No. 15-6001

UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE EIGHTH CIRCUIT

In re SUZETTE WOODWARD, *Debtor.*

HERITAGE BANK,
Creditor-Appellant,
– vs. –

SUZETTE WOODWARD,
Debtor-Appellee.

Direct Appeal from the U.S. Bankruptcy Court for the District of Nebraska
Bankruptcy Case No. 11-409-36-TLS

AMICUS BRIEF *for the* NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS

In Support of Debtor/Appellee, Supporting Affirmance

NATIONAL ASSOC. OF CONSUMER
BANKRUPTCY ATTORNEYS
By its attorney
Tara Twomey, Esq.
National Consumer Bankruptcy
Rights Center
1501 The Alameda
San Jose, CA 95126
tara.twomey@comcast.net

On brief: David Barnes

Dated: May 12, 2015

Appellate Case: 15-6001 Page: 1 Date Filed: 05/12/2015 Entry ID: 4274580

CORPORATE DISCLOSURE STATEMENT

Pursuant to FRAP 26.1 and Fed. R. Bankr. P. 8012, Amicus National Association of Consumer Bankruptcy Attorneys ("NACBA"), makes the following disclosures: NACBA is a non-governmental corporate entity that has no parent corporations and does not issue stock.

Appellate Case: 15-6001 Page: 3 Date Filed: 05/12/2015 Entry ID: 4274580

TABLE OF CONTENTS

Corporate Disclosure Statement i

Table of Authorities iii

Statement of Interest of *Amicus Curiae* 1

Statement Pursuant to Fed. R. Bankr. P. 8017(c)(4) 2

Summary of Argument 3

Argument 5

THE ABSOLUTE PRIORITY RULE DOES NOT APPLY TO THE DEBTOR'S CHAPTER 11 PLAN, AND THE PLAN WAS CORRECTLY CONFIRMED BY THE BANKRUPTCY COURT....................................... 5

CONCLUSION.. 14

Appellate Case: 15-6001 Page: 4 Date Filed: 05/12/2015 Entry ID: 4274580

Table of Authorities

Cases:

Case v. Los Angeles Lumber Co.,
308 U.S. 106, 60 S. Ct. 1 (1939)... 12

Davis v. Mich. Dept. of Treasury,
489 U.S. 803 (1989)... 9

Hamilton v. Lanning,
560 U.S. 505, 130 S. Ct. 2464, 177 L. Ed. 2d 23 (2010).. 13

Ice House America, LLC v. Cardin,
751 F.3d 734 (6th Cir. 2014) 6, 11

In re Friedman,
466 B.R. 471 (B.A.P. 9th Cir. 2012) 7, 9

In re Kamel,
451 B.R. 505 (Bankr. C.D. Cal. 2011) 11

In re Lively,
717 F. 3d 406 (5th Cir. 2013) 11

In re Maharaj,
681 F. 3d 558 (4th Cir. 2012) 11

In re O'Neal,
490 B.R. 837 (Bankr. W.D. Ark. 2013)... 8, 9, 13

In re Seafort,
669 F. 3d 662 (6th Cir. 2012) 8

In re Shat,
424 B.R. 854 (Bankr. D. Nev. 2010) 9, 13

In re Stephens,
704 F. 3d 1279 (10th Cir. 2013) 11

Appellate Case: 15-6001 Page: 5 Date Filed: 05/12/2015 Entry ID: 4274580

In re Tegeder,
369 B.R. 477 (Bankr. Neb. 2007) 8

Lafayette v. Louisiana Power &Light Co.,
435 U.S. 389, 98 S.Ct. 1123, 55 L.Ed.2d 364 (1978) 10

Lamie v. U.S. Trustee,
540 U.S. 526, 124 S. Ct. 1023, 157 L. Ed. 2d 1024 (2004) 7

Louisville Trust Co. v. Louisville, N.A. & C. Ry. Co.,
174 U.S. 674 (1899) 12

Mogis v. Lyman-Richey Sand & Gravel Corp.,
189 F. 2d 130 (8th Cir 1951) 10

Norwest Bank Worthington v. Ahlers,
485 U.S. 197, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988) 12, 13

Railroad Co. v. Howard,
7 Wall. 392 (1868) 12

Security Farms v. Gen. Teamsters, Warehousemen and Helpers Union, Local 890,
265 F. 3d 869 (9th Cir. 2001) 12

