

# **SUBCHAPTER V UPDATE**

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References in these materials to the “SBRA Guide” are to Paul W. Bonapfel, *A Guide to the Small Business Reorganization Act of 2019* (June 2022 rev. ed.), available at:

[https://www.ganb.uscourts.gov/sites/default/files/sbra\\_guide\\_pwb.pdf](https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf).

This Update is a revision of an earlier Update. New material is marked as follows: “\*\*\*” indicates the beginning of new material; “###” indicates the end of the new material

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**2024 SOUTHEASTERN BANKRUPTCY LAW INSTITUTE**

**ELIGIBILITY, DEBT LIMITS & VOTING, OH MY!**  
**THE ANNUAL SUBCHAPTER V UPDATE**

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**SUBCHAPTER V UPDATE**

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## I. How Is Subchapter V Working?

Available data indicates that subchapter V is working as intended to permit smaller businesses to reorganize successfully.

Based on an empirical study, Bankruptcy Judge (and former bankruptcy professor) Michelle Harner and her staff concluded:<sup>1</sup>

Overall, subchapter V appears to be working as intended. Small businesses are using the subchapter with some regularity. The businesses also are, for the most part, confirming reorganization plans at a relatively high rate in a relatively short period of time. Although more data is needed to fully understand the impact of invoking the subchapter on both the short- and longer-term prospects of financially distressed small businesses, the initial results are promising. Small businesses appear now to have a restructuring tool that is both affordable and effective for addressing their financial needs.

The survey shows that confirmation occurred in more than half of all the cases and in over 62 percent of those that were not dismissed.<sup>2</sup>

The results are consistent with data compiled by the United States Trustee Program with regard to subchapter V cases, which shows confirmation in approximately 55 percent of the cases.<sup>3</sup> The report notes that, compared to non-subchapter V cases historically, subchapter V

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<sup>1</sup> Hon. Michelle Harner, Emily Lamasa, and Kimberly Goodwin, *Subchapter V Cases By The Numbers*, 40-Oct Am. Bankr. Inst. J. 12, 59 (October 2021). Emily Lamasa is a career law clerk, and Kimberly Goodwin is Judge Harner's paralegal.

<sup>2</sup> The dataset included 438 randomly selected cases filed between February 19, 2020, and December 31, 2020, with data collection ending on December 31, 2021. The cases were randomly selected based on a list of 1,278 cases (excluding duplicate cases) filed during the period, representing approximately 36 percent of the cases filed. The data set included at least one case in each Circuit. Hon. Michelle Harner, Emily Lamasa, and Kimberly Goodwin, *Subchapter V Cases By The Numbers*, 40-Oct Am. Bankr. Inst. J. 12 & nn. 6-8 (October 2021).

As of December 21, 2020, the court had confirmed a plan in 221 cases, the debtor had filed a plan that had not yet been confirmed in 105 cases, the debtor had not filed a plan in 30 cases, and the court had dismissed 82 cases. The debtor had not filed a plan at the time of dismissal in 55 of them. *Id.* at 12 n. 10. In the 30 cases with no plan, the court had converted 25 cases (24 to chapter 7, one to chapter 13) and extended the deadline for the filing of a plan in five. *Id.* at 12.

Consensual confirmation occurred in 130 cases, approximately 59 percent. When nonconsensual confirmation occurred in the other 91 cases, 40 had at least one class of impaired creditors voting against the plan and 51 had impaired classes that did not vote. *Id.* at 59. The average time from filing of the case to confirmation was 184 days, and the median time was 168 days. *Id.* at 59.

<sup>3</sup> United States Trustee Program, *Chapter 11 Subchapter V Statistical Summary Through September 30, 2023*, available at <https://www.justice.gov/ust/page/file/1499276/download> (last visited Jan. 29, 2024). The data includes only cases filed in United States Trustee Program districts, which thus excludes Alabama and North Carolina.

For subchapter V cases through September 30, 2023, the report shows that confirmation occurred in 55 percent of them and that confirmation was consensual in nearly 70 percent of them. Conversion occurred in 11 percent of the cases, and 30 percent were dismissed. The remaining four percent were pending without a confirmed plan. It reports the median months to confirmation as 6.6 and the median months to dismissal as 4.7.

cases “have had approximately double the percentage of confirmed plans and half the percentage of dismissals, as well as a shorter time to confirmation or dismissal.”<sup>4</sup>

Anecdotal evidence indicates that most lawyers and judges agree that subchapter V is working well.<sup>5</sup> As the court noted in *In re Corinthian Communications, Inc.*, 642 B.R. 224, 225 (Bankr. S.D.N.Y. 2022), subchapter V has been “a remarkably successful addition to Chapter 11 of the Bankruptcy Code.”

## **II. Amendments to the Bankruptcy Rules With Regard to Subchapter V Cases**

The Committee on Rules of Practice and Procedure of the Judicial Conference of the United States (the “Rules Committee”) promulgated Interim Rules pending amendments to the Bankruptcy Rules, which take three years or more under procedures that the Rules Enabling Act, 28 U.S.C. §§ 2071-77, require. See SBRA Guide at 5-6.

Effective December 1, 2022, the provisions of the Interim Rules were incorporated as amendments to the Federal Rules of Bankruptcy Procedure.

The following summarizes the changes:

Rule 1007(b)(5) – Eliminates requirement for filing statement of current monthly income for individual in a subchapter V case.

Rule 1007(h) – Modifies exceptions to requirement for filing supplemental schedule of property the debtor acquires after the filing of the case, as provided in § 541(a)(5), after the closing of the case. The exception does not apply to a chapter 11 plan confirmed under § 1191(b) (cramdown) but does apply after the discharge of a debtor in a plan confirmed under § 1191(b).

Rules 1015(c), (d), and (e) are renumbered as (d), (e), and (f).

Rule 1020(a) – Provides for election of subchapter V to be included in voluntary petition.

Rule 1020(c) – Eliminates provisions for case to proceed as small business case depending on whether committee of unsecured creditors has been appointed or whether an appointed committee has been sufficiently active.

Rule 1020(d) – Renumbered as Rule 1020(c) and eliminates requirement for service of objection to debtor’s classification as a small business (or not) or election of subchapter

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<sup>4</sup> *Id.*

<sup>5</sup> The author has presented more than 30 continuing legal education programs on subchapter V since its enactment. Although some have expressed reservations or problems with subchapter V, most conclude that it is working as intended to expedite reorganization of smaller businesses that should be reorganized and to expedite dismissal or conversion of cases where reorganization is not feasible.

V (unless committee has been appointed) and instead requires service on 20 largest creditors.

Rule 2009 – Permits single trustee in jointly administered case under subchapter V as well as in cases under chapter 7.

Rule 2011—Amends title of rule dealing with unclaimed funds to include cases under subchapter V.

Rule 2012 – Makes automatic substitution of trustee in chapter 11 case for debtor in possession in any pending action, proceeding, or matter in applicable to subchapter V trustee, unless debtor is removed from possession. (Same rule as Chapter 12).

Rule 2015(a)(1) – Makes requirement for chapter 11 trustee to file complete inventory of property of debtor (if court directs) inapplicable to subchapter V trustee.

Rule 2015(a)(5) – Makes requirement for payment of UST fees inapplicable in subchapter V case.

Rule 2015(b) – Rule 2015(b) – (e) renumbered as Rule 2015(c)—(f). New Rule 2015(b) requires debtor in possession in subchapter V case to perform duties of trustee described in Rule 2015(a)(2) through (4) and to file inventory if the court directs. Requires trustee to perform these duties if debtor is removed from possession.

Rules 3010(b) and 3011 – Rules relating to trustee’s payments of small dividends and unclaimed funds extended to subchapter V cases.

Rule 3014 – Provides for court to determine the date for making of § 1111(b) election by secured creditor in case under subchapter V in which § 1125 provisions for disclosure statement do not apply. (General rule is that election must be made before conclusion of hearing on disclosure statement.)

Rule 3016(b) – Makes provisions for disclosure statement applicable only if a disclosure statement is required.

Rule 3016(d) – Makes provisions for use of standard form in “small business case” also applicable to a case under subchapter V case. (Note that, under SBRA, a subchapter V case is not a “small business case.”)

Rule 3017.1(a) – Permits conditional approval of disclosure statement in subchapter V case in which court has ordered that disclosure statement requirements of § 1125 apply.

Rule 3017.2 – New rule requires court to fix, in a subchapter case in which § 1125 does not apply: (a) the time for accepting or rejecting a plan; (b) the record date for holders of equity security interests; (c) the date for the hearing on confirmation; (d) the date for

transmission of the plan and notice of the (1) the time to accept or reject and (2) the confirmation hearing.

Rule 3018 – Conforming amendment to take account of new Rule 3017.2 and change in Rule 3017.1.

Rule 3019(c) – Rule 3019(c) provides that request to modify plan after confirmation in subchapter V case is governed by Rule 9014 and that provisions of Rule 3019(b) (procedures for postconfirmation modification of plan in individual chapter 11 case) apply.

### **III. Application of § 523(a) Exceptions to Discharge of Corporation After Cramdown Discharge**

In a subchapter V case, consensual confirmation under § 1191(a) results in a discharge under § 1141(d)(1). A corporation’s discharge under § 1141(d)(1) is not subject to the § 523(a) exceptions. When confirmation occurs under the cramdown provisions of § 1191(b), however, § 1141(d) does not apply. § 1181(c). Instead, § 1192 governs the discharge.

Section 1192(2) provides that the discharge does not discharge any debt “of the kind” specified in § 523(a). Section 523(a) provides that a discharge under § 1192 does not discharge an *individual* debtor from the 21 categories of debt § 523(a) lists.

SBRA Guide § X(D)(2) discusses whether the § 523(a) exceptions apply to the discharge under § 1192 of an entity after cramdown confirmation under § 1191(b). It explains the decisions of bankruptcy courts ruling that the exceptions do not apply<sup>6</sup> and the Fourth Circuit’s

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<sup>6</sup> Jennings v. Lapeer Aviation, Inc. (*In re* LaPeer Aviation, Inc.), 2022 WL 1110072 (Bankr. E.D. Mich. 2022); Catt v. Rtech Fabrications, LLC (*In re* Rtech Fabrications LLC), 635 B.R. 559 (Bankr. D. Idaho 2021); Cantwell-Cleary Co. v. Cleary Packaging, LLC (*In re* Cleary Packaging, LLC), 630 B.R. 466 (Bankr. D. Md. 2021), *rev’d* 36 F.4th 509 (4th Cir. 2022); Gaske v. Satellite Restaurants, Inc., Crabcake Factory USA (*In re* Satellite Restaurants, Inc., Crabcake Factory USA), 626 B.R. 871, 876 (Bankr. D. Md. 2021). Two bankruptcy courts have reached the opposite conclusion. *In re* Duntov Motor Co., LLC. Docket No. 21-40348-MXM-11, ECF No. 27 (Bankr. N.D. Tex. Aug. 26, 2021); Sun City Truck Sales v. Tonka Int’l. Corp. (*In re* Tonka Int’l. Corp.), 2020 WL 13881422 (Bankr. E.D. Tex. 2020) (denying motion to dismiss complaint to except debt from discharge). The court in *Duntov Motor Co.* later concluded that the creditor had not meet its burden of establishing nondischargeability. *In re* Duntov Motor Company, LLC, 2023 WL 8252914 at \*29-31, n. 265 (Bankr. N.D. Tex. 2023). \*\*\* The court in *Tonka* later dismissed the complaint after confirmation of a consensual plan. Sun City Truck Sales v. Tonka Int’l. Corp. (*In re* Tonka Int’l. Corp.), 2020 WL 13881425 (Bankr. E.D. Tex. 2020). ### Another bankruptcy court ruled that a judgment for patent infringement against a corporation in a subchapter V case was excepted from discharge under § 523(a)(6) as a willful and malicious injury without addressing whether § 523(a) exceptions apply to the discharge of a corporation or citing the applicable subchapter V discharge provision, 11 U.S.C. § 1192(2). Concrete Log Systems, Inc. v. Better Than Logs, Inc. (*In re* Better Than Logs, Inc.), 631 B.R. 670, 688–89 (Bankr. D. Mont. 2021).

\*\*\* In *Synergetic Oil Tools, Inc. v. Relevant Holdings LLC* (*In re* Relevant Holdings, LLC), 2023 U.S. DistLEXIS 53042 (D. Colo. 2023), the bankruptcy court had denied the creditor’s motion to extend the time to object to the dischargeability of its debt on the ground that no exceptions to discharge existed. The District Court reversed and remanded for further consideration in light of the Fourth Circuit’s decision in *Cleary Packaging*. ###

opinion in *Cantwell-Cleary Co. v. Cleary Packaging, LLC (In re Cleary Packaging, LLC)*, 36 F.4th 509 (4th Cir. 2022), that the exceptions are applicable.

Three more bankruptcy courts<sup>7</sup> and the Bankruptcy Appellate Panel for the Ninth Circuit<sup>8</sup> have ruled that the § 523(a) exceptions do not apply to the discharge of an entity, rejecting the Fourth Circuit’s interpretation. The Fifth Circuit<sup>9</sup> and the Eleventh Circuit<sup>10</sup> have accepted direct appeals and the BAP’s decision is on appeal to the Ninth Circuit.<sup>11</sup>

In addition to the text of the two statutes, the debate involves analysis of the context of the statutes, chapter 11 policy, and legislative history. For a detailed discussion of the reasons that support each of the competing interpretations and why the interpretation of the bankruptcy courts is the better one, see \*\*\* Paul W. Bonapfel and Robert Schaaf, *Do § 523(a) Exceptions to Discharge Apply to The Discharge of a Corporation in a Subchapter V Case After “Cramdown” Confirmation Under § 1191(b)?* 32 NORTON JOURNAL OF BANKRUPTCY LAW AND PRACTICE (No. 4 Dec. 2023). ### See also SBRA Guide § X(D)(2).

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After the Fourth Circuit’s ruling in *Cleary Packaging* that the discharge exceptions apply to the discharge of an entity after confirmation of a cramdown plan, the debtor amended its subchapter V election to remove it and to proceed in a traditional chapter 11 case. The withdrawal of the election effectively mooted that dischargeability action because exceptions to the discharge of an entity do not exist in a traditional chapter 11 case. The court considered confirmation of plans filed by the debtor and by the creditor in *In re Cleary Packaging, LLC*, 2023 WL 8703920 (Bankr. D. Md. 2023).

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<sup>7</sup> BenShot, LLC v. 2 Monkey Trading, LLC (*In re 2 Monkey Trading, LLC*). 650 B.R. 521 (Bankr. M.D. Fla. 2023), certified for direct appeal to Eleventh Circuit, 2023 WL 3947494 (Bankr. M.D. Fla. June 12, 2023), leave for direct appeal granted, Eleventh Circuit Case No. 23-90009 (July 19, 2023), notice of appeal filed, No. 23-12342 (11th Cir. July 19, 2023); Nutrien Ag Solutions v. Hall (*In re Hall*), 651 B.R. 62 (Bankr. M.D. Fla. 2023); Avion Funding LLC v. GFS Industries, LLC (*In re GFS Industries, LLC*), 647 B.R. 337 (Bankr. W.D. Tex. 2022), certified for direct appeal to Fifth Circuit, 2023 WL 1768414 (Bankr. W.D. Tex. Feb. 3, 2023), leave for direct appeal granted, Fifth Circuit Case No. 23-50237 (Apr. 7, 2023).

