379 (Bankr. D.N.M. 2006); *In re Tranmar*, 355 B.R. 234 (Bankr. D. Mont. 2006).

130. Pub. L. No. 109-439, 120 Stat. 3285.

131. The same would be true for amounts mentioned in 11 U.S.C.A. § 1325(b)(2)(A)(i) for expenditures to pay a domestic support obligation like alimony or child support. A different section, however, makes it clear that such payments are allowable deductions under the means test. *See* 11 U.S.C.A. § 707(b)(2)(A)(iv) (West Supp. 2006) (allowing deduction for payments on priority debt, including priority child support and alimony).

stands as yet another example of congressional antipathy or apathy toward financially distressed small businesses and their owners.

III. SOME PREDICTIONS AND AN EMPIRICAL RESEARCH AGENDA

The previous part demonstrated that the doctrinal changes in the 2005 bankruptcy law restricted the access of small businesses to federal bankruptcy protection. Unlike every other area of public policy, the changes to the federal bankruptcy law singled out small businesses for harsher treatment than their larger counterparts. This section considers what these changes will possibly mean. Today, the effects of these changes are necessarily speculative, but with the passage of time, we will have facts against which to measure the effects of the changes. By their nature, each of my predictions is a hypothesis that can be tested through empirical data, and I will offer a few thoughts on the availability of empirical data to test each prediction.

A. Prediction 1—Increased Costs & Increased Financial Distress

This article posits the 2005 changes will have deleterious effects on smaller businesses seeking relief in bankruptcy court. First, the 2005 changes imposed substantially increased new disclosure requirements on small businesses in bankruptcy. Second, the 2005 amendments create more opportunities for litigation in small business bankruptcy cases. If nothing else, there will be the attendant litigation that comes as courts sort out ambiguities in any new piece of legislation, but the litigation costs should be much more than that. For example, small business debtors will face an increased likelihood of litigation over a motion to dismiss their chapter 11 case.¹³² Set against these increased litigation costs are perhaps some savings from standard-form reorganization plans and disclosure statements, but the length and complexity of the proposed forms suggests any costs savings will be modest.¹³³

Thus, one testable hypothesis is the costs of small business bankruptcy will be greater after the 2005 bankruptcy law than it was previously. Although the changes may result in increases in other direct costs, such as accountants' fees perhaps to deal with the enhanced disclosure, attorneys' fees

132. *See supra* Part II.C.4.

133. *See supra* Part II.E.

should be the most likely place to find increased costs. Specifically, we should expect to see the changes lead to increased attorneys' fees as small business debtors struggle with challenges to their eligibility for bankruptcy or with demands for increased disclosure. As a preliminary estimate of pre-2005 costs, consider my own previous research looking at a sample of cases from 1991–1995 found in the median case that attorneys' fees were 2.7% of the total assets listed at filing in a small business chapter 11.¹³⁴ To properly assess the effect of the 2005 bankruptcy law, a comparative figure should be established closer to the law's effective date.

As a corollary to the prediction of increased costs after the 2005 bankruptcy law, we should see small businesses delay filing bankruptcy and hence arrive in bankruptcy court in worse financial shape than their pre-2005 predecessors. Hence, we should expect post-2005 bankrupt small businesses to have higher debt-asset ratios, lower income-debt ratios, and generally a worse financial picture overall.

Moreover, the data to test this hypothesis is readily available or at least available with a little effort. Bankruptcy filers must complete voluminous schedules stating their financial condition. Similarly, payments for professionals to run the bankruptcy case (e.g., attorneys, accountants, auctioneers) generally must be reported to the bankruptcy court. It would be a simple matter to gather this data and compare the cost levels before and after the 2005 bankruptcy law.

B. Prediction 2—Fewer Business Chapter 11 Cases

Legal systems are adaptive. In addition to possibly increased costs, the 2005 bankruptcy law certainly raised the hassle—more technically will raise the opportunity costs of management's time—and harshness of small business bankruptcy. The increased amount of hassle will merely cause small businesses in financial distress to seek help elsewhere. Indeed, even before the 2005 bankruptcy law, most financially distressed small businesses liquidated or reorganized without the intervention of a formal bankruptcy proceeding. The 2005 bankruptcy law should cause a decline in the number of businesses using formal bankruptcy proceedings.

Along with Professor Warren, I have previously written about the slippery notion of a “business debtor” and demonstrated that current U.S. bankruptcy filing numbers from the Administrative Office of U.S. Courts undercount the

134. Stephen P. Ferris & Robert M. Lawless, *The Expenses of Financial Distress: The Direct Costs of Chapter 11*, 61 U. PITT. L. REV. 629, 650 (2000).

number of business bankruptcies using traditional definitions.¹³⁵ To gain the most accurate measure of declining small business filing rates, it will be necessary to go beyond the government data. Rather, scholars will have to examine underlying files to capture the business cases that the government data will miss.