Toibb v. Radloff,
501 U.S. 157, 111 S.Ct. 2197 (1991) 13

U.S. v. I.L.,
614 F. 3d 817 (8th Cir. 2010) 7

United States v. White,
508 F. 3d 453 (8th Cir. 1974) 11

Statutes and Rules:

11 U.S.C. §102(3) 8

Appellate Case: 15-6001 Page: 6 Date Filed: 05/12/2015 Entry ID: 4274580

11 U.S.C. §1115 6-8

11 U.S.C. §1123 5

11 U.S.C. §1123(8) 5

11 U.S.C. §1129(a) 5

11 U.S.C. §1129(a)(15) 5

11 U.S.C. §1129(b)(2)(B) 12

11 U.S.C. §1129(b)(2)(B)(ii) 5-8

11 U.S.C. §1141 5

11 U.S.C. §1141(d)(5)(a) 5

11 U.S.C. §1306 6

11 U.S.C. §541 6

Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA")
Pub. L. No. 109-8, 119 Stat. 23 (2005) 5

Bankruptcy Act §77B 12

Appellate Case: 15-6001 Page: 7 Date Filed: 05/12/2015 Entry ID: 4274580

Other Authorities:

1A Sutherland,
Statutory Construction (7th ed 2009), §23:1 10

Appellate Case: 15-6001 Page: 8 Date Filed: 05/12/2015 Entry ID: 4274580

STATEMENT OF INTEREST OF *AMICUS CURIAE*

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys (NACBA) is a non–profit organization consisting of more than 3,000 consumer bankruptcy attorneys nationwide.

NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors. NACBA has filed *amicus curiae* briefs in various cases seeking to protect the rights of consumer bankruptcy debtors. *See, e.g., Schwab v. Reilly*, 560 U.S. 770, 130 S.Ct. 2652 (2010); *Kawaauhau v. Geiger*, 523 U.S. 57 (1998).

NACBA members primarily represent individuals in bankruptcy cases. Individuals who are sole proprietors or who own businesses or rental properties are often are ineligible for chapter 13 because their debts exceed the limits set forth in 11 U.S.C. § 109(e). Once in chapter 11, many such individuals who want to reorganize are forced into liquidation because of the application of the absolute priority rule. In 2005, Congress made significant amendments to chapter 11 insofar as it applies to individuals, which gave individual debtors a realistic

Appellate Case: 15-6001 Page: 9 Date Filed: 05/12/2015 Entry ID: 4274580

opportunity to reorganize while continuing to protect unsecured creditors. While a significant number of bankruptcy courts and the Ninth Circuit's Bankruptcy Appellate Panel have held that the 2005 amendments to the Bankruptcy Code abrogate the absolute priority rule for individual chapter 11 debtors, other cases have held that individual debtors remain subject to the absolute priority rule. As such, this case is of great importance to NACBA and its membership.

STATEMENT PURSUANT TO FED. R. BANKR. P. 8017(c)(4)

(a) No party's counsel authored this Amicus Curiae Brief in whole or in part;

(b) No party or party's counsel contributed money that was intended to fund preparing or submitting this brief; and

(c) No person, other than the amicus curiae, it members, or its counsel, contributed money that was intended to fund preparing or submitting the brief.

Appellate Case: 15-6001 Page: 10 Date Filed: 05/12/2015 Entry ID: 4274580

SUMMARY OF ARGUMENT

Suzanne Woodward, the Debtor is a one-fourth owner/member of Pathology Specialties, LLC, the entity that employs her as a pathologist. She has proposed a plan, under Chapter 11 of the Bankruptcy Code, under which she will pay all of her disposable income ($4,500 a month) for five years. At the end of the Plan, she will remain vested with her ownership interest in Pathology Specialists. The Bankruptcy Court confirmed her plan over the objection of Heritage Bank, which argued that her retention of her ownership interest in the business violates the absolute priority rule of 11 U.S.C. § 1129(b)(2)(B)(ii).

The 2005 BAPCPA amendments created a Chapter 13-like scheme for individual Chapter 11 debtors. That scheme, for the first time, required individual Chapter 11 debtors to commit to their reorganization plan all their disposable income for five years. Echoing Chapter 13, 11 U.S.C. § 1115 enhanced the bankruptcy estate for a Chapter 11 individual debtor to include post-petition earnings as well as pre-petition property. Simultaneously, Congress amended 11 U.S.C. § 1129(b)(2)(B)(ii) to exclude the application of the absolute priority rule, in the case of individual debtors only, to property defined in § 1115. The plain meaning of this exclusion is that the absolute priority rule does not apply to individual debtors who commit all of their disposable income for five years and otherwise propose a plan that is fair and equitable.