<sup>8</sup>Lafferty v. Off-Spec Solutions, LLC (*In re Off-Spec Solutions, LLC*), 2023 WL 4360311 (B.A.P. 9th Cir. 2023), notice of appeal filed, Ninth Circuit Case No. 23-60034 (July 20, 2023).

<sup>9</sup> Avion Funding LLC v. GFS Industries, LLC (*In re GFS Industries, LLC*), 647 B.R. 337 (Bankr. W.D. Tex. 2022), certified for direct appeal to Fifth Circuit, 2023 WL 1768414 (Bankr. W.D. Tex. Feb. 3, 2023), leave for direct appeal granted, Fifth Circuit Case No. 23-50237 (Apr. 7, 2023), notice of appeal filed, No. 23-50237 (5th Cir., Apr. 7, 2023).

<sup>10</sup> BenShot, LLC v. 2 Monkey Trading, LLC (*In re 2 Monkey Trading, LLC*). 650 B.R. 521 (Bankr. M.D. Fla. 2023), certified for direct appeal to Eleventh Circuit, 2023 WL 3947494 (Bankr. M.D. Fla. June 12, 2023), leave for direct appeal granted, No. 23-90009 (11th Cir., July 19, 2023), notice of appeal filed, No. 23-12342 (11th Cir. July 19, 2023).

<sup>11</sup> Lafferty v. Off-Spec Solutions, LLC (*In re Off-Spec Solutions, LLC*), 2023 WL 4360311 (B.A.P. 9th Cir. July 6, 2023), notice of appeal filed, Ninth Circuit Case No. 23-60034 (July 20, 2023).

The debtor's plan provided for payment of its projected disposable income to creditors for five years, which would have resulted in an estimated 27 percent dividend to unsecured creditors, including the judgment creditor. The plan proposed for the owner to retain the ownership interest and for the principal to contribute \$ 25,000 in cash, to waive prepetition claims of \$ 49,000 (some of which were entitled to priority), and to waive an administrative claim for a postpetition loan of \$ 35,000.

The creditor also filed a plan. The creditor proposed to purchase the equity in the debtor for \$ 250,000, to operate the business, and to fund additional payments to unsecured creditors (including its claim) for nine years. It also proposed to preserve and pursue avoidance actions that would not be pursued under the debtor's plan. The plan subordinated payment on the creditor's claim to the claims of other unsecured creditors. Unsecured creditors would receive a greater percentage of their claims under the creditor's plan.

The judgment creditor and three general unsecured creditors voted on each plan. The judgment creditor, whose claim was separately classified in the debtor's plan, rejected the debtor's plan. The other creditors accepted it. The judgment creditor accepted its plan, but the other three creditors rejected it.

The court denied confirmation of both plans. The court concluded that the contribution of the principal did not satisfy the "new value" exception to the absolute priority rule, which applied in view of the judgment creditor's rejection of the plan.

The court concluded that the creditor's plan did not meet the requirements of paragraphs (a)(5) (dealing with postconfirmation management of the debtor) and (a)(11) (feasibility) of § 1129(a). The court noted the testimony of three key employees of the debtor that they would not continue to work for the debtor under the creditor's management.

With regard to postconfirmation management, the court concluded that the plan contained "no definite structure proposed or any plausible strategy to address potential employee and customer retention issues and other operational challenges that a reorganized Debtor under the Creditor's Plan might encounter." *Id.* at \*22. The court noted that the creditor's principal had testified about his hopes of what would happen to allow the debtor's business to continue under the creditor's plan, but the court found "no evidence of the details of that strategy or the likelihood of its success." *Id.* The court ruled, therefore, that the creditor had failed to meet its burden to establish feasibility under § 1129(a)(11).

In *In re Model Management Inc.*, 2023 WL 5338580 at \*7 (Bankr. S.D.N.Y. 2023), the court ruled that it need not consider the creditor's request for determination that its debt was excepted from discharge after confirmation of a cramdown plan because the creditor had not filed a timely proof of claim. Because the creditor had not filed a timely proof of claim, the court reasoned, it was barred from asserting any prepetition claim against the debtor and thus had

no debt to be discharged. The ruling seems inconsistent with the principle that disallowance of a claim is a separate matter from dischargeability.<sup>12</sup>

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#### **IV. Postconfirmation Modification**

Subsections (b) and (c) of § 1193 govern postconfirmation modifications to subchapter V plans. Section 1193(b) addresses postconfirmation modification after consensual confirmation, and § 1193(c) deals with modification after cramdown confirmation.

Under both subsections, only the debtor can modify the confirmed plan, and the debtor must demonstrate that the “circumstances warrant such modification.” Both subsections also require that the plan as modified meet confirmation requirements of § 1191(a) or § 1191(b), as applicable.

The key difference between the subsections is one of timing. A consensual plan may only be modified before the plan is “substantially consummated,”<sup>13</sup> whereas a nonconsensual plan may be modified at any time during the three to five year period for the payment of projected disposable income.

In *In re Samurai Martial Sports*, 644 B.R. 667 (Bankr. S.D. Tex. 2022), the debtor sought to modify its plan after cramdown confirmation when its business suffered due to air conditioning problems—a significant problem for an athletic facility operating in the Texas summer—and after defaulting on a few payments. The modification proposed to pause payments for three months and cure the arrearage near the end of the plan. The primary creditor and the subchapter V trustee objected.

At the hearing on modification, it became apparent that the debtor’s principal had intentionally withheld plan payments on the advice of a group of potential investors, who had urged debtor’s principal not to make payments in order to trigger foreclosure and permit the investors to acquire the assets at a lower price.

The court denied the modification. The court focused on two aspects of the requirements for postconfirmation modification: (1) whether the circumstances warranted modification, as § 1193(c) requires; and (2) whether the plan as modified satisfied § 1191(b).

In the absence of case law addressing when circumstances would warrant modification under § 1193, the court looked to cases analyzing similar language in § 1127.

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<sup>12</sup> See, e.g., *State of Florida Dept. of Revenue v. Diaz (In re Diaz)*, 647 F.3d 1073, 1090 (11th Cir. 2011); *United States v. Swanson (In re Swanson)*, 986 F.2d 367, 370-71 (10th Cir. 1993).

<sup>13</sup> See 11 U.S.C. § 1101(2); SBRA Guide at 161-64.

The court rejected the proposition, advanced by other courts, that a debtor's inability to pay, without more, was insufficient to warrant modification. Instead, it adopted a test that examined the *circumstances* surrounding that inability to pay.

Thus, the court concluded that modification is warranted when the debtor shows that the circumstances that gave rise to modification were unforeseen and rendered the confirmed plan unworkable. *Id.* at 681. The court noted that the inquiries regarding both foreseeability and workability are factual ones where, particularly for the foreseeability inquiry, the "debtor's good faith and business judgment are relevant." *Id.* at 681.

The court concluded that the failure of the air conditioning equipment was a circumstance that could warrant modification, rejecting the argument that the debtor knew or should have known that it would fail in the near future. *Id.* at 681-82.

But the court concluded that the debtor's intentional failure to make plan payments, rather than the air conditioning problems, was the cause of the need for modification. The derailing of the confirmed plan "could only be attributed to Debtor's deliberate and conscious decision to disregard this Court's order directing Debtor to make all payments under the Plan, and not [to] any unforeseen circumstance rendering the Plan unworkable." *Id.* at 683.

The court reached a similar conclusion regarding the debtor's failure to maintain an escrow fund for emergencies as the plan required. The failure to fund the reserve, the court said, was also the result of the debtor's "bad faith or poor business judgment," because its accounting records indicated that the debtor had been capable of making the requisite payments. *Id.* at 683.

Although the court ruled that the debtor's failure to demonstrate that circumstances warranted modification was sufficient to deny modification, the court also considered whether the debtor's proposed modification complied with the requirements of § 1191(b).

After examining the provisions of that section and the sections it incorporates by cross-reference, the court concluded that the plan as modified (1) would not have been feasible, as required by § 1129(a)(11), in view of the debtor's deficient performance; (2) had not been proposed in good faith, as required by § 1129(a)(3), for the reasons discussed above; and (3) did not satisfy § 1129(a)(1) because it did not include an updated liquidation analysis or adequate projections.

## **V. Revocation of Subchapter V Election Without Debtor's Amendment of Election**

When debtor misbehavior in a subchapter V case results in removal of the debtor from possession, the subchapter V trustee takes over the assets and management of the business, but only the debtor can file a plan in a subchapter V case.

Does the court have authority to address this issue through revocation of the debtor's subchapter V election so that the case proceeds as a traditional or small business case, in which

the trustee has authority to file a plan and the debtor has no exclusive period within which to file a plan? § 1121(c)(1).

In *In re National Small Business Alliance*, 642 B.R. 345 (Bankr. D.D.C. 2022), the court revoked the debtor’s subchapter V designation, “converting” the case to a standard chapter 11. The debtor operated a 700-strong membership network for small businesses, providing its dues-paying members with referrals and marketing support. It filed under subchapter V in early 2021.

Two very active creditors—one secured and one unsecured—had used the case as a battleground to litigate claims among themselves and the debtor, to the detriment of other stakeholders in the debtor, *id.* at 349-50, and the case had accordingly sprawled. In the course of the lengthy proceedings, the debtor had been removed from possession for cause under § 1185, the docket had ballooned to over 300 entries, and the debtor had proposed five plans, none of which had been timely filed or were confirmable. *Id.* at 347.

After considering conversion to chapter 7 and dismissal under § 1112, the court concluded that the interests of creditors and of the estate would best be served by permitting the debtor to remain in chapter 11 but revoking the debtor’s subchapter V designation so that the trustee or other parties could file a plan.<sup>14</sup>

Although nothing in the Code specifically permits the revocation of a subchapter V election, the court noted, courts permitted pre-SBRA chapter 11 debtors to amend their petitions pursuant to Bankruptcy Rule 1009 to take advantage of the newly effective subchapter V provisions. “[I]f a petition may be amended to elect to proceed under Subchapter V post-petition, logically it follows that the opposite must also be an option for debtors and courts.” *Id.* at 348.

The court also reasoned that the Code permitted an eligible debtor to convert its case from one chapter to another, and that—although moving into or out of subchapter V is not properly a *conversion* between chapters—“chapter 11 and Subchapter V are materially different, much like the differences in chapters under the Bankruptcy Code[, and] the ability to revoke a Subchapter V election is consistent with the Bankruptcy Code.” *Id.* at 348.

The court accordingly revoked the subchapter V designation and directed that the U.S. Trustee immediately appoint a chapter 11 trustee to manage the estate.

In *In re ComedyMX, LLC*, 2022 WL 17742295 (Bankr. D. Del. 2022), the court addressed whether revocation of the debtor’s subchapter V designation was permissible but did not decide the issue, deciding that the proper remedy was removal of the debtor from possession.

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<sup>14</sup> “If a debtor discovers post-petition that it is unable to meet the deadlines of Subchapter V, the option to revoke such designation provides the ability to continue to attempt to reorganize under the rigors and requirements of standard chapter 11.” *In re National Small Business Alliance*, 642 B.R. 345, 349 (Bankr. D.D.C. 2022)

Alleging that current management was unfit to manage the debtors, a rival company and the U.S. Trustee filed motions to minimize the principal's impact on the debtor's business. They requested, alternatively, (1) the conversion of the case to a traditional chapter 11 case to permit the appointment of a chapter 11 trustee, as had occurred in *National Small Business Alliance*; (2) the § 1185 removal of the debtor as debtor-in-possession, which would permit the already-appointed subchapter V trustee to run the debtor's business under § 1183(b)(5); or (3) the dismissal of the case for cause under § 1112(b).

In considering the "close" question of whether a court could permissibly revoke the subchapter V designation over a debtor's objection, the court noted that the *National Small Business Alliance* result was the right one on policy grounds, *id.* at \*4, and that the cases permitting debtors in pending cases to elect subchapter V after its enactment support that result.<sup>15</sup>

The court was concerned, however, that § 103(i) reserves the decision to proceed under subchapter V to the *debtor*. In the post-SBRA cases in which the courts permitted a debtor to amend its petition to proceed under subchapter V, the debtor had requested the amendment.

Because non-debtor parties in interest may not force a debtor into subchapter V over the debtor's objection, the *ComedyMX* court reasoned, "it cannot be argued that parties in interest have *carte blanche* to . . . move debtors in or out subchapter V as they see fit." *Id.* at \*5. Further, the court noted, Rule 1020<sup>16</sup> implies that the debtor's subchapter V designation controls unless the court finds the debtor statutorily ineligible to proceed. *Id.* at \*5.

The court did not decide the issue because it concluded that revocation of the election would be permissible only as a measure of last resort and that removal of the debtors from possession was the appropriate remedy. Because the case was in an early stage and the debtors had not yet proposed a plan, the court reasoned that they should have the chance to proceed under subchapter V, although under the control of the subchapter V trustee. *Id.* at \*5.

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<sup>15</sup> The court elaborated on the argument: "Indeed, the argument can be taken a step further. Because Rule 1009(a) states that a petition may be amended 'on a motion of a party in interest,' while Rule 1009(b) permits the statement of intention to be amended only by 'the debtor,' one might draw an inference that the Advisory Committee, at least, made an express determination to permit parties in interest other than just the debtor move the Court to amend a bankruptcy petition." *In re ComedyMX, LLC*, 2022 WL 17742295, at \*4.

<sup>16</sup> "The status of the case as a small business case or a case under subchapter V of chapter 11 shall be in accordance with the debtor's statement under this subdivision, unless and until the court enters an order finding that the debtor's statement is incorrect." Bankruptcy Rule 1020(a).

## VI. Projected Disposable Income Issues

### A. Can court require debtor to pay PDI based on actual results?

An issue with regard to the projected disposable income requirement of § 1191(c)(2) is whether a debtor can be required to pay PDI based on actual, as opposed to projected results.

Section 1191(c)(2) states two alternative ways to satisfy the PDI test.

The first alternative, subparagraph (A), is familiar from chapter 13. It states that the PDI requirement is met if:

The plan provides that all of the projected disposable income of the debtor to be received [during the three to five year period] will be applied to make payments under the plan.

The second alternative, subparagraph (B), provides for satisfaction of the PDI requirement by payment of the *value* of the PDI. It thus permits a “cash-out” of PDI in a lump sum, something that chapter 13 does not permit. But it has other implications, which later text discusses.

The language in subparagraph (A) says: calculate PDI and pay it for the applicable period. In chapter 13 cases, under this same language, the plan proposes fixed payments (that sometimes “step up” over time), usually payable monthly, for the required time.

In chapter 13 cases, courts have ruled that the payments must be based on *projected* disposable income and that payments to creditors cannot be based on the debtor’s actual income and expenditures. *Anderson v. Satterlee (In re Anderson)*, 21 F.3d 355 (9th Cir.1994). We come up with a fixed amount, monthly in chapter 13 cases, and pay it for the required time.