One area where it should be easiest to measure the declining small business filing rate is chapter 11. Many of the 2005 law's provisions directed at small business are directed at small businesses in chapter 11. To measure any possible decline in chapter 11 filings, however, it is important that the effect be measured at the margins. Bankruptcy filings have declined generally since enactment of the 2005 bankruptcy law. It is not enough simply to observe that bankruptcy or chapter 11 filings have gone down. The prediction is that fewer chapter 11s will be filed than would have been had it not been for the 2005 bankruptcy law. Sophisticated econometric techniques will be necessary to tease out the effect of the 2005 law separate from other economic factors.¹³⁶

Merely because fewer businesses will file chapter 11 does not mean there will be less financial distress. Bankruptcy is not a cause of financial distress but a symptom of it. As we see less use of formal bankruptcy proceedings, we should expect to see greater use of other mechanisms to resolve financial distress. One proceeding that is reportedly on the rise is the use of assignments for the benefit of creditors. Unfortunately, the use of chapter 11 alternatives are difficult to track. Assignments for the benefits of creditors, for example, are state law proceedings, and general statistics are not kept about the use of such proceedings. An open research question is both the incidence and the dynamics of these sorts of proceedings.

C. Prediction 3—Entrepreneurial Activity Will Decline

Several scholars have noted that the harshness or leniency of a bankruptcy system can be negatively or positively associated with entrepreneurial activity. Armour constructed an index to capture the harshness of bankruptcy laws within the European Union and finds harsher bankruptcy laws were associated with lower levels of venture capital.¹³⁷ Fan and White found that, within the

135. See Lawless & Warren, *supra* note 29; see also *supra* notes 29–30 and accompanying text (estimating total number of debtors with a business that current filing statistics might miss).

136. See Robert M. Lawless, *The Paradox of Consumer Credit*, 2006 U. ILL. L. REV. 347 (using time-series analysis to separate short-term and long-term effects of consumer credit on bankruptcy filing rates).

137. See John Armour, *Personal Insolvency Law and the Demand for Venture Capital*, 5 EUR. BUS. ORG. L. REV. 87 (2004).

United States, persons living in a state that offers more asset protection through higher exemptions are 35% more likely to own a business than persons in low exemption states.¹³⁸ A recent working paper finds that persons in states surrounded by high exemption states are less likely to start businesses.¹³⁹

The 2005 bankruptcy laws affect both small businesses and small business owners. Small businesses that experience financial distress will have a more difficulty reorganizing. Small business owners will have more difficult time escaping the debts of a failed business. Not only will small business owners be saddled with debts of an old business and thereby less able to start a new enterprise, but they also will find it less attractive to undertake a new startup business. Consistent with this previous work, we can expect entrepreneurial activity in the United States to decline *ceteris paribus*. Again, the effect will have to be measured at the margin. My prediction is not that the 2005 bankruptcy law will cause United States entrepreneurial activity, to suddenly cease. Rather, as measured before and after—and again using sophisticated econometric techniques to control for general economic factors—we should see less entrepreneurial activity after the 2005 law than before.

IV. CONCLUSION

Although the consumer credit industry sold the 2005 law primarily as a law to rid the bankruptcy system of abusive consumers, the statute actually makes significant changes to the bankruptcy laws most relevant for small businesses and small business owners. Congress did not stop there and made a more recent change that might affect the deductibility of small business expenses in chapter 13. These are unprecedented developments in American law. Never before has Congress singled out small businesses for harsher treatment than large corporations. This article has catalogued the changes Congress made, explained why these changes create problems for small

138. See Wei Fan & Michelle J. White, *Personal Bankruptcy and the Level of Entrepreneurial Activity*, 46 J.L. & ECON. 543 (2003). Section 522 of the Bankruptcy Code allows a bankrupt debtor to keep certain assets, such as a homestead, car, and other personal items, generally up to a certain value. These assets are said to be “exempt.” 11 U.S.C.A. § 522 (West Supp. 2006). Under section 522, each state may decide that its own state exemption laws will apply to federal bankruptcy proceedings for its residents. Thirty-seven states have made this election.

139. Aparna Murtha, Working Paper, *A Spatial Model of the Impact on State Bankruptcy Exemptions on Entrepreneurship* (2005) (available at <http://www.sba.gov/advo/research/rs261tot.pdf>) (last visited Feb. 12, 2007).

business, and proffered some empirical predictions about changes we are likely to see.