Appellate Case: 15-6001 Page: 11 Date Filed: 05/12/2015 Entry ID: 4274580

Heritage Bank argues that the language is ambiguous because courts disagree about its meaning. However, courts holding that the absolute priority rule continues to apply in individual cases have made serious mistakes in interpreting the statutory language. The only reasonable construction of sections 1115 and 1129(b)(2)(B)(ii) is that individual debtors are not subject to the absolute priority rule.

If the statutory language is ambiguous, consideration of the BAPCPA amendments as a whole demonstrates that the narrow view adopted by some courts renders the amendments ineffectual and delivers a "double whammy" to individual Chapter 11 debtors, making it particularly difficult, if not impossible, for a sole proprietor to propose a confirmable plan over a creditor objection. The broad view of the amendments avoids this double whammy, and it comports with the fresh start policy of the Code and the particular BAPCPA policy to enhance creditor recoveries by getting debtors to pay all they can afford for five years. The absolute priority rule was created for corporate bankruptcies, to protect creditors from shareholder manipulation. Application of the absolute priority rule for individual debtors is neither long-standing nor a "cornerstone" of bankruptcy practice. The BAPCPA amendments clearly intend a change in bankruptcy practice by altering the treatment of individual Chapter 11 debtors, and the broad view of this change is most consistent with the overall scheme of the Bankruptcy Code.

Appellate Case: 15-6001 Page: 12 Date Filed: 05/12/2015 Entry ID: 4274580

ARGUMENT

THE ABSOLUTE PRIORITY RULE DOES NOT APPLY TO THE DEBTOR'S CHAPTER 11 PLAN, AND THE PLAN WAS CORRECTLY CONFIRMED BY THE BANKRUPTCY COURT

Statutory framework. In 2005, Congress adopted significant amendments to the Bankruptcy Code.[1] As part of these revisions, Congress adopted a Chapter 13-like procedure for individual debtors filing under Chapter 11. Section 1123 was amended to require that an individual debtor's Chapter 11 plan must provide for the payment to creditors of all future income needed to execute the plan. 11 U.S.C. § 1123(a)(8). Section 1129(a) was amended to require that, if any creditor objects, the plan must either pay all creditors in full or provide for payment of all the debtor's projected disposable income for five years. 11 U.S.C. § 1129(a)(15). Section 1141 was amended to delay discharge for an individual debtor until after all plan payments are completed. 11 U.S.C. § 1141(d)(5)(a).

Section 1129(b)(2)(B)(ii) adopted an exception to the absolute priority rule for individual debtors:

> (B) With respect to a class of unsecured claims —
>
> (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

[1] Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23 (2005).

Appellate Case: 15-6001 Page: 13 Date Filed: 05/12/2015 Entry ID: 4274580

> (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, *except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section*. [emphasis added].

Section 1115 then defines "property of the estate" for purposes of an individual filing under Chapter 11:

> (a) In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541--
>
> (1) all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first; and
>
> (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first.
>
> (b) Except as provided in section 1104 or a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.

The courts considering the meaning of the statutory amendments have reached different conclusions as to the plain meaning of the statutes. The "narrow view" cases have read "property included under" in § 1129(b)(2)(B)(ii) to mean only that property "added to" property of the estate by § 1115 post-petition properly acquisitions and earning. *Ice House America, LLC v. Cardin,* 751 F.3d 734, 735 (6th Cir. 2014). The "broad view" courts read "property included under §1115" to

Appellate Case: 15-6001 Page: 14 Date Filed: 05/12/2015 Entry ID: 4274580

mean *all* the property included in 1115, both pre-petition (541) property and post-petition property. *In re Friedman*, 466 B.R. 471 (B.A.P. 9th Cir. 2012).

Any case involving the meaning of a statute must begin with an examination of its language. *U.S. v. I.L.*, 614 F. 3d 817, 820-821 (8th Cir. 2010):

> To get at the thought or meaning expressed in a statute, a contract, or a constitution, the first resort, in all cases, is to the natural signification of the words, in the order of grammatical arrangement in which the framers of the instrument have placed them. If the words convey a definite meaning, which involves no absurdity, nor any contradiction of other parts of the instrument, then that meaning, apparent on the face of the instrument, must be accepted, and neither the courts nor the legislature have the right to add to it or take from it. So, also, where a law is expressed in plain and unambiguous terms, . . . the legislature should be intended to mean what they have plainly expressed, and consequently no room is left for construction.