When chapter 12 was enacted as a temporary measure in 1986, it used the same language as the chapter 13 PDI test (and subparagraph (A) in subchapter V cases), which had come into the Bankruptcy Code in 1984. But in chapter 12 cases, courts began requiring that the debtor show, at the end of the case and in connection with an application for a discharge, that the debtor had paid all disposable income during the plan period to creditors. The court would then determine whether the debtor had paid all disposable income retroactively, and a debtor would have to either pay that amount or the case would be dismissed. *E.g., Rowley v. Yarnall (In re Rowley)*, 22 F.3d 190 (8th Cir. 1994).

The chapter 12 case law would support the proposition that PDI in a subchapter V case under paragraph (A) should be determined on an actual basis, not a projected one, and would pose the interesting issue of whether subchapter V PDI should be based on a chapter 13 approach – determination of PDI at confirmation on the basis of projected income and expenses – or a chapter 12 approach – determination of PDI at the end of the case as a discharge matter on the basis of actual disposable income.

This analysis, however, does not take paragraph (B) of § 1191(c)(2) into account.

Paragraph (B) has its origins in amendments to Chapter 12 in 2005 in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. We mostly know about BAPCPA because of the changes it made in consumer bankruptcy, but it did at least two things for farmers.

First, it made chapter 12 permanent.

Second, it added an additional alternative for satisfaction of the chapter 12 PDI test. The language of the alternative is the same language that is in subparagraph (B) of the subchapter V test. At least one contemporary commentator stated that the purpose of the amendment was to eliminate the retroactive determination of PDI, which was a hardship for farmers. Susan A. Schneider, *Bankruptcy Reform and Family Farmers: Correcting the Disposable Income Problem*, 38 Tex. Tech. L. Rev. 309, 342-43 (2006).

If the language in the second chapter 12 alternative has the same meaning in subchapter V, then a subchapter V debtor can insist that PDI be determined at confirmation on a projected basis and that the statute does not permit a “true-up” during or at the end of the case.

Without consideration of any of the foregoing, two cases have ruled on the issue.

In *Legal Service Bureau, Inc., v. Orange County Bail Bonds, Inc. (In re Orange County Bail Bonds, Inc.)*, 638 B.R. 137 (B.A.P. 9th Cir. 2022), the debtor’s plan proposed to pay creditors from two sources. One was \$433,000 the debtor had realized from the liquidation of an estate asset. The other was its actual disposable income over five years. The debtor’s projections were that it would have disposable income of \$287,000 over three years and \$493,000 over five, but the plan provided that creditors might receive less, based on actual earnings.<sup>17</sup>

The Ninth Circuit Bankruptcy Appellate Panel concluded that the plan’s provision for payment of projected disposable income based on actual results did not meet the requirement of § 1191(c)(2)(A) that the plan provide for payment of *projected* disposable income because it did not commit the debtor to pay what it projected. *Orange County Bail Bonds* thus holds that a provision for payment of disposable income based on actual results is impermissible, even if the debtor proposes it.

The court concluded, however, that the plan’s provision for the payment of the liquidation proceeds of \$433,000 met the requirement of § 1191(c)(2)(B) that the debtor pay the *value* of its projected disposable income for the commitment period. The \$433,000 payment exceeded the projected disposable income of \$287,000 for three years, which the court held was the proper period in the absence of the bankruptcy court’s fixing of a longer time.

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<sup>17</sup> The facts are simplified. For a more detailed statement of the facts, amplified by reference to documents in the bankruptcy court’s record, see SBRA Guide at 154-55 & n. 406.

In *In re Staples*, 2023 WL 119431 (M.D. Fla. 2023), the *pro se* debtor proposed to pay projected disposable income of \$150 per quarter for five years. The bankruptcy court confirmed the plan but changed the payment provision to require the debtor to pay actual disposable income as reflected on quarterly reports, with a minimum quarterly payment of \$150.00. *Id.* at \*2.

On appeal, the district court stated that paragraph 2(A) of § 1191(c)(2) “simply requires that a plan provide that all projected disposable income be applied to make the distribution payments” and that paragraph 2(B) requires that “the value of property to be distributed is not less than the projected disposable income. *Id.* at \*3.

The court then concluded that “requiring all the disposable income to be reported and distributed does not violate” these rules. *Id.* at \*3. The court added that the bankruptcy court’s requirements were within its authority under the All Writs Act<sup>18</sup> and § 105(a) because they “were clearly necessary and appropriate under the facts of this case.” *Id.* at \*4.

## **B. PDI in individual cases**

SBRA Guide § VIII(B)(1) discusses determination of disposable income under § 1191(d) for purposes of the projected disposable income requirement in § 1191(c)(2) for cramdown confirmation under § 1191(b). *In re Cesaretti*, 2023 WL 3676888 (Bankr. D. Nev. Feb. 4, 2023), concludes that appropriate guidance for determining an individual’s reasonable expenditures in a subchapter V case is in chapter 13 case law in cases prior to enactment of the “means test” by the Bankruptcy Abuse Prevention and Consumer Protection Act in 2005 and in cases of below-median debtors after its enactment (in which the means test standards do not apply). The opinion reviews the case law.

To establish compliance with the PDI requirement for cramdown confirmation, an individual debtor must produce projections of all personal income and expenses, not just net income from the operation of the debtor’s business. In *In re McBride*, 2023 WL 8446205 at \*3-4 (Bankr. D. Me. 2023), the court required the debtor to amend schedules I and J to separately show gross receipts, necessary business expenses and total monthly net income for the debtor’s business, as Line 8a of Schedule I requires; to show the debtor’s personal expenses; and to show the nonfiling spouse’s income if schedule J showed all of their household expenses. The court stated, “The decision to include or omit the non-filing spouse’s income and any corresponding allocation of household expenses should reflect the economic realities of the household.” *Id.* at 3.<sup>19</sup>

The debtor in *McBride* had personally guaranteed a debt secured by real estate owned by a limited liability company in which the debtor had a 90 percent interest and owned a camp

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<sup>18</sup> 28 U.S.C. § 1651(a) provides, “The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.”

<sup>19</sup> For a discussion of inclusion of a nonfiling spouse’s income and expenditures in chapter 13 cases, see W. Homer Drake, Jr., Paul W. Bonapfel, and Adam M. Goodman, CHAPTER 13 PRACTICE AND PROCEDURE § 8:70.

jointly with the nonfiling spouse that was subject to a mortgage. The plan provided for payment of both debts in accordance with the applicable loan documents.

The court stated that, if the guaranty claim was secured only by property of the LLC, the claim was a general unsecured one that should not be classified separately from the claims of other unsecured creditors.

The court also questioned whether the debtor's proposal to pay the mortgage on the camp was "fair and equitable when general unsecured creditors are receiving so little on their claims." *Id.* at \*7. The court continued, *id.*:

The Court views a camp as a luxury rather than a necessary expenditure. If the Debtor must resort to the provision of § 1191(b) for confirmation of an amended plan, she should be prepared to explain why continued ownership of the camp does not weigh against a finding of fairness and equity.

The *McBride* court stated that failure to address issues regarding payments on a mortgage secured by property the debtor did not own and payments on the camp might result in a finding of bad faith under § 1129(a)(3). *Id.*

### **C. Projected Disposable Income and Payments on Secured Claims**

In *In re McBride*, 2023 WL 8446205 at \*3-4 (Bankr. D. Me. 2023), a partially secured creditor held a secured claim for \$ 214,000 (the value of its collateral) and an unsecured deficiency claim for approximately \$ 261,300. The debtor proposed to satisfy the secured claim with a promissory note in the principal amount of the value of the collateral, payable with interest at 8.5 percent over eight years in quarterly installments. Like other general unsecured creditors, the creditor would receive a pro rata share of \$ 105,000 on its unsecured deficiency claim. The plan also provided for issuance of a note payable over eight years to satisfy the fully secured claim of approximately \$ 200,300 held by another creditor.

The creditor voted its secured and unsecured deficiency claims to reject the plan and objected to confirmation. No other creditors voted. The court concluded that the plan was not confirmable because the debtor's calculation of projected disposable income was faulty, as the previous section discusses.

The court also addressed two issues regarding the operation of the alternative method in subparagraph (B) of § 1191(c)(2) for satisfying the projected disposable income test for cramdown confirmation.

Subparagraph (A) of § 1191(c)(2) requires that the debtor commit projected disposable income for a period of three to five years, as the court determines, "to make payments under the plan." § 1191(c)(2)(A). In *McBride*, however, the debtor contended that the plan satisfied the alternative in paragraph (B), which provides that the value of property to be distributed in the applicable period is not less than the debtor's PDI. *See McBride*, 2023 WL 8446205 at \*3.

The first issue was the debtor's deduction of plan payments from the business's profits before determining projected disposable income. The court concluded that the deduction was improper. *Id.* at \*5. (Note that the issue does not matter when confirmation involves payment of PDI under subparagraph (A) because PDI may be applied to make payments on the secured claim.)

The court stated, *id.*:

In comparing the value of property to be distributed under the Amended Plan to the Debtor's projected disposable income during the commitment period for the purposes of § 1191(c)(2)(B), it makes no sense to deduct from disposable income the payments made for the benefit of creditors under the terms of the Amended Plan.

In a plan confirmed under § 1191(c)(2)(A), the Debtor would pay all of her disposable income for the benefit of all classes, including [the two secured creditors]. In a plan confirmed under § 1191(c)(2)(B), the Debtor distributes property, not her disposable income.

Before confirming under this section, then, the Court must ensure that creditors are no worse off than they would be under a plan confirmed pursuant to § 1191(c)(2)(A). Therefore, in calculating the Debtor's disposable income for the purpose of comparing that value to the value of the property to be distributed, no payments paid for the benefit of creditors under the terms of the Amended Plan should be first deducted from projected disposable income. This approach is consistent with the wording of § 1191(d) which makes no mention of plan payments in listing the types of expenses to be deducted from a debtor's net income when determining disposable income. Since [the Debtor's PDI calculation] first deducts the plan payments before determining the Debtor's projected disposable income, the projections are inaccurate.

Second, the court addressed the competing interpretations of subparagraph (B) of § 1191(c)(2) that the debtor and the creditor advanced. The debtor contended that the distribution of the notes to the two secured creditors met the requirement because their present value exceeded its projected disposable income. The creditor argued that subparagraph (B) requires that each impaired class receive property with a value equal to or greater than the debtor's PDI. *Id.* at \*7. (As noted earlier, the *McBride* court, as stated in the preceding excerpt from its opinion, had concluded that the subparagraph (A) alternative provides for application of PDI for payment of claims in all classes.)

The court reasoned that a debtor could not commit all of its disposable income to more than one class and that "to require a debtor to distribute property equal to or greater in value than his or her disposable [income] to more than one class would be overly burdensome." *Id.* at \*7. The only way the creditor's interpretation avoids an absurd result, the court continued, "is if a debtor only needs to satisfy the requirements of § 1191(c)(2) with respect to just one class of claims." *Id.*

The court posited an interpretation of § 1191(c)(1) as containing all the requirements for classes of secured claims such that § 1191(c)(2) applies to all other classes of claims or interests. In the case before it, therefore, the debtor would have to satisfy subparagraph (B) only with respect to the class of unsecured claims. *Id.* at 7.

The court identified two problems with this approach.

The first problem is that § 1191(c)(2) is not expressly limited to a specific class of claims. The court noted that, although the cramdown provision applicable in a traditional case, § 1129(b)(2), explicitly states different requirements for classes of secured claims, unsecured claims, and interests, the subchapter V requirements in paragraphs (2) (PDI) and (3) (feasibility) of § 1191(c) are not similarly limited. The feasibility test in paragraph (3), the court observed, “does not address the treatment of claims at all and is obviously generally applied to a plan, as a whole.” *Id.* at \*7. In the absence of limiting language in § 1191(c), the court reasoned, “the more reasonable interpretation is that § 1191(c)(2), like § 1191(c)(3), is more globally applicable to the entire structure of the plan.” *Id.*

Second, the court pointed out that, because § 1191(c) does not specifically address classes of interests, an interpretation applying § 1191(c)(2) to all other classes except classes of secured claims would require it to include classes of interests. In the unlikely event that both a class of unsecured claims and a class of interests rejected a plan, the court reasoned, the posited interpretation would require the commitment of all disposable income, or the distribution of property of equivalent value, to more than one class. *Id.* at \*8.

The *McBride* court adopted, therefore, a “more reasoned approach,” *id.* at \*8:

For a plan to be fair and equitable under § 1191(c), classes of secured claims that are impaired and do not accept the plan must be treated in accordance with § 1129(b)(2)(A) [pursuant to § 1191(c)(1)] and, in addition, a debtor must either pay all of [the debtor’s] disposable income into the plan, or distribute property equal in value to that disposable income. Finally, the plan must also provide adequate remedies unless the debtor can meet the more stringent feasibility analysis [in § 1191(c)(3)(A)].

The court acknowledged the possibility that, under its interpretation, a debtor by giving promissory notes with a present value equal to or greater than its projected disposable income could pay little to unsecured creditors while accruing disposable income. *Id.* at 8. The court noted its “explicit and implicit authority to implement further measures to ensure fairness and equity,” *id.*, such as increasing the applicable commitment period to five years. In addition, the court continued, because § 1191(c) states that the fair and equitable requirement *includes* the specific requirements in paragraphs (1) through (3), “a court might require something more to satisfy that condition.” *Id.*

The combined effect of the two rulings is that, although PDI does not include payments on a secured claim satisfied by the distribution of a note, payments on the secured claim are

accounted for because the notes are taken into account in determining whether the property distributed under the plan (including the notes) has a value equal to or greater than PDI.

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#### **D. Salary or other compensation of owners**

In *In re J & J Pizza*, 2022 WL 4082059 (D.N.J. 2022), the bankruptcy court confirmed a plan over the objection of a creditor that the principal's salary should be reduced from \$100,000 to \$50,000. The district court affirmed, noting the subchapter V trustee had testified that the salary was reasonable. *Id.* at \*4.

In *In re Twisted Oak Winery, LLC*, 2022 WL 5264708, at \* 3 (Bankr. E.D. Cal. 2022), the debtor avoided an objection to the debtor's payment of rent to an insider, which appeared to be compensation to the owners of the business for operating it, by terminating the payments during the plan period.

#### **VII. Injunction To Prevent Collection from Principal on Guaranty Pending Payments Under the Plan**

In *In re Global Travel, Inc.*, 2022 WL 4690426 (Bankr. M.D. Fla. 2022), the debtor filed a subchapter V case to deal with financial distress arising from embezzlement of about \$1.2 million by an internal accountant and from the coronavirus pandemic that adversely affected the travel company's business.

At the time of filing, Qualpay, Inc., had filed an arbitration proceeding against the principal of the debtor on his alleged guaranty of the company's debt to Qualpay. The debtor sought and obtained a preliminary injunction against the pursuit of litigation against the principal pending development of a reorganization plan.

The debtor proposed a plan that, among other things, provided for payment of unsecured claims, including Qualpay, from quarterly payments of projected disposable income over three years and from proceeds from certain causes of action after payment of priority claims. The only two classes were equity interests and unsecured claims.

Other unsecured creditors holding allowed claims of \$732,745.95 voted to accept the plan; Qualpay, with a disputed claim of \$288,596.70 allowed for voting purposes only, was the only creditor to reject it. Because a majority of the creditors in the class holding 71.72 percent of the value of the voting claims accepted the plan, the class accepted the plan. § 1126(c).

