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**BANKRUPTCY, REORGANIZATION AND CREDITORS' RIGHTS GROUP  
CLIENT ALERT**

To: Our Clients and Friends

November 9, 2012

**Bankruptcy Court Opinion Makes It Virtually Impossible for Individual Chapter 11 Debtors to Confirm a Plan Over Objection by an Undersecured Lender**

Today, the United States Bankruptcy Court for the District of Puerto Rico, in a case of first impression in this district, issued the attached opinion and order, concluding that the absolute priority rule applies to individual Chapter 11 debtors. *In re Lee Min Ho Chen*, Case No. 11-08170 (BKT), Docket No. 211.

The absolute priority rule of Section 1129(b) of the Bankruptcy Code is a fundamental creditor protection in a Chapter 11 bankruptcy case. In general terms, the rule provides that if a class of unsecured creditors rejects a debtor's reorganization plan and is not paid in full, junior creditors and equity interestholders may not receive or retain any property under the plan. The rule thus implements the general state-law principle that creditors are entitled to payment before shareholders, unless creditors agree to a different result. Recent litigation in the federal courts nationwide has raised the issue and created a split among courts as to whether the absolute priority rule still applies in Chapter 11 cases filed by individuals.

The absolute priority rule has been prominent in bankruptcy disputes, including a number of Supreme Court decisions. The current controversy concerns whether the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), which otherwise is a creditor-friendly statute, modified the Bankruptcy Code to eliminate the absolute priority rule if the debtor is an individual. The issue is particularly important because BAPCPA's restrictions on eligibility for relief under Chapter 7 or Chapter 13 have made Chapter 11 the only realistic option for many individual debtors.

In today's opinion, the first from the U.S. Bankruptcy Court for the District of Puerto Rico on this issue, the Court held that the absolute priority rule applies in individual Chapter 11 cases and, accordingly, a debtor may not retain any pre-petition property "unless senior classes of claims are paid in full *or* unless all senior classes vote to accept the proposed plan". *In re Lee Min Ho Chen*, Case No. 11-08170 (BKT), Docket No. 211. In this case, the debtor proposed a chapter 11 plan of reorganization that would pay unsecured creditors approximately .05% on their claims, yet the debtor sought to retain her pre-petition non-exempt property which included, among other things, her home and certain commercial properties. The debtor's lender, represented by O'Neill & Borges, objected to the plan and argued that the plan, among other things, violated the absolute priority rule as the debtor was not paying unsecured claims (including the lender's unsecured deficiency claim) in full. The Court agreed.

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This is an important decision for debtors and creditors, marking a major shift in the leverage of undersecured lenders in the negotiation and confirmation of an individual debtor's chapter 11 plan. The ruling is significant in that, among other things, it makes it virtually impossible for individual debtors to confirm a plan over an undersecured lender's objection, which would require the debtor to do one of the following: (a) pay in full the lender's unsecured deficiency claim (as well as all other unsecured claims) and all senior claims; or (b) surrender all of the debtor's non-exempt pre-bankruptcy property. This decision is expected also to weigh heavily in the pre-bankruptcy planning for individual Chapter 11 debtors, as the ability to confirm a Chapter 11 plan now depends to a substantial degree on such debtor's ability to obtain its lender's consent and acceptance of such plan.

To discuss this issue further, please contact us. A full list of O'Neill & Borges LLC's Bankruptcy, Reorganization and Creditors' Rights professionals may be found at: [www.oneillborges.com/areasofpractice-bankruptcy-reorganization.htm](http://www.oneillborges.com/areasofpractice-bankruptcy-reorganization.htm).