Heritage Bank concludes, without analysis of the statutory language, that §§ 1129(b)(2)(B)(ii) and 1115 of the Bankruptcy Code are ambiguous because multiple courts have reached different conclusions as to the meaning of these statutes. However, the simple fact that courts disagree does not automatically create ambiguity. An important part of this court's analysis must be the language used by Congress. *Lamie v. U.S. Trustee*, 540 U.S. 526, 534, 124 S. Ct. 1023, 157 L. Ed. 2d 1024 (2004); *Friedman*, 466 B.R. at 480.

The "narrow view" courts' reading, that "property included under" 1115 in § 1129(b)(2)(B)(ii) means only that property which is "added to" an individual

debtor's chapter 11 estate by operation of § 1115, is not consistent with the ordinary meaning of "included," is at odds with the meaning giving to the same language in 11 U.S.C. §1306, and undermines the purpose of the amendments. "Included" is much broader than "added to." Both pre-petition and post-petition property are included as property of an individual debtor's estate under § 1115. "Included" in its ordinary usage means "[c]ontained as part of a whole." Oxford English Online Dictionary.[2] "Included" is not a term of limitation in the Bankruptcy Code. 11 U.S.C. § 102(3). Section 1115 uses almost identical language to § 1306, which defines property of the estate in the case of a Chapter 13 debtor. Construing § 1306, the Court in *In re Seafort*, 669 F. 3d 662, 667 (6th Cir. 2012) states "Section 1306(a) expressly incorporates section 541." Section 541 (pre-petition) property is also incorporated in § 1115, and is part of property included under that action. *In re Tegeder*, 369 B.R. 477, 480 (Bankr. Neb. 2007). In *In re O'Neal*, 490 B.R. 837, 851 (Bankr. W.D. Ark. 2013), the court observed:

> Section 1129(b)(2)(B)(ii) with respect to individual debtors eliminates the application of the absolute priority rule from property described in section 1115. Section 1115 provides that all property described in Section 541 and property from post petition personal services is included in an individual Chapter 11 estate. Section 1115 is written word for word like section 1306 and courts interpreting section 1306 have never bifurcated this section into two species of property as the narrow view does in individual Chapter 11.

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[2]http://www.oxfordictionaries.com/us/definition/americanenglish/included

Appellate Case: 15-6001 Page: 16 Date Filed: 05/12/2015 Entry ID: 4274580

In ascertaining the plain meaning of this language, it is also important to place that language in context. *Davis v. Mich. Dept. of Treasury*, 489 U.S. 803, 809 (1989); *In re Shat*, 424 B.R. 854, 865 (Bankr. D. Nev. 2010). In that regard, the multiple amendments to chapter 11 created a Chapter 13-like regime where debtor could have a plan confirmed over a creditor's objection by committing all disposable income for five years. *In re Friedman*, 466 B.R. 471, 483-484 (B.A.P. 9th Cir. 2012). Under the narrow view, this primary purpose of the 2005 amendments is rendered less than marginal. It is particularly difficult, if not impossible, for a sole proprietor and individual chapter 11 debtor to propose a plan that can be confirmed over the objection of a creditor even if all the debtor's disposable income is committed to the plan.

In *In re O'Neal*, 490 B.R. at 851, the court stated:

> To read section 1115 and section 1129(b)(2)(B)(ii) as exempting only future income from the absolute priority rule renders ineffective any practical application of section 1115, especially in light of the additional requirements of section 1129(a)(15)(B). When considered in the context of all the applicable sections, section 1115 accomplishes nothing of substance under the narrow view. As one author paraphrased the explanation of the Ninth Circuit BAP in *Friedman*:
>
> [I]t would be "illogical" to require individual debtors to devote five years of disposable income to their plans, but remove the debtors' means of providing that income, which would be the result if the application of the absolute priority rule were to prevent debtors from retaining valuable prepetition business assets.
>
> Andrew G. Balbus, *Continued Disagreements Over the Application of*

> *the Absolute Priority Rule to Individuals in Chapter 11: Friedman and Maharaj*, 21 Norton Bankr. L. & Prac. 755, 761 (2012).