The plan contained a "conditional temporal injunction" that protected the principal and a key employee from litigation by the debtor's creditors against them during the three-year payment period, provided that the debtor was performing under the plan. It tolled and abated statutes of limitation so that enjoined parties could pursue their claims if the plan did not result in

full payment. The plan provided for the two beneficiaries of the injunction to contribute \$25,000 to the plan, to limit their compensation to 10% of the excess of actual income over projected income, and to continue to provide their time, resources, and industry knowledge towards the successful completion of the plan for the benefit of creditors.

The debtor asserted that the proposed injunction was fair in view of the contributions of the individuals and limitations on their compensation and that, absent the injunction, protracted litigation would jeopardize the debtor's restructuring by depleting its assets, primarily the principal.

Qualpay objected to confirmation on the ground that the injunction was an impermissible third-party release of claims against a non-debtor in violation of § 524(e).

The court concluded that the plan did not contain a third-party release or permanent bar to the assertion of claims on the guaranty. Although the injunction was not a permanent bar order, the court evaluated the requested injunction by evaluating the factors identified in *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002), with regard to a plan's bar order, in accordance with the Eleventh Circuit's decision in *In re Seaside Eng's & Surveying, Inc.*, 780 F.3d 1070, 1079 (11th Cir. 2015). *Global Travel*, 2022 WL 17581986 at \*3.

Thus, the court listed these factors, *id.*:

1. Whether an identity of interests exists between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate;
2. Whether the non-debtor has contributed substantial assets to the reorganization;
3. Whether the injunction is essential to the reorganization, namely whether the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor;
4. Whether the impacted class has overwhelmingly accepted the plan;
5. Whether the plan provides a mechanism to pay for all, or substantially all, of the class members affected by the injunction;
6. Whether the plan provides an opportunity for those claimants who choose not to settle to recover in full.

The *Global Travel* court noted, 2022 WL 17581986 at \*3, that the list is nonexclusive and flexibly applied, *Seaside*, 780 F.3d at 1079, that bar orders must be essential to a successful reorganization and that the bankruptcy court must make specific factual findings to support entry of a bar order, with discretion to determine which *Dow Corning* factors are relevant in each case. *Id.* at 1078-79.

Addressing the factors, the court concluded that the facts merited the injunction.

First, with regard to identity of interests, the court noted that, although no indemnity obligation existed, the principal was the debtor's primary asset and that without him the business would suffer. The court credited his testimony that the arbitration was "massively consuming" and that he would have to be replaced at an annual cost of \$100,000 to \$150,000 while he defended the arbitration. The court concluded that "the proposed injunction is essential to the reorganization due to the identity of interests" between the debtor and the principal. 2022 WL 17581986 at \*4.

Second, the court concluded that the cash contribution and the limitation on compensation was "substantial and sufficient consideration" for the temporary injunction. *Id.* at \*4.

Third, the court concluded that the temporary injunction was essential to the reorganization. *Id.* at \*4.

Fourth, the court concluded that the impacted class had overwhelmingly accepted the plan. The court rejected Qualpay's contention that it was receiving worse treatment than other creditors in the class because the plan forced it to give up rights to pursue the principal on a guaranty that other members of the class did not have. The court concluded that Qualpay was an unsecured creditor like all other members of the class based on its rights against the debtor. *Id.* at \*5.

Fifth, the court concluded that the plan had a mechanism to pay Qualpay, which would receive payments in the same manner as other members of the class, and expressly preserved Qualpay's rights on the guaranty if it did not receive payment in full. *Id.* at \*5.

Finally, the court concluded that the plan provided Qualpay with the opportunity to recover on its claim in full because it left Qualpay's rights intact by tolling and abating all statutes of limitations and deadlines during the three-year term. *Id.* at \*5.

The court summarized its ruling, *id.* at \*6, "In sum, the Court finds that the Plan does not contain a nonconsensual third-party release. Qualpay's Objection is overruled, and the Plan is confirmed."

*See also In re Central Florida Civil, LLC*, 649 B.R. 77 (Bankr. M.D. Fla. 2023). (Plan confirmed with injunction preventing pursuit of guaranty claims pending payments under plan).

In *Ferrandino & Son, Inc. v. Sahene Construction, LLC (In re Sahene Constructions, LLC)*, 2023 WL 3010073 (Bankr. M.D. La. 2023), the debtor was a subcontractor on a construction project and indemnified the general contractor for any damages arising from its failure to perform the work properly. The property owner made demand on the general contractor for damages caused by the debtor's abandonment of work on the project and instituted an arbitration proceeding against the general contractor.

The general contractor sought a preliminary injunction to stay the arbitration on the theory that the owner's demand and prosecution of the arbitration were effectively actions against the debtor and property of the estate because the debtor was ultimately responsible for any arbitration award under its indemnity obligations to the general contractor.

The court denied the preliminary injunction, concluding that the general contractor was not likely to prevail on its claim because it had an adequate remedy at law, did not show irreparable injury, and did not establish harm to the estate.

For a discussion of third-party releases in the Subchapter V context, see *infra* Section XXI(12).

## **VIII. Role and Compensation of the Trustee in Subchapter V Cases**

### **A. Role of subchapter V trustee generally**

A principal duty of the subchapter V trustee is to “facilitate the development of a consensual plan of reorganization.” § 1186(b)(7).

In *In re Corinthian Communications, Inc.*, 642 B.R. 224, 225 (Bankr. S.D.N.Y. 2022), the court observed:

Subchapter V provides for the appointment by the United States Trustee of a non-operating trustee who provides oversight of the debtor in possession and helps facilitate negotiation of what will hopefully be a consensual plan of reorganization plan. See 11 U.S.C. § 1183. In this Court's experience, Subchapter V trustees are the “honest brokers,” who through their efforts have provided credibility in evaluating the debtor's business prospects for a successful reorganization and facilitated negotiation of a plan of reorganization with the debtor's stakeholders, thereby enabling a small business to reorganize.

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The court in *In re New York Hand & Physical Therapy PLLC.*, 2023 WL 2962204, at \*1 (Bankr. S.D.N.Y. 2023), summarized the subchapter V trustee's role:

Importantly, Subchapter V provides for the appointment of a trustee to assist the debtor in possession, provide oversight, and to help facilitate negotiation of a consensual plan of reorganization. 11 U.S.C. § 1183. The Subchapter V trustee appears at status conferences and provides the Court with valuable information on the progress of the case. *Id.* § 1183(b)(3). The Subchapter V trustee may be called on to perform the duties of the debtor in possession and operate the business. *Id.* § 1183(b)(5). Bankruptcy courts rely on the Subchapter V trustee to provide candid advice concerning a debtor's efforts to comply with its duties under the Code. *Id.* § 1183(b)(4); *In re Corinthian Commc'n, Inc.*, 642

B.R. 224, 225 (Bankr. S.D.N.Y. 2022) (“Subchapter V Trustees are the ‘honest brokers,’ who through their efforts have provided credibility in evaluating the debtor's business's prospects for a successful reorganization and facilitated negotiation of a plan of reorganization with the debtor's stakeholders, thereby enabling a small business to reorganize.”). The success of an individual Subchapter V case and of the bankruptcy courts in overseeing them depends in part on “the openness and transparency of the debtor with the Subchapter V Trustee, the U.S. Trustee, creditors, and with the Court.” *Id.*

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Several cases illustrate how subchapter V trustees have assisted the confirmation process or the administration of subchapter V cases.

In *In re Channel Clarity Holdings, LLC*, 2022 WL 3710602, at \* 6 (Bankr. N.D. Ill. 2022), an objector attacked the projections attached to the debtor’s plan. The court noted that the subchapter V trustee “testified convincingly that he not only had a hand in preparing the financial projections but has also reviewed them and concludes they show a viable path forward for Debtor.”

The court continued, *id.* at 6:

As the subchapter V trustee, his primary duty is to facilitate development of a consensual plan of reorganization. 11 U.S.C. § 1183(b)(7). The [subchapter V] Trustee’s expertise as a financial advisor is integral to this process of attempting to bridge the gap between debtors in distress and creditors seeking repayment.”

Although the court concluded that other issues required amendment of the plan for it to be confirmable, the court ruled that the debtor had meet its burden of establishing that the plan complied with the requirement of § 1190(1)(C) that the plan contain financial projections that demonstrated the debtor’s ability to make payments under the plan.

The *Channel Clarity* court also considered and discussed the subchapter V trustee’s views and proposals, stated at the hearing, concerning management of the debtor and encouraged the debtor to explore them with the trustee and other parties objecting to confirmation in response to the court’s concerns about management. Section XV(B) *infra* discusses this aspect of the case.

In *In re Lapeer Aviation, Inc.*, 2022 WL 7204871 (Bankr. E.D. Mich. 2022), the court denied confirmation because the plan did not meet the “best interests of creditors test” of § 1129(a)(7) and because it unfairly discriminated against the holder of an equity interest. The court overruled objections, however, based on good faith and feasibility.

The good faith objection, in part, was that the debtors had not provided accurate financial disclosures in their monthly operating reports. The court agreed that initial reports were not

entirely accurate and were incomplete. The court found no absence of good faith, however, stating, *id.* at \*4:

[T]he Debtors readily provided Debtors' complete financial records to the Subchapter V Trustee, . . . a seasoned financial consultant with decades of experience assisting troubled companies, [who] testified that the Debtors were cooperative and responsive in providing the source documents containing the financial information he needed to prepare his 13 week cash flow and the projections which form the basis of the Plan. The monthly operating reports played no role in [the trustee's] formulation of the Plan's financial projections and, in any event, those monthly operating reports have now been amended and corrected.

The court concluded that the debtors had not filed the inaccurate reports to mislead creditors or the court and that, while "certainly imperfect," they generally complied with the reporting requirements in § 308.

With regard to feasibility, the court found that the plan was feasible based in part on the subchapter V trustee's testimony that he had reviewed all of the necessary source financial information to "model a 13 week rolling cash flow inclusive of all income and expenses" and that his plan projections based on this cash flow forecast were realistic and achievable. *Id.* at \*6.

The "best interests" problem was that the debtors had identified potential claims that the debtors *might* pursue for the benefit of creditors. The court concluded that the best interests test required pursuit of the claims and that the plan must include provisions requiring the debtors to pursue them or granting derivative standing to other interested parties if the debtors chose not to pursue them. *Id.* at 5.

The court did not mention it, but an alternative might be to provide for the subchapter V trustee to pursue the claims.

*In re Corinthian Communications, Inc.*, 642 B.R. 224 (Bankr. S.D.N.Y. 2022), involved an apparently viable business that might reorganize. The debtor's management, however, had been accused of fraud with several conflicts of interest and had failed to provide information to, and otherwise cooperate with, the subchapter V trustee. The court found that the debtor's "grudging disclosure of information" was "completely unacceptable." *Id.* at 232.

Concerned that "the result of removing the debtor as debtor-in-possession could very well lead to the failure or collapse of the business," the court instead expanded the powers of the subchapter V trustee to include investigation of the debtor under § 1183(b)(2). *Id.* at 234. The court noted that further relief, such as removal of the debtor from possession, dismissal, or conversion might be required, based on the outcome of the investigation. *Id.* at 234.

*Corinthian Communications* illustrates two points. First, it is an example of how a debtor should *not* deal with the subchapter V trustee. Second, it is an example of how the presence of

the subchapter V trustee provides an opportunity to salvage a viable business *if* the debtor follows the approach of the debtors in *Channel Clarity* and *Lapeer Aviation*.

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In *In re Major Model Management, Inc.*, 641 B.R. 302 (Bankr. S.D.N.Y. June 21, 2022), the court declined to permit the filing of a proof of claim on behalf of a class under Rule 23 of the Federal Rules of Civil Procedure. Noting that an independent trustee serves in subchapter V cases to provide “oversight and guidance” to the court and the parties, the court agreed with the subchapter V trustee’s views at the hearing that the most efficient way to deal with the claims of the putative class members was through the claims objection process.

In *In re Central Florida Civil, LLC*, 649 B.R. 77 (Bankr. M.D. Fla. 2023), the court confirmed a plan providing for an injunction that prevented pursuit of guaranty claims against the debtor’s managers pending payments under plan. The court observed that the input of trustee in support of confirmation was “especially instructive.” The trustee stated the plan could not go forward without an injunction to protect the debtor’s managers.

The court in *In re Rosa Mosaic & Tile Company*, 643 B.R. 865 (Bankr. W.D. Ky. 2022), permitted the debtor to reject a collective bargaining agreement after an extensive factual analysis of the debtor’s negotiations with the union to determine whether § 1113(c) permitted the rejection. The subchapter V trustee participated in the negotiations and testified at the hearing on the debtor’s application for approval of the rejection.

The subchapter V trustee’s involvement in a subchapter V case provided an “extra safeguard” with regard to patient issues that provided “additional comfort” to the court that the debtor’s dental practice operations were being monitored such that the appointment of a patient care ombudsman under § 333 was not necessary. *In re Sameh H. Anouk Dental Services, P.C.*, 648 B.R. 755, 766 (Bankr. S.D.N.Y. 2023).

A subchapter V trustee and a bankruptcy administrator have standing to appear and be heard in an adversary proceeding brought by a creditor to determine ownership of personal property. *Palmetto State Armory, LLC v. Ikon Weapons, LLC (In re Ikon Weapons)*, 650 B.R. 670, 677 n. 3 (Bankr. M.D. N.C. Nov. 30, 2022). *See also* 7 Collier on Bankruptcy ¶¶ 1109.04, 1112.04[1] n. 5 (16th ed.).

## **B. Authority of subchapter V trustee to exercise trustee powers**

Section 1184 provides that “a debtor in possession shall have all the rights, other than the right to compensation under [§ 330], and powers . . . of a trustee serving in a case under [chapter 11], including operating the business of the debtor.” Section 1186(b) provides that the debtor remains in possession of all property of the estate, unless the debtor is removed from possession or a confirmed plan or confirmation order provides otherwise.

A question is whether the subchapter V trustee has the authority to exercise the rights that a trustee has in a chapter 11 case. A chapter 11 trustee's rights include the rights to use, sell, or lease property of the estate under § 363(b) other than in the ordinary course of business, to obtain postpetition financing under § 364, and to pursue avoidance actions under §§ 545, 547, 548, 549.

The court in *In re Roe*, 2024 WL 206678 (Bankr. D. Ore. 2024), addressed the issue in the context of a subchapter V trustee's motion under § 363(b) to require the debtor to post a retainer for the trustee's fees and expenses. The court observed that § 1184 does not provide for the subchapter V debtor in possession to have the rights and powers of a trustee exclusive of the subchapter V trustee and concluded, *id.* at \*2:

[A] subchapter V trustee may use the trustee's rights and powers under the Bankruptcy Code to the extent it is necessary for a subchapter V trustee to fulfill the statutory duties given to subchapter V trustees in section 1183. Such authority is concurrent with the debtor's authority to use those same trustee's rights and powers under the Bankruptcy Code to fulfill the debtor's duties as a debtor in possession, including those duties under section 1184.

The *Roe* court held that it could not grant the trustee's motion because the trustee had not served it on all parties in interest, as Bankruptcy Rule 2002(a)(2) requires for a motion to use property outside of the ordinary course of business. The court ruled, however, that it would require the debtor to establish a trust account for the benefit of all administrative claimants if, after service of the motion on all parties in interest, no one objected. *Id.* at \*5.

The next section discusses the *Roe* court's reasoning in support of its decision.

### **C. Deposit for payment of compensation and payment of the subchapter V trustee**

Judges in the Middle District of Florida have included a provision for interim trustee compensation in subchapter V cases in an "Order Prescribing Procedures in Chapter 11 Subchapter V Case, Setting Deadline for Filing Plan, and Setting Status Conference."<sup>20</sup> The orders require the debtor to pay \$ 1,000 as interim compensation to the subchapter V trustee within 30 days of the petition date and monthly thereafter. The amount is subject to adjustment upon request of any interested party and to the court's approval of the trustee's compensation under § 330. The debtor must include the interim compensation in any cash collateral budget.

Other courts are requiring similar deposits.

The court considered a subchapter V trustee's request for the debtor to post a retainer for the subchapter V trustee in *In re Roe*, 2024 WL 206678 (Bankr. D. Ore. 2024), discussed in the preceding section.

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<sup>20</sup> *E.g.*, *In re Nostalgia Family Medicine P.A.*, Case No. 6:21-bk-00274-LVV, Doc. No. 22, at ¶ 3 (Bankr. M.D. Fla. Mar. 26, 2021).

The *Roe* court concluded that the trustee had shown a valid business judgment to require the debtor to set money aside “to establish a viable source of funds to pay an obligation that Debtor has incurred in [the] case” and that a deposit of \$ 7,500 was reasonable given the fees that the trustee had incurred and was likely to incur. *Id.* at \*3. The court ruled, however, that the funds should be available for the pro rata benefit of all administrative claimants, not just the trustee, reasoning that claims of equal priority under the Bankruptcy Code must be treated the same. The court stated, *id.* at \*3 (footnote omitted):

[The] funds should be placed in a trust account to be used to pay administrative expenses, and not in the form of a retainer in which only the Subchapter V trustee would have a property interest. Section 1194(a) authorizes subchapter V trustees to hold funds before plan confirmation. Funds may not be paid from the trust account unless and until payment to the Subchapter V Trustee and any other administrative expenses is authorized by the Bankruptcy Code and approved by the court.

#### **D. Trustee’s receipt and distribution of preconfirmation payments -- § 1194(a)**

SBRA Guide § IV(C)(1) discusses the trustee’s preconfirmation receipt and distribution of payments and funds the trustee receives from the debtor prior to confirmation. It states, *id.* at 61, “Subchapter V contains no requirement for the debtor to make preconfirmation payments to the trustee, secured creditors, or lessors, and nothing in subchapter V authorizes the debtor to make preconfirmation payments to the trustee.”

The court in *In re Roe*, 2024 WL 206678 (Bankr. D. Ore. 2024), discussed in the previous Section, however, found an appropriate situation to require the debtor to make payments to the trustee. As section VIII(C) of this Update discusses, the court concluded that it had authority to require the debtor to make a preconfirmation payment to the trustee to establish a trust account for the benefit of administrative claimants, including the trustee. The court stated, *id.* at \*3:

Section 1194(a) authorizes subchapter V trustees to hold funds before plan confirmation. Funds may not be paid from the trust account unless and until payment to the Subchapter V Trustee and any other administrative expenses is authorized by the Bankruptcy Code and approved by the court.

A potential problem with the use of § 1194 in this circumstance is that § 1194(a) requires the trustee to hold prepetition payments and funds until confirmation or denial of confirmation of a plan. A court might avoid this complication (which could prevent, for example, use of the funds for the trustee’s interim compensation prior to a hearing on confirmation) by stating the terms for disbursement in the order requiring the trust account. As the *Roe* court held (see *supra* Section VIII(C)), § 363(b) may authorize the trustee to use funds of the debtor outside the ordinary course of business to establish a trust account that the trustee controls, without the necessity of invoking § 1194.

### **E. Payment of trustee’s fees as condition of dismissal**

When a court considers dismissal of a subchapter V case, the subchapter V trustee may request that the dismissal be conditioned on payment of the trustee’s fees. SBRA Guide § IV(E)(2) discusses the issue.

The court in *In re New York Hand & Physical Therapy PLLC*, 2023 WL 2962204 (Bankr. S.D. N.Y. Apr. 14, 2023), concluded that § 349(b) permits a structured dismissal and that payment of professional fees as a condition to dismissal is appropriate. The court required payment of the trustee’s fees within 45 days, in the absence of which the case would be converted to chapter 7.

In *In re East Coast Diesel, LLC*, 2022 WL 19078763 (Bankr. M.D.N.C. 2022), the court declined to condition dismissal on payment of the trustee’s fees and postpetition taxes. The court refused to permit a structured dismissal as proposed because the evidence did not establish that all postpetition wages had been paid and that disputes over the amount of the prepetition taxes existed. Because the parties had not demonstrated that payments would occur in accordance with the priority provisions of the Bankruptcy Code, the court dismissed the case without conditions.

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### **IX. Debtor Misbehavior in Subchapter V Cases: Conversion or Dismissal; Removal of Debtor From Possession; Expansion of Trustee’s Duties**

One problem arising in subchapter V cases is not unique to them: debtor misbehavior.

In a traditional chapter 11 case, § 1112(b)(2) permits dismissal or conversion to chapter 7 for “cause,” defined in § 1112(b)(4). Section 1104(a) requires appointment of a trustee for cause or if appointment of a trustee is in the interests of “creditors, any equity security holders, and other interests of the estate.”

Section 1112 applies in a subchapter V case, and § 1185(a) permits removal of the subchapter V debtor in possession for cause.

A common thread in subchapter V cases considering dismissal, conversion, or removal of the debtor from possession is inaccurate or incomplete disclosure of required information, failure to file proper operating reports, or both. Cases may also involve questionable transactions with, or transfers to, insiders and failure to disclose information about them or conflicts of interest arising from them. They often involve a noncooperative relationship with the subchapter V trustee that may border on hostility, failure to timely comply with court orders, and feasibility issues. Gross mismanagement of the estate or continuing losses may also be issues. *E.g.*, *In re Coeptis Equity Fund, LLC*, 2002 WL 17581986 (B.A.P. 9th Cir. 2022) (unpublished); *In re Jar 259 Food Corp.*, 2023 WL 6201739 (Bankr. E.D.N.Y. 2023); *In re California Palms Addiction, Recovery Campus, Inc.*, 2023 WL 2664284 (N.D. Ohio Mar. 27, 2023); *In re Duling Sons, Inc.*,

650 B.R. 579 (Bankr. D. S.D. April 10, 2023); *In re East Coast Diesel*, 2022 WL 19078763 (Bankr. M.D. N.C. Dec. 29, 2022); *In re No Rust Rebar, Inc.*, 641 B.R. 412 (Bankr. S.D. Fla. 2022). *In re Hao*, 644 B.R. 339 (Bankr. E.D. Va. 2022); *In re Corinthian Communications, Inc.*, 642 B.R. 224 (Bankr. S.D.N.Y. 2022); *In re KLMKH, Inc.*, 2022 WL 4281478 (Bankr. W.D.N.C. 2022).

A trustee in a traditional chapter 11 case has investigative duties under §§ 1106(a)(3), (4), and (7). Section 1183(b)(2), however, provides for the subchapter V trustee to perform such duties only if the court orders it. The same types of debtor misbehavior may give rise to entry of an order expanding the trustee's duties as an alternative to removal of the debtor from possession when reorganization may require debtor management. *In re Corinthian Communications, Inc.*, 642 B.R. 224 (Bankr. S.D.N.Y. 2022).

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Courts have faced the question of whether to convert the case to chapter 7, dismiss it, or remove the debtor from possession when cause for any of them exists. For example, in *In re Duling Sons, Inc.*, 650 B.R. 579 (Bankr. D. S.D. April 10, 2023), the court concluded that cause for dismissal, conversion, or removal existed because of incurable conflicts of interest between the debtor and the debtor's principal who held all corporate positions of the debtor and the debtor arising from prepetition conduct of the principal.

Because the debtor intended to market and sell its assets to fund a liquidating plan, the *Duling Sons* court concluded that the best remedy was removal of the debtor in possession. Liquidation by the subchapter V trustee, the court reasoned, would be better than conversion to chapter 7 because trustee fees would be lower, the subchapter V trustee was already familiar with the case, and the "natural learning curve" for a chapter 7 trustee would require duplicative work and delay distributions to creditors.

The *Duling Sons* court addressed the fact that a subchapter V trustee cannot file a plan, regardless of the removal of the debtor in possession, by directing the debtor and the subchapter V trustee to file a joint plan and that, if they did not do so within 90 days, the case would automatically convert to chapter 7.

In *In re M.A.R. Designs & Construction, Inc.*, 653 B.R. 843 (Bankr. S.D. Tex. 2023), however, the court concluded that cause for conversion or dismissal existed and that no unusual circumstances prevented conversion to chapter 7. The court rejected the debtor's arguments that confirmation of a plan providing for liquidation by the subchapter V trustee would be better for creditors than conversion. The subchapter V trustee's familiarity with the case, the court ruled, did not establish unusual circumstances because a trustee's professional familiarity with a case is common to all cases.

SBRA Guide § V(C) notes that the Supreme Court's ruling in *Lamie v. United States Trustee*, 540 U.S. 526, 124 S. Ct. 1023 (2004), appears to preclude compensation of the debtor's attorney for services following removal of the subchapter V debtor from possession. The court

in *In re NIR West Coast, Inc.*, 638 B.R. 441, 451-52 (Bankr. E.D. Cal. 2022), applied *Lamie* to deny compensation to the debtor’s attorney for services following removal.<sup>21</sup>

In an unreported order entered without objection by the U.S. Trustee or any other party after notice and a hearing, the court in *In re ComedyMX, LLC*, Case No. 22-11181 (CTG), D. Del. (Apr. 25, 2023), permitted attorneys to seek compensation for services rendered after the dispossession of the debtor under § 1185(a). The court stated (footnotes in original):

Such compensation may be appropriate on several potential bases. The fees may be awardable on the ground that they are actual, necessary costs and expenses of preserving the estate under § 503(b)(1)(A). Alternatively, it could be argued that an award is appropriate under § 330 on the ground that, as prior counsel to the debtor, the firm is a professional person employed under § 327.<sup>22</sup> A third potential basis for the relief is that it could be argued that the effect of § 1189 is to leave a debtor that has been dispossessed under § 1185(a) with certain limited obligations of a trustee, such that the dispossessed debtor remains entitled to retain counsel under § 327(a) (who may thus be compensated under § 330) to carry out that role.<sup>23</sup> Each of these potential bases is subject to counterarguments that are at least colorable. This Order does not adjudicate or resolve any such issue. Rather, in the circumstances of this case, no party objects to awarding [the debtor’s attorneys) compensation from the estate for actual, necessary worked performed for the benefit of the estate after the Dispossession Date. The Court accordingly grants this relief on that basis. *See In re Arsenal Intermediate Holdings, LLC*, No. 23-10097, D.I. 176 (Bankr. D. Del. March 27, 2023) (addressing the

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<sup>21</sup> When the best interests of the estate require that the debtor be represented after its removal from possession, one potential argument is that the fees of the debtor’s counsel (or other professionals) are actual, necessary costs and expenses of preserving the estate under § 503(b)(1)(A).

A second theory could be that fees are appropriate under § 330 because, as prior counsel to the debtor, the professional is a professional person employed under § 327. *Lamie* is potentially distinguishable because the case involved services after conversion to chapter 7. The Court did not address the contention that the attorney was a professional employed under § 327, perhaps in light of the directive in § 348(e) that conversion terminates the service of the trustee (the debtor-in-possession) in the chapter 11 case.

A third approach arises from the fact that dispossession under § 1185(a) does not alter the debtor’s exclusive right under § 1189(a) to file a plan. The argument is that, after dispossession, the debtor retains the limited obligation of a trustee to file a plan so that the dispossessed debtor can retain counsel under § 327(a) (entitled to compensation under § 330(a)) for services necessary to perform that function. The difficulty with this position is that the duty of a trustee to file a plan under § 1106(a)(5) is not applicable in a subchapter V case. See § 1181(a). The argument thus depends on the proposition that the duty to file a plan is a trustee duty that § 1189 vests in the debtor and that the debtor retains this trustee duty even after dispossession.

<sup>22</sup> *But see Lamie v. United States Trustee*, 540 U.S. 526 (2004) (holding that counsel for chapter 11 debtor could not be compensated under § 330 following conversion of case to chapter 7, but not considering or addressing the contention that such counsel remained “a professional person employed under section 327,” perhaps in light of the directive of § 348(e), which is inapplicable here).

<sup>23</sup> 11 U.S.C. § 1106(a)(5) describes the filing of a plan under § 1121 as a duty of a trustee. While §§ 1106 and 1121 are inapplicable in a subchapter V case, *see* 11 U.S.C. § 1181(a), one might nevertheless contend that these provisions suggest that the filing of a plan – which under § 1189 is a right vested exclusively in the debtor – is a duty of a “trustee.”

circumstances in which it may be appropriate, in an adversary system, for a court to grant relief on the ground that it is unopposed).

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A court may remove a debtor from possession or expand the trustee's powers *sua sponte*. *In re Coeptis Equity Fund, LLC*, 2002 WL 17581986 (B.A.P. 9th Cir. 2022) (unpublished); *In re Corinthian Communications, Inc.*, 642 B.R. 224 (Bankr. S.D.N.Y. 2022); *In re Ozelbi*, 639 B.R. 365, 425 (Bankr. S.D. Tex. 2022).

An order removing the debtor from possession is not a final order for purposes of appeal. *In re Green v. Nosek (In re Green)*, 2022 WL 16857106 (D. Minn. 2022).

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## **X. Deadline for Filing Plan; Extension of Deadline; Modification After Denial of Confirmation**

Section 1198(b) requires the debtor to file a plan within 90 days of the order for relief, but subchapter V contains no deadlines for a confirmation hearing or entry of a confirmation order. *See* SBRA Guide § VI(D). Section 1193(a) permits preconfirmation modification of a plan at any time.

Section 1189(b) permits the court to extend the deadline for filing the plan “if the need for the extension is attributable to circumstances for which the debtor should not justly be held accountable.” SBRA Guide § VI(J) discusses the different approaches courts have taken to the determination of what constitutes “circumstances for which the debtor should not justly be held accountable.”

Courts continue to differ in the proper standard for extending the time for the debtor to file a plan.

In *In re Trinity Consortium, LLC*, 2023 WL 6217784 (Bankr. D.N.M. 2023), the debtor sought an extension of the plan deadline, which had previously been extended several times, because it was still engaged in mediation with creditors that showed promise of resulting in settlements that would permit the debtor to file a meaningful and confirmable plan.

The court noted that the disagreement among courts about the standard for granting an extension “centers around whether the court may only consider whether the delay was due to circumstances beyond the debtor’s reasonable control or whether the court can take other things into account that relate to the subchapter V case, such as undue prejudice, lack of good faith, or whether the debtor has made progress in drafting a plan.” 2023 WL 6217784 at \*3.