Implied Repeal. The narrow view courts all conclude that the broad view is precluded by the presumption against the implied repeal of a cornerstone rule that has been around for over a century. Almost all legislation changes the law in some way and thus has some repealing effect. 1A Sutherland, Statutory Construction (7th ed 2009), §23:1. In fact, "[a]s a general principle of statutory construction, it will be presumed that the legislature in adopting an amendment of a statute, intended to make some change in existing law." *Mogis v. Lyman-Richey Sand & Gravel Corp.*, 189 F. 2d 130 (8th Cir 1951). The presumption against implied repeal has particular application to important public statutes of long standing, and it ordinarily arises when enactment of a law on one subject could be read to repeal another important law. As the Supreme Court stated in *Lafayette v. Louisiana Power &Light Co.,* 435 U.S. 389, 398-99, 98 S.Ct. 1123, 55 L.Ed.2d 364 (1978)]:

> [C]ases reviewing the legislative history of the Sherman Act have concluded that Congress, exercising the full extent of its constitutional power, sought to establish a regime of competition as the fundamental principle governing commerce in this country.
>
> For this reason, our cases have held that even when Congress by subsequent legislation establishes a regulatory regime over an area of commercial activity, the antitrust laws will not be displaced unless it appears that the antitrust and regulatory provisions are plainly repugnant. *E.g., United States v. Philadelphia Nat. Bank*, 374 U.S. 321, 350-351, and n. 28 (1963) (collecting cases). The presumption against repeal by implication reflects the understanding that the

Appellate Case: 15-6001 Page: 18 Date Filed: 05/12/2015 Entry ID: 4274580

antitrust laws establish overarching and fundamental policies . . .

See also United States v. White, 508 F. 3d 453 (8th Cir. 1974)[treaty].

The circuit courts applying this presumption to this issue have in fact relied on the assertion that the absolute priority rule is an important public statute of long standing: "The absolute priority rule has been a cornerstone of equitable distribution for Chapter 11 creditors for over a century." *In re Lively,* 717 F. 3d 406, 410 (5th Cir. 2013), *quoted in Ice House America, LLC v. Cardin*, 751 F. 3d 734 (6th Cir. 2014). "[T]he statutory language and legislative history lack any clear indication that Congress intended to repeal a pillar of creditor bankruptcy protection." *In re Stephens*, 704 F. 3d 1279, 1287 (10th Cir. 2013).

> [T]he [absolute priority rule] or something very like it has been acknowledged as far back as at least the 1890's. . . . From such awkward and convoluted language the court cannot infer that Congress truly intended such a wide and important change in individual Chapter 11 practice as discarding the [absolute priority rule].

In re Maharaj, 681 F. 3d 558, 572 (4th Cir. 2012), quoting with approval, *In re Kamel*, 451 B.R. 505, 509-10 (Bankr. C.D. Cal. 2011). The problem with this view is that the "broad view" does not argue that BAPCPA should be construed to repeal the absolute priority rule that goes back over a century. Modifying the absolute priority rule to eliminate its application to individual Chapter 11 debtors is not the same this as repealing the absolute priority rule as it applies to corporations

Appellate Case: 15-6001 Page: 19 Date Filed: 05/12/2015 Entry ID: 4274580

and other entities.

The absolute priority rule originated in the railroad reorganization cases cited in *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 115, 60 S. Ct. 1 (1939); *Railroad Co. v. Howard*, 7 Wall. 392 (1868); *Louisville Trust Co. v. Louisville, N.A. & C. Ry. Co.,* 174 U.S. 674 (1899), *et al*. The principle applied in those cases (and to §77B of the Bankruptcy Act by the Supreme Court in *Case*) was that a "fair and equitable" reorganization must give creditors priority over stockholders against the property of an insolvent corporation. *Case* held that the harshness of the absolute priority rule is abated by the ability of stockholders to retain an interest if they contributed new money. 305 U.S. at 121-122. Creditors were not entitled to priority over the interests of members of organizations, where those members who did not hold "equity interest." *Security Farms v. Gen. Teamsters, Warehousemen and Helpers Union, Local 890*, 265 F. 3d 869, 874 (9th Cir. 2001). From 1952 to 1978, the absolute priority rule had no application to individual debtors. In 1978, the absolute priority rule was codified in § 1129(b)(2)(B) of the Bankruptcy Code. Although the statute does not mention individual debtors, it was settled by 1991 that individual debtors– including consumer debtors– were eligible for Chapter 11 relief and subject to the absolute priority rule. *Norwest Bank Worthington v. Ahlers,* 485 U.S. 197, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988)*; Toibb v. Radloff,* 501 U.S. 157, 111 S.Ct. 2197 (1991). In short, the rule has never been absolute and its

Appellate Case: 15-6001 Page: 20 Date Filed: 05/12/2015 Entry ID: 4274580

application to individuals is neither longstanding nor a "cornerstone" of equitable distribution.