The court examined three approaches to the issue in the case law. One view is that the debtor must establish that the circumstances are beyond the debtor's control.<sup>24</sup>

A second approach involves a four-factor test: “(1) whether the circumstances raised by Debtor were within his control, (2) whether Debtor has made progress in drafting a plan, (3) whether the deficiencies preventing that draft from being filed are reasonably related to the identified circumstances, and (4) whether any party-in-interest has moved to dismiss or convert Debtor's case or otherwise objected to a deadline extension in any way.”<sup>25</sup>

The court identified a third approach that involves an equitable inquiry into whether the debtor is “fairly responsible for his inability” to file a plan by the deadline.<sup>26</sup> The inquiry seeks to “strike the correct balance of [subchapter V's] goals of speed and access to a realistic reorganization scheme” and takes into account “whether the debtor manipulated the timing of his bankruptcy case, potential prejudice to creditors, and whether the debtor [is complying] with his obligations under the Code.”<sup>27</sup>

The *Trinity Consortium* court concluded that the determination of whether the need for an extension under § 1189(b) is “attributable to circumstances for which the debtor should not justly be held accountable” allows an equitable inquiry “to take into account all relevant circumstances surrounding the debtor's need for an extension of time to file a plan and to balance the interests of the affected parties.” 2023 WL 6217784 at \*8 (footnotes omitted).

The court continued, *id.*:

In striking that balance under § 1189(b), the Court should be guided by the overarching goals of subchapter V to (i) provide a process by which debtors may reorganize and rehabilitate their financial affairs, (ii) provide a framework for an expeditious and economical resolution of the case under subchapter V, and (iii) facilitate the development of a consensual plan. In striking the proper balance, the Court should give due regard to the particularly important protection § 1189(b) affords creditors because subchapter V eliminates various creditor protections available to creditors in chapter 11 cases not governed by subchapter V.

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<sup>24</sup> *Trinity Consortium*, 2023 WL 6217784 at \*5. The court cited *In re Majestic Gardens Condo. C Ass'n, Inc.*, 637 B.R. 755, 756 (Bankr. S.D. Fla. 2022); *In re Keffer*, 628 B.R. 897, 910 (Bankr. S.D.W. Va. 2021); *In re Seven Stars on the Hudson Corp.*, 618 B.R. 333, 346 (Bankr. S.D. Fla. 2020).

<sup>25</sup> *Trinity Consortium*, 2023 WL 6217784 at \*5, quoting *In re Baker*, 625 B.R. 27, 35 (Bankr. S.D. Tex. 2020).

<sup>26</sup> *Trinity Consortium*, 2023 WL 6217784 at \*6, quoting *In re Trepitin*, 617 B.R. 841, 849 (Bankr. D. Md. 2020). The court also cited: *In re HBL SNF, LLC*, 635 B.R. 725, 730 (Bankr. S.D.N.Y. 2022) (considering prejudice to the parties); *In re Greater Blessed Assurance Apostolic Temple, Inc.*, 624 B.R. 742, 746 (Bankr. M.D. Fla. 2020) (considering prejudice to creditors).

<sup>27</sup> *Trinity Consortium*, 2023 WL 6217784 at \*6, discussing *In re Trepitin*, 617 B.R. 841, 848-49 (Bankr. D. Md. 2020). The *Trinity Consortium* court observed that *Trepitin* stated that it was following the “circumstances beyond the control of the debtor” test but that the test *Trepitin* actually applied was an equitable one. 2023 WL 6217784 at \*6.

The court then identified specific factors to consider, *id.*:

Circumstances surrounding the debtor's need for an extension of time to file a plan which should be taken into account include whether the need for the extension is within the debtor's reasonable control and may include such things as the danger of prejudice by granting or refusing to grant the extension, the length of the extension, the debtor's good faith, the debtor's progress in formulating a meaningful plan, and the views of creditors as a whole and the subchapter V trustee.

Applying this standard, the court granted the extension. The court found that the debtor was close to concluding its negotiations with creditors in the mediation and that the extension would not unduly prejudice creditors. *Id.* at 10.

*In re Mateos*, 2023 WL 4842301 (Bankr. M.D. Fl. 2023), involved similar circumstances. The married debtors who had personally guaranteed debts of a company in chapter 11 sought an extension of time based on the need to resolve matters in the company's chapter 11 case so that their plan could properly take account of that resolution. The court found that the ability to settle matters in the company's case was important to their cases and granted the extension.

The court in *In re Signia, Ltd.*, 2024 WL 331967 (Bankr. D. Colo. 2024), after a review of the various approaches in the case law and extensive analysis and application of principles of statutory construction, adopted the "beyond-the debtor's control" approach.

The court began by stating that it had "little doubt" about the plain or ordinary meaning of the operative statutory language, "the debtor should not justly be held accountable." The court stated, *id.* at \*8:

It means simply that the debtor should not be responsible for external events that the debtor did not cause. And, the corollary is that the debtor is responsible for the debtor's own conduct. This corresponds exactly with the Beyond-the-Debtor's-Control Standard. Extensions may be warranted for external events beyond a debtor's control which make it impossible for a debtor to file a timely plan."

The court checked its interpretation by consulting dictionary definitions of the two key statutory words, "justly" and "accountable." Definitions of "accountable," the court noted, included "expected or required to account for one's actions: answerable" and "liable to be called to account, or to answer for responsibilities and conduct: answerable, responsible." *Id.* at \*9. The best meaning of "justly" in the context of the statute, the court said, is "in conformity with fact or reason: correctly, properly." *Id.* The court concluded that a reasonable reader would understand the words to have these meanings such that the statutory language "does mean that the debtor should not be responsible for external events that the debtor did not cause but is accountable for the debtor's own conduct." *Id.*

The *Signia* court then observed that, "[w]hile considering the constituent parts of the clause at issue – 'accountable' and 'justly' – might have some relevance, merely stringing the

words together is not enough and could lead in the wrong direction.” *Id.* at \*9. The court explained that “the entire clause (‘the debtor should not justly be held accountable’) must be considered as a single unit in the special context of the Bankruptcy Code.” *Id.* The court noted that, in the legal field, “terms of art” develop and that ordinary legal meaning may be different from common meaning. Specifically, the court referred to Justice Frankfurter’s statement on statutory interpretation, *id.* at \*9:<sup>28</sup>

[I]f a word is obviously transplanted from another legal source, whether the common law or other legislation, it brings the old soil with it.

The *Signia* court concluded that, in addition to having plain or ordinary meaning, the clause also has “specialized meaning and ‘old soil,’” the “old soil” being § 1221 in chapter 12, which permits an extension of the debtor’s deadline for filing a plan with the same language as the subchapter V statute.

The court extensively reviewed the legislative history of § 1221 and the case law interpreting that section, concluding that § 1221 permits an extension only if the inability to file a plan is due to circumstances beyond the debtor’s control. *Id.* at 10-11. Accordingly, the court explained, *id.* at 12:

When Congress copied the exact same language used in Section 1221 into Section 1189(b), it must be presumed that Congress meant for the same Beyond-the-Debtor’s-Control Standard to apply given that that had been the law for decades. The Supreme Court has repeatedly invoked this “longstanding interpretive principle”: “[w]hen a statutory term [or phrase] is ‘obviously transplanted from another legal source,’ it brings the old soil with it.”<sup>29</sup>

The *Signia* court summarized its holding, *id.* at 11:

So, the meaning of Section 1189(b) already has been settled in the context of Section 1221. The Court reaffirms that the Beyond-the-Debtor’s-Control Standard (derived from Section 1221) is the right standard for evaluating requests for extension under Section 1189(b).

The court denied the motion to extend the deadline because the only basis for the extension was an unresolved dispute concerning financing. This circumstance, the court concluded, was not beyond the debtor’s control because it could have filed its financing motion earlier, asked for an expedited hearing, reached some agreement with the objecting party, or

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<sup>28</sup> The Court quoted Antonin Scalia & Bryan A. Garner, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* 73 (Thomson West 2012) and Felix Frankfurter, *Reflections on the Reading of Statutes*, 47 *COLUM. L. REV.* 527, 537 (1947).

<sup>29</sup> Quoting *Taggart v. Lorenzen*, \_\_\_ U.S. \_\_\_, 139 S.Ct. 1795, 1801 (2019) (construing bankruptcy statutes pertaining to injunctions), and citing *Hall v. Hall*, \_\_\_ U.S. \_\_\_, 139 S.Ct. 1118, 1128 (2018).

drafted around the issue in a plan with differing provisions depending on whether the debtor prevailed. *Id.* at 12.

The *Signia* court observed that in its district debtors and their counsel were manipulating the § 1189(b) deadline by filing “bogus placeholder plans of reorganization on the ninetieth day” that were “obviously deficient (many containing blanks, inadequate information, and missing financials) [with] no chance of confirmation.” *Id.* at 1. The court criticized the practice because the plans “seem to be filed in an attempt to pay lip service to the 90-day Section 1189(b) requirement while obviously skirting the import of the statute.” *Id.*

The debtor in *In re S-Tek I, LLC*, 2023 WL 2529729 (Bankr. D. N.M. 2023), timely filed its original plan, followed by second and third plans that the court considered to be preconfirmation modifications of the original plan. After denial of confirmation of the third plan, the debtor filed a fourth plan.

The court ruled that, after denial of confirmation, no plan existed that the debtor could modify and that the fourth plan was not timely. *Id.* at \*5. The court noted that chapter 12 cases had permitted modification after denial of confirmation. *Id.* at \*5, n. 36 (citing *Novak v. DeRosa*, 934 F.2d 401, 403-04 (2d Cir. 1991) (providing that a chapter 12 plan may still be modified after denial of confirmation); *In re Mortellite*, No. 17-21818-ABA, 2018 WL 388966, at \*1 n.3 (Bankr. D.N.J. Jan. 11, 2018) (same)).

The *S-Tek* court declined to give the debtor more time to file a plan based on the circumstances of the case, including the facts that the case had been pending for two years, was essentially a two-party dispute, and had involved contentious and expensive litigation. *Id.* at \*8-9.

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## **XI. What is “Unfair Discrimination” That Precludes Cramdown Confirmation?**

One of the requirements for cramdown confirmation in both traditional (§ 1129(b)) and subchapter V (§ 1191(b)) cases is that the plan must not “discriminate unfairly.”

The court in *In re Lapeer Aviation, Inc.*, 2022 WL 7204871, at \*8-9 (Bankr. E.D. Mich. 2022), addressed the requirement in connection with the plan’s treatment of equity interests. The plan provided that one holder would retain his equity interest but that the other would be required to accept \$15,000 for his.

The court adopted the so-called “Markell test,” articulated in an article by Hon. Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 Am. Bankr. L. J. 227 (1998), and adopted by the bankruptcy court in *In re Dow Corning Corp.*, 244 B.R. 705, 710 (Bankr. E.D. Mich. 1999), *aff’d*, 255 B.R. 445 (E.D. Mich. 2000), *aff’d*, 280 F.3d 648 (6th Cir.

2002). *See also In re Mallinckrodt, PLC*, 639 B.R. 837, 898-99 (D. Del. 2022) (applying the Markell test).

The court summarized the test as creating a “rebuttable presumption that a plan is unfairly discriminatory” when three conditions exist. *Lapeer Aviation* at \*8. The first two are the presence of a dissenting class and of another class with the same priority.

The third condition is that the difference in the plan’s treatment of the two classes result in either “(a) a materially lower percentage recovery for the dissenting class (measured in terms of the net present value of all payments), or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with the proposed distribution.” *Id.* at \*8.

The first two requirements were met because the plan put the two equity interests with the same priority in separate classes and one of them rejected the plan.

The third requirement was met because the cash-out provision had the potential to result in a materially lower recovery for the dissenting holder than the other would receive through retention of his interest in the reorganized debtor. *Id.* at \*9. The court rejected the proposition that the discrimination was not unfair because of the dissenting holder’s opposition to reorganization efforts, noting that he had no management or control rights. *Id.* at \*9.

## **XII. The “Appropriate Remedies” Requirement for Cramdown Confirmation, § 1191(c)(3)(B)(ii)**

The Bankruptcy Threshold Adjustments and Technical Corrections Act, Pub. L. No. 117-151, 136 Stat. 1298 (June 21, 2022), amended § 1191(c)(3) to provide that, as a condition for cramdown confirmation, the plan must provide “appropriate remedies” to protect creditors only if the court concludes that there is a reasonable likelihood that the debtor will make plan payments. Prior to the amendment, the remedies requirement arguably also applied if the court found that the debtor would be able to make all payments under the plan. The amendment applies to cases filed before its enactment. *In re Channel Clarity Holdings, LLC*, 2022 WL 3710602, at \*15 n. 12 (Bankr. N.D. Ill. 2022).

The plan in *Channel Clarity Holdings* provided that a creditor could “pursue its remedies as are available to it pursuant to applicable law” if plan payments were not made. *Id.* at 16. The court concluded that it was “clear that the language proposed by Debtor is deficient.” *Id.* at 16. The court explained, *id.* at 16:

[I]t offers no specific protections for unsecured creditors who are forced to forgo some of the standard protections of a typical chapter 11 case when debtors elect to proceed under subchapter V. To assert that creditors can pursue remedies under applicable law if Debtor should default is a toothless remedy.

Noting that the debtor’s limited assets would likely be depleted by the time of a default and that a “race to the courthouse” would be “contrary to the spirit and intent of the bankruptcy policy of orderly distribution of limited assets,” the court suggested, *id.* at 16:

Under these circumstances where the objecting unsecured creditor bears a disproportionate amount of risk, Debtor could offer options such as expedited liquidation of nonexempt assets, or a truncated process for declaring a default and allowing collections to begin, or immediate conversion to allow a chapter 7 trustee to take over business operations and possibly conduct a winddown and liquidation.

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In *In re McBride*, 2023 WL 8446205 (D. Maine 2023), the court observed that a provision in a plan for the court to retain jurisdiction to address postconfirmation issues did not provide an adequate remedy. The court noted that a remedy is insufficient “if it is not tailored to the specific circumstances of the plan” and that “providing creditors with the opportunity to pursue their state law rights or to seek enforcement of a plan is insufficient.” 2023 WL 8446205 at \* 6.

In contrast, other courts have concluded that the availability of relief in the bankruptcy court to enforce the plan or seek relief available under federal or applicable state law is an adequate remedy. *Samurai Martial Sports, Inc.*, 644 B.R. 667, 691 (Bankr. S.D. Tex. 2022) (A provision in a plan permitting a creditor, upon the debtor’s failure to cure a default after 30 days’ notice, to proceed to collect “all amounts owed pursuant to state law without further recourse to the Bankruptcy Court” is a “marginally sufficient” remedy.); *In re Ellingsworth Residential Cmty. Ass’n, Inc.*, 2021 WL 6122645, at \*2 (Bankr. M.D. Fla. 2020); *In re Urgent Care Physicians, Ltd.*, 2021 WL 6090985, at \* 11 (Bankr. E.D. Wis. 2021).

*Hamilton v. Curiel (In re Curiel)*, 2023 WL 4146017 (B.A.P. 9th Cir. 2023), did not directly involve the issue of appropriate remedies. Rather, the Ninth Circuit Bankruptcy Appellate Panel reversed the bankruptcy court’s cramdown confirmation of the debtor’s plan over the objection of a secured creditor because the BAP concluded that the evidence did not establish feasibility under § 1129(a)(1). Nevertheless, the court’s remand to the bankruptcy court is relevant to the adequate remedies issue for two reasons.

First, the court in remanding for further proceedings regarding feasibility specifically directed the bankruptcy court to determine whether the objecting secured creditor could invoke the subchapter V feasibility requirement for cramdown confirmation in § 1191(c)(3). *Id.* at \*1. The same issue arises with regard to a secured creditor’s objection to cramdown confirmation based on the adequate remedies requirement in § 1191(c)(3).

Second, the court commented on the question of whether the remedies in the plan were adequate, although that issue was not before it. The court stated, *id.* at \*10, n. 11:

[The debtor’s] Plan provided that in the event of a default [the creditor] could serve a notice of default and give [the debtor] at least sixty days to cure the default. If the default was material, the creditor “may: (i) take any action permitted under bankruptcy or non-bankruptcy law to enforce the terms of the Plan; (ii) seek liquidation of nonexempt assets pursuant to § 1191(c)(3)(B); (iii) seek to remove the Debtor as a DIP; and/or (iv) move to dismiss this case or to convert this case to Chapter 7 pursuant to § 1112(b).” We note the dearth of cases discussing what are, or are not, appropriate remedies under § 1191(c)(3)(B)(ii). But we agree with the bankruptcy court’s observation in *In re Channel Clarity Holdings LLC*, 2022 WL 3710602 at \*16 [(Bankr. N.D. Ill. 2022)], that merely allowing creditors to “pursue remedies under applicable law if Debtor should default is a toothless remedy.” The requirement under § 1191(c)(3)(B)(ii) that the remedies provided be “appropriate” suggests that they should be tailored to the situation. [The debtor] could bolster the default remedies to provide for a prompt auction of the Properties, a stipulated foreclosure, or an automatic deed in lieu of foreclosure. The prospect of an immediate, certain, and inexpensive remedy would increase [the debtor’s] incentive to obtain funding for the balloon payment and decrease the prejudice to [the creditor] if she is not successful.

Does the Bankruptcy Appellate Panel’s discussion of remedies for the secured creditor indicate that the Panel thinks the § 1191(c)(3) requirements should govern cramdown confirmation of a secured claim?

*In re McBride*, 2023 WL 8446205 (D. Maine 2023), supports the proposition that a secured creditor may invoke § 1191(c)(3) in opposition to cramdown confirmation of a plan that it has rejected. The court noted (in connection with its discussion of the projected disposable income requirement of § 1191(c)(2)(B), discussed in Section VI(C)) that § 1191(c)(3) “does not address the treatment of claims at all and is obviously generally applied to a plan, as a whole” and that § 1191(c)(3) is “globally applicable to the entire structure of the plan.” *Id.* at \*7.

The opposite view is that a secured creditor does not have the right to invoke § 1191(c)(3) in opposition to cramdown confirmation of its claim:

Because section 1191(b) states that the plan must be “fair and equitable” with regard to the class that has not accepted the plan, and because section 1191(c)(1) states specifically that the plan must meet the requirements of section 1129(b)(2)(A) “with respect to a class of secured claims, one argument is that a secured creditor may not invoke the other fair and equitable requirements in paragraphs (2) and (3) of section 1191(c).

COLLIER ON BANKRUPTCY ¶ 1191.04[1] at 1191-16.

The issue may be more theoretical than real because the fair and equitable requirement of § 1129(b)(2)(A) applicable to cramdown of secured claims includes consideration of feasibility. COLLIER ON BANKRUPTCY ¶ 1191.04[1] at 1191-16; *see also id.* ¶¶ 1129.03[4]b][ii]; 1129.04[2][a][v].

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### **XIII. Plan Provisions Inconsistent With Statutory Provisions**

Section 1193(b) does not permit modification of a plan after consensual confirmation under § 1191(a) once “substantial consummation” has occurred. In *In re North Richland Hills Alamo, LLC*, 2022 WL 2975121 (Bankr. N.D. Tex. 2022), all impaired classes accepted the plan, *id.* at \*9, and the debtor received a discharge upon the plan’s effective date because the plan was confirmed under § 1191(a), *id.* at 15. Nevertheless, the confirmation order permitted postconfirmation modification at any time within the “Commitment Period,” *id.* at 15.

If cramdown confirmation occurs under § 1191(b): (1) property of the estate includes postpetition assets and earnings, § 1186(a); and (2) the subchapter V trustee remains in place until completion of PDI payments. In *In re ActiTech, L.P.*, 2022 WL 6271936 (Bankr. N.D. Tex. 2022), the court confirmed the plan under § 1191(b) because all impaired classes did not accept it. *Id.* at \*3. Nevertheless, the confirmation order provided for (1) the revesting of property in the reorganized debtor, *id.* at \*9; and (2) termination of the trustee’s services as of the effective date of the plan, *id.* at \*14, which under the plan occurred upon entry of a final confirmation order, certain governmental and material third-party approvals, execution of required documents, and approval of settlements. *Id.* at \*22, 42-43.

See also *In re Bronson*, 2022 WL 3637566, at \*2 (Bankr. D. Or. 2022) (In resolving postconfirmation issues, the court noted that the plan confirmed under § 1191(b) had revested all property “except property required to perform obligations under the Plan” in the reorganized debtor.).

### **XIV. Confirmation Requirements of § 1129(a) Applicable for Confirmation in Subchapter V Cases**

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#### **A. Compliance with provisions of Bankruptcy Code (§ 1129(a)(2))**

In *In re Cesaretti*, 2023 WL 3676888 (Bankr. D. Nev. Feb. 24, 2023), the debtor had paid prepetition credit card and tax debts without court approval. The court concluded that the unauthorized postpetition payment of prepetition debt violated § 363 and that the violation of this provision of the Bankruptcy Code precluded confirmation under § 1129(a)(2). The court also concluded that the plan was not confirmable for several other reasons. The court did not address whether the payments, made from postpetition earnings, did not violate § 363 because an individual’s postpetition earnings are not property of the estate. See SBRA Guide § XI(B)(2).

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## **B. Postconfirmation management (§ 1129(a)(5))**

The confirmation requirement in § 1129(a)(5) requires the plan to disclose the identities of directors and officers and that their appointment to, or continuance in, office is “consistent with the interests of creditors and equity security holders and with public policy.”

This requirement rarely receives much attention in confirmation disputes, but it was an issue in *In re Channel Clarity Holdings, LLC*, 2022 WL 3710602, at \* 11-12 (Bankr. N.D. Ill. 2022).

The court noted concerns about the lack of a “defined management structure” for the debtor that involved someone other than the principal, who was also the majority shareholder. The debtor’s management structure lacked someone “who can hold him accountable” in view of the principal’s conduct in securing preferred member majority status, his conflicts of interest as the principal of affiliates doing business with the debtor, a number of high-level vacancies, and the fact that the debtor might not have anyone in charge of accounting functions.

The court noted that the subchapter V trustee had made proposals for management that involved appointment of a plan administrator with authority ranging from full control over all debtor bank accounts and sole signing authority to no signing authority but responsibility for making disbursements. *Id.* at \*12.

The court concluded that the debtor continuing its operation with only the principal in charge was inconsistent with the interests of creditors and equity security holders and public policy, stating, *id.* at \*12:

No evidence was presented at the hearing as to the propriety or legality of one proposal over another. The Court encourages Debtor to explore them all with the Objecting Parties and the SBRA Trustee in hopes of identifying an acceptable solution to allay the Court’s legitimate concerns about Debtor putting all its eggs in [the principal’s] basket at a time when he will be dealing with other pressing obligations. But to be clear, to satisfy section 1129(a)(5), any amended plan will need to specifically address Debtor’s management structure, including but not limited to [the principal’s] potentially conflicting roles and the provision of accounting services and financial controls.

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## **C. Best interest of creditors test (§ 1129(a)(7))**

The court in *In re Boteilho Hawaii Enterprises, Inc.*, 2023 WL 7117223 (Bankr. D. Haw. 2023), considered whether the debtor’s subchapter V plan satisfied the “best interest of creditors” test of § 1129(a)(7), which requires that the plan provide for creditors who have not accepted it to receive not less than they would receive if the debtor were liquidated under chapter 7.

The court concluded that the debtor’s plan met the test because a hypothetical liquidation of the debtor’s assets by a trustee in a chapter 7 case would produce less than what the plan provided for creditors. In its analysis, the court took into account the facts and circumstances that exist when a chapter 7 trustee liquidates assets.

In its discussion of the hypothetical chapter 7 liquidation of the debtor, the court noted that a trustee must liquidate assets “as expeditiously as is compatible with the best interests of parties in interest” under § 704(a)(1) and that, therefore, the trustee must “always dispose of the property quickly (although not necessarily at ‘fire sale’ prices.)” *Id.* at \* 2. The court rejected the valuations proposed by the objecting creditors based on its assessment of what the trustee’s disposition of the assets would likely realize and concluded that the trustee’s liquidation would not produce any funds for distribution to unsecured creditors after satisfaction of secured, administrative, and priority claims, including a postpetition loan made by the debtor’s principal. Accordingly, the court concluded that the plan that provided for no payments to unsecured creditors complied with § 1129(a)(7). The court in a separate order concluded that the plan met all other requirements for cramdown confirmation under § 1191(b). *In re Boteilho Hawaii Enterprises, Inc.*, 2023 WL 7411176 (Bankr. D. Haw. 2023).

#### **D. Acceptance by all impaired classes (§ 1129(a)(8))**

SBRA Guide § VIII(D)(2) discusses the issue of whether a class is deemed to accept a plan when no members of the class vote or object to confirmation.

Following *In re Ruti-Sweetwater, Inc.*, 836 F.2d 1263, 1267-68 (10th Cir. 1988), the court in *In re Jaramillo*, 2022 WL 4389292 (Bankr. D.N.M. Sept. 22, 2022), ruled that a class is deemed to accept a plan when no one votes or objects. The court noted, however, that affirmative acceptance is required for compliance with § 1129(a)(10), which requires that at least one impaired class of creditors accept the plan if any class of claims is impaired. Section 1129(a)(10) applies in the case of consensual confirmation in a subchapter V case under § 1191(a), but not to cramdown confirmation under § 1191(b). (Section 1129(a)(10) is somewhat superfluous for consensual confirmation because, by definition, all impaired classes have accepted the plan.)

The court in *In re Creason*, 2023 WL 2190623 (Bankr. W.D. Mich. Feb. 23, 2023), concluded that *Ruti-Sweetwater* was wrongly decided and ruled that a class that had not voted had not accepted the plan. The court, therefore, confirmed the plan under the cramdown provision in § 1191(b).

In *In re Vega Cruz*, 2022 WL 2309798 (Bankr. D. P.R. June 27, 2022), the court had confirmed a consensual plan but had deferred entry of a discharge order because the court wanted briefing regarding whether the cancellation of junior liens under the plan would occur upon discharge. The court concluded that the individual was entitled to discharge upon confirmation and to an order discharging and cancelling the junior liens. It appears that the junior lienholders had not objected to confirmation, but it is not clear whether they had

affirmatively accepted the plan. The court did not address the issue of whether their acceptance would be required for consensual confirmation.

Two courts outside the Tenth Circuit have concluded that classes that do not vote are not counted for purposes of determining whether § 1129(a)(8) is satisfied. *In re Hot 'z Power Wash, Inc.*, 655 B.R. 107 (Bankr. S. D. Tex. 2023); *In re Franco's Paving LLC*, 654 B.R. 107, 110 (Bankr. S.D. Tex. 2023). The courts reasoned that section 1126(c) requires determination of acceptance by dividing the number of acceptances by the total votes in the class. When no creditor in an impaired class has voted, the computation requires division of zero by zero, which produces an indeterminate result that is absurd and could not have been intended by Congress.

Thus, the court in *Hotz Power Wash*, 65 B.R. at 188, concluded:

This Court concludes, similar to the court in *In re Franco's Paving LLC*, that the result of a § 1126(c) computation for a nonvoting class is absurd, unsolvable, and was not contemplated by Congress. Furthermore, as discussed *supra*, treating a nonvoting class as having implicitly accepted or rejected the plan is prohibited by the Code and applicable rules. Thus, since the application of the mathematical calculation in § 1126(c) is absurd as applied to a nonvoting class, and because the Code is silent on the correct treatment of a nonvoting class, this Court is left with only one option: when an impaired class of creditors fails to cast a ballot, that class will not be counted for purposes of whether § 1129(a)(8) is satisfied.

#### **E. Whether balloting is required**

SBRA Guide § VIII(A)(4) considers whether balloting on a plan is necessary if the debtor wants to bypass the solicitation of acceptances and seek cramdown confirmation under § 1191(b).

In the course of dealing with the debtor's proposal that creditors who did not "opt out" of the plan's provisions for third-party releases would be bound by them, the court in *In re Arsenal Intermediate Holdings, LLC*, 2023 WL 2655592 (Bankr. D. Del. Mar. 27, 2023), addressed the need for balloting in the case, where the debtor intended to pursue cramdown confirmation without soliciting any acceptances. The court stated, *id.* at \*2:

The typical practice in this Court has been for creditors' consent (or not) to a third-party release to be determined in connection with the vote on the plan. In subchapter V cases, however, § 1191(b) of the Bankruptcy Code eliminates § 1129(a)(10)'s requirement of an impaired accepting class. As a result, so long as the plan is nondiscriminatory and satisfies absolute priority, there is no requirement that creditor votes be solicited in a case under subchapter V.

Another court took a different approach in *In re Samurai Martial Sports, Inc.*, 644 B.R. 667, 690-91 (Bankr. S.D. Tex. 2002). The court noted that the two subsections of § 1129(a) which impose the balloting duty—§ 1129(a)(8) and (a)(10)—do not apply in a cramdown

situation. The court reasoned, however, that a good-faith effort to solicit ballots is still necessary on the debtor's part because, absent balloting, the court cannot determine whether the plan should be confirmed under § 1191(a) or (b).

#### **F. Feasibility (§ 1129(a)(11))**

SBRA Guide § VIII(B)(5) discusses feasibility issues under § 1191(c)(3), applicable in connection with cramdown confirmation under § 1191(b).

In *Hamilton v. Curiel (In re Curiel)*, 2023 WL 4146017 (B.A.P. 9<sup>th</sup> Cir. 2023), the court considered feasibility in a subchapter V case under § 1129(a)(11). The bankruptcy court had confirmed the debtor's plan over the objection of a secured creditor that the plan was not feasible. Concluding that the debtor had not established feasibility under the requirement of § 1129(a)(11), the court remanded for further proceedings.

In the course of its opinion, the court summarized the feasibility standard as follows, *id.* at \*10:

It is [the debtor's] burden, as the Plan proponent, to present concrete evidence to establish that she has sufficient cash flow to maintain her ongoing personal expenses while funding all Plan payments. *See In re Pizza of Haw., Inc.*, 761 F.2d [1374,] 1382 [(9th Cir. 1985)]; 7 Collier on Bankruptcy ¶ 1129.02 (16th ed. 2023). And while feasibility under § 1129(a) presents a relatively low threshold, it still depends on adequate evidence. *Legal Serv. Bureau, Inc. v. Orange Cnty. Bail Bonds, Inc., (In re Orange Cnty. Bail Bonds, Inc.)*, 638 B.R. 137, 148 (9th Cir. BAP 2022) (citing *In re Brotby*, 303 B.R. [177,] 191 [B.A.P. 9th Cir. 20030]). To this end, “[f]actual support must be shown for the Debtor's projections.” *In re Hobble-Diamond Cattle Co.*, 89 B.R. 856, 858 (Bankr. D. Mont. 1988). “The use of the word ‘likely’ in Section 1129(a)(11) requires the Court to assess whether the plan offers a reasonable ‘probability of success, rather than a mere possibility.’ ” *In re Sanam Conyers Lodging, LLC*, 619 B.R. 784, 789 (Bankr. N.D. Ga. 2020) (quoting *In re Aspen Vill. at Lost Mountain Memory Care, LLC*, 609 B.R. 536, 543 (Bankr. N.D. Ga. 2019)). Thus, “[t]he mere fact that the bare numbers in the income and expense projections provided in the plan demonstrate an apparent surplus to adequately fund the plan is not enough to meet the burden on feasibility.” *In re Kowalzyk*, 2006 WL 3032145, at \*5 (Bankr. D. Minn. 2006).

The court concluded that the debtor had not met her burden, *id.* at \* 12:

We agree with the bankruptcy court that if one were to accept [the debtor's] projected income and expenses, feasibility would be a very close question. We also understand that we must give due deference to the bankruptcy court's findings. *See Cardenas v. Shannon (In re Shannon)*, 553 B.R. 380, 387 (9th Cir. BAP 2016). But “sheer optimism and hopefulness, without more, is not sufficient to support a finding of feasibility.” *In re Om Shivai, Inc.*, 447 B.R. 459, 463 (Bankr. D. S.C. 2011); *see also In re Walker*, 165 B.R. 994, 1004 (E.D. Va. 1994) (“sincerity, honesty and willingness are

not sufficient to make the plan feasible, and neither are visionary promises” (cleaned up)). [The debtor’s monthly operating reports] undermine her projections. They similarly undermine the bankruptcy court’s inference based on the projections that Curiel’s income was reasonably sufficient to support performance of her Plan. Her calculations suggest that if everything were to go as projected, she initially would have just enough to perform her Plan obligations. However, her monthly reporting cannot be reconciled with the projections or the bankruptcy court’s feasibility findings. More specifically, there is no reliable, concrete evidence to support that [her business venture] will be able to fund the necessary income—that [the debtor] will be able to contribute \$4,500 in gross monthly income from her wages and receive \$3,000 from [a third party]. See *In re Aurora Memory Care, LLC*, 589 B.R. [631,] 642 [(Bankr. N.D. Ill. 2018)] (“Optimistic but hollow declarations from a debtor’s principal about hopes for funding do not do the job.” (cleaned up)).

The debtor in *In re Saturno Design, LLC*, 2023 WL 5962573 (Bankr. D. Or. 2023), sought cramdown confirmation of a plan that provided for interim monthly payments to the objecting secured creditor and a balloon payment in three years to be made through refinancing. Based on the testimony of the principal who had refinanced other businesses and the debtor’s accountant, the court found that the plan was feasible and confirmed it.

The court noted that the feasibility requirement in § 1191(c)(3)(B)(i) (that the court find a “reasonable likelihood” that the debtor will make plan payments) is indistinguishable from the feasibility standard in § 1129(a), which the court defined as a “reasonable probability of success.” The court stated, *id.* at \* 2 (footnotes in original renumbered):

The Ninth Circuit Bankruptcy Appellate Panel has held that, when a plan turns on sale or refinancing of collateral, satisfaction of the “reasonable probability” standard requires that the bankruptcy court “determine whether a sufficient refinancing or sale is reasonably likely to occur . . . .”<sup>30</sup> The BAP has also held that a debtor need not “prove that success is inevitable.”<sup>31</sup>

See also *In re S-Tek 1, LLC*, 2023 WL 2529729, at \* 3 (Bankr. D.N.M. 2023) (discussing adequacy of financial projections in concluding that the plan was not feasible under § 1129(a)(11) or § 1191(c)(3)).

## **XV. Cramdown Confirmation: “Indubitable Equivalent” Treatment of Secured Claim**

Section 1191(c) makes the cramdown requirements in § 1129(b)(2)(A) with regard to a secured claim applicable to cramdown confirmation under § 1191(b) in a subchapter V case. See SBRA Guide § VIII(B)(2).

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<sup>30</sup> Hamilton v. Curiel (*In re Curiel*), 651 B.R. 548, 567 (9th Cir. B.A.P. 2023).

<sup>31</sup> Comput. Task Grp., Inc. v. Brotby (*In re Brotby*), 303 B.R. 177, 191 (9th Cir. B.A.P. 2003).

In *In re Creason*, 2023 WL 2190623 (Bankr. W.D. Mich. Feb. 23, 2023), a creditor held a security interest in personal property, but it was avoidable under § 544(a) because the financing statement did not have the correct name for the debtor. The debtor’s plan put the creditor in a separate class and treated the creditor as an unsecured creditor.

The creditor did not vote on the plan. The court held that, because the creditor had not voted, the class had rejected the plan so that consensual confirmation under § 1191(a) was not permissible.

The court concluded that the plan was, however, confirmable under the cramdown provisions of § 1191(b) because the plan provided for the creditor to receive the “indubitable equivalent” of the claim under § 1129(b)(2)(A)(iii). The court reasoned, *id.* at 3:

Suffice it to say that treating as unsecured the holder of an inevitably avoidable security interest offers the “indubitable equivalent” of its claim, as required for confirmation under § 1191(b). *See* 11 U.S.C. § 1191(c)(1) (incorporating § 1129(b)(2)(A)(iii) as rule of construction). On this point, [the creditor’s] failure to participate in the confirmation process certainly backfired. The court finds that the plan is fair and equitable in its treatment of [the creditor], and § 1141(c) permits revesting of [the creditor’s] supposed collateral in [the debtor], free and clear of [the creditor’s] lien.

## **XVI. Eligibility for Subchapter V**

### **A. Debtor must be “engaged in commercial or business activities”**

As SBRA Guide § III(C)(2) discusses, a number of courts have broadly interpreted “commercial or business activities” to include “wind-down” activities for a business that has discontinued active business operations. More courts have taken this approach.

In *In re Hillman*, 2023 WL 3804195 (Bankr. N.D.N.Y. June 2, 2023), the debtor held a 50 percent equity interest in two entities. A creditor had filed a lawsuit against one of them and the debtor for defaults under a commercial lease agreement with the company and the debtor’s personal guaranty of its obligations. The creditor objected to subchapter V eligibility on the ground that neither of the debtor’s two companies was engaged in commercial or business activities at the time of the filing of the petition.

The court agreed that eligibility must be determined based on the existence of activities on the petition date but held that the debtor met the requirement under the “totality of circumstances” approach because both companies were currently engaged in commercial or business activities.

Although the defendant company had closed, the court ruled that the defense of the claim on the guaranty constituted sufficient winding down activity for the debtor to satisfy the “engaged in commercial or business activities” requirement. *Id.* at \*4. The court found no “reason to distinguish between pursuing versus defending commercial litigation when

determining subchapter V eligibility.” *Id.* at \* 4 n. 8 (citing *In re Port Arthur Steam Energy*, 629 B.R. 233, 237 (Bankr. S.D. Tex. 2021)).

The creditor alleged that the operations of the other entity were not enough to constitute being presently involved in business or commercial activity, characterizing it as a “hobby.” The court rejected the contention that “little or scarce business activity is insufficient for subchapter V eligibility,” noting that the company had completed a sale of goods for profit within 60 days of the bankruptcy filing. *Id.* at \*4 n. 7.

In *In re Robinson*, 2023 WL 2975630 (Bankr. S.D. Miss. Apr. 17, 2023), the debtor filed the subchapter V case over a year after the closing of a poultry farming operation when its contract for chicken processing terminated. At the time of the filing, the debtor had a job as a loader operator at a lumberyard. The debtor filed the case to liquidate the farm’s assets after efforts to find another grower contract were unsuccessful.

The U.S. Trustee objected to the debtor’s eligibility, contending that the cessation of farming operations more than a year before the filing was so distant that his current activities could not be characterized as winding down.

The court concluded that, under the “totality of circumstances” approach, the debtor’s continued management of farm assets, his efforts to sell the farm or parts of it, and his maintenance and inspection of improvements on the farm were sufficient wind-down activities to satisfy the “engaged in” commercial or business activities requirement. The court reasoned, “[T]he totality of the circumstances standard does not dictate a quantum of activities or time engaged in them.” *Id.* at \*4.

In *In re Free Speech Systems, LLC*, 649 B.R. 729, 733 n.14 (Bankr. S.D. Tex. 2023), the court noted that the requirement that the debtor be engaged in commercial or business activities is not a continuing one, such that the termination of business operations after filing does not render the debtor ineligible.

In two related cases, the bankruptcy court held that the individual debtors, siblings who each owned 25 percent of a construction and contracting company but had not had any involvement with the company for about seven years, were “engaged in commercial or business activities” because they were appealing a judgment against them on a guaranty of a debt of the business and were pursuing an action against former business associates for taking excessive distributions from the company. *In re Fama-Chiarizia*, 655 B.R. 48 (Bankr. E.D.N.Y. 2023); *In re Fama*, 2023 WL 6131466 (Bankr. E.D.N.Y. 2023). (In *Fama-Chiarizia*, the court also found that the debtor’s rental of an apartment in her residence satisfied the requirement.)

After an extensive review of the case law, the court agreed “with the substantial majority of courts that have found that a debtor may be eligible to reorganize under Subchapter V when it seeks to address residual business debt, and to marshal residual business assets. And here, the facts and circumstances show that [the debtors seek] to do exactly that with respect to the business debt and assets of [the company].” 655 B.R. at 69 and 2023 WL 6131466 at \* 18.

The court further observed, 655 B.R. at 70 and 2023 WL 6131466 at \* 18:

And, for better or worse, courts agree that where – as here – the “business and commercial activities” are, in large part, in the nature of evaluating, asserting, pursuing, and defending litigation claims, this can still amount to addressing the business’ debts and marshaling its assets, and can satisfy Section 1182(1)(A)’s requirement of “commercial or business activities.”

### **B. Debt limit: debts of affiliates**

As amended by the Bankruptcy Threshold Adjustments and Technical Corrections Act (“BTATCA”), Pub. L. No. 117-151, 136 Stat. 1298 (June 21, 2022), debts for purposes of the debt limit for subchapter V eligibility include debts of affiliates of the debtor if the affiliate is a debtor in a bankruptcy case. § 1182(a).

When an affiliate of an eligible subchapter V debtor later files its own bankruptcy case, and the combined debts of all affiliates exceed the debt limit, the second debtor is clearly not eligible for subchapter V. The question is whether the second filing affects the eligibility of the debtor in the first case.

Two courts have ruled that, because eligibility is determined as of the filing date, the second filing does not render the first debtor ineligible, even when the total of the debt of the affiliates exceeds the debt limit.

In *In re Free Speech Systems, LLC*, 649 B.R. 729 (Bankr. S.D. Tex. 2023), the debtor filed a subchapter V petition. It was eligible despite the existence of substantial defamation claims against it because the damages had not yet been determined and, therefore, were unliquidated debts excluded from the calculation of debts for purposes of eligibility. After the court lifted the stay to permit the defamation litigation to proceed and a jury awarded substantial damages against the debtor and its jointly liable principal, the principal filed his own chapter 11 case.

Plaintiffs in the defamation action sought revocation of the subchapter V election in the first case based on the fact that the total debt of the affiliates exceeded the debt limit. The court rejected the argument, ruling that determination of eligibility on the effective date was not affected by the affiliate’s later filing. The court observed, “If postpetition affiliate filings lead to ineligibility and revocation, it means that debtors could float in and out of Subchapter V at any time.” *Id.* at 734.

In *In re Dobson*, 2023 WL 3520546 (Bankr. W.D. Va. 2023), the sole shareholder of a construction company and his spouse filed a joint subchapter V petition. The next day, the corporation filed a chapter 7 case. The U.S. Trustee contested the eligibility of the individuals for subchapter V because the total of their debts and the corporation’s debts exceeded the debt

limit. The court agreed with *Free Speech* and ruled that the debtors' correct statement of eligibility on the petition date did not become incorrect based on a later event.

The court also rejected the U.S. Trustee's argument that the timing of the filing demonstrated an abuse. The court stated, *id.* at \*6:

The U.S. Trustee asks this Court to consider the strategic decision by [the corporation] to not file a bankruptcy petition until after its sole shareholder filed his petition as if the professional planning is by itself an abuse or an indication of harm. Yet, the U.S. Trustee has failed to show how professional advice and deliberate planning of the timing of a bankruptcy petition is unlawful or abusive.

A debtor desiring to proceed in subchapter V must pay careful attention to the debts of any affiliate in a pending bankruptcy case, even if the debtor has no realizable interest in the affiliated entities in bankruptcy. In *In re Carter*, 2023 WL 9103614 (Bankr. N.D. Ga. 2023), the individual debtor owned 65 percent of one company that had been in bankruptcy for seven years and 99 percent of another that had been in bankruptcy for five years. Both had been pending under chapter 7 for five years, and their cases remained open.

Although the individual's debts were less than the debt limit, inclusion of the debts of the chapter 7 debtors put the debtor over the limit. The court rejected the debtor's contention that the two companies were not his affiliates because they were controlled by the chapter 7 trustees.

A debtor in such a situation might seek to avoid this result through divestment of the worthless ownership interests prior to the filing of a subchapter V case.

### **C: Debt limit: whether debt is contingent or unliquidated**

Debts for purposes of determining the debt limit for subchapter V eligibility do not include contingent or unliquidated debts. § 1182(1)(A).

In *In re Parking Management, Inc.*, 620 B.R. 544 (Bankr. D. Md. 2020), the court concluded that claims for damages arising from the rejection of unexpired leases were contingent and that the debtor's obligations under a note pursuant to the Paycheck Protection Funding Program of the CARES Act were both contingent and unliquidated. Excluding those debts from the debt eligibility calculation, the court ruled that the debtor was eligible for subchapter V.

In *In re Macedon Consulting, Inc.*, 2023 WL 400484 (Bankr. E.D. Va. 2023), the court ruled that the entire, uncapped liability of the debtor for rent for the remainder of the lease term was noncontingent and liquidated.

The next subsection further discusses a debtor's liability for future rent under a real estate lease for purposes of the debt cap.

In *In re Hall*, 650 B.R. 595 (Bankr. M.D. Fla. 2023), a creditor objected to the eligibility of the debtor and an affiliated corporation on the ground that their debts exceeded the debt limit. The debtors contended that the creditor's debt should be excluded because it was disputed, and therefore unliquidated.

The court concluded that, under *United States v. Verdunn*, 89 F.3d 799 (11th Cir. 1996) ("vigorously disputed" tax penalties are liquidated), the existence of the dispute did not render the creditor's claim unliquidated. The debtors' pending adversary proceeding contesting the claim based on fraud in the inducement, intentional misrepresentation, negligent misrepresentation, and equitable subordination did not make the claim unliquidated.

The court summarized principles relating to determination of whether a debt is liquidated as follows, *id.* at 599:

"[C]ourts have generally held that a debt is liquidated if its amount is readily and precisely determinable, where the claim is determinable by reference to an agreement." *United States v. May*, 211 B.R. 991, 996 [Bankr. M.D