The narrow view courts also rely on *Hamilton v. Lanning,* 560 U.S. 505, 130 S. Ct. 2464, 2473, 177 L. Ed. 2d 23 (2010), where the court held, "we will not read the Bankruptcy Code to erode prior bankruptcy practice absent a clear indication that Congress intended such a departure." There is no question here, however, that Congress did intend to erode prior bankruptcy practice with regard to individuals filing under Chapter 11. To have their reorganization plan confirmed, debtors must now commit to the plan all of their disposable income for at least five years. The express language of 1129(b)(2)(B)(ii) excepts individual debtors from the application of the absolute priority rule. The issue of whether that exception permits the debtor to retain any interest in pre-petition property is not a question of implied repeal.

Congress could have expressed its intentions better. The legislative history of BAPCPA is sparse, and its drafting is in many places convoluted, but it is clear that Congress sought to move debtors who could pay something to their creditors into reorganization chapters. *In re Shat*, *supra; In re O'Neal*, *supra*. This debtor, like most individual Chapter 11 debtors, has too much debt for Chapter 13. Congress, by its elaborate amendments to Chapter 11, intended that she be able to propose a confirmable plan over the objection of a creditor, as long as she devoted

Appellate Case: 15-6001 Page: 21 Date Filed: 05/12/2015 Entry ID: 4274580

to the plan all of her disposable income for five years and the plan is otherwise fair and equitable. Imposing on her the additional requirement that she not retain an interest in the business that pays her salary will make it impossible for her to propose a confirmable plan.

CONCLUSION

By the 2005 BAPCPA amendments Congress intended to permit individual debtors under Chapter 11 to retain some interests in property of the estate when creditors object to the plan, so long as the plan commits all of the debtor's disposable income for at least five years and the plan is otherwise fair and equitable. This intention is apparent from the plain language of the amendments. Even if the language were considered ambiguous, the primary purpose of the amendments is rendered meaningless if the debtor must satisfy both the absolute priority rule and the disposable income requirement. The broad view recognizes the clear legislative intent to create this Chapter 13-like procedure under Chapter 11. It does not work a repeal of the longstanding absolute priority rule, which remains unchanged for non-individual debtors. Congress made clear its intent to change prior bankruptcy practice, and unless this change is to be rendered meaningless, the narrow view must be rejected.

Appellate Case: 15-6001 Page: 22 Date Filed: 05/12/2015 Entry ID: 4274580

For all the foregoing reasons, *amicus* respectfully requests that this Court affirm the decision of the Bankruptcy Court.

Respectfully submitted,

/s/ Tara Twomey
NATIONAL ASSOC. OF CONSUMER
BANKRUPTCY ATTORNEYS
By its attorney
Tara Twomey, Esq.
National Consumer Bankruptcy
Rights Center
1501 The Alameda
San Jose, CA 95126
tara.twomey@comcast.net

CERTIFICATION OF COMPLIANCE
WITH TYPE-VOLUME LIMITATIONS

I hereby certify that the foregoing Brief contains approximately 3,446 words, excluding the parts of the Brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). In preparing this certification, I relied on the MS Word word-processing system used to prepare the foregoing Brief.

The foregoing Brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it was prepared in a proportionally spaced typeface using Microsoft Word 14-point Times New Roman font.

Dated: May 12, 2015

/s/Tara Twomey
Tara Twomey

Appellate Case: 15-6001 Page: 24 Date Filed: 05/12/2015 Entry ID: 4274580

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Eighth Circuit by using the appellate CM/ECF system on May 12, 2015.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

/s/ Tara Twomey

Tara Twomey, Esq.
National Consumer Bankruptcy
Rights Center
1501 The Alameda
San Jose, CA 95126
tara.twomey@comcast.net

Appellate Case: 15-6001 Page: 25 Date Filed: 05/12/2015 Entry ID: 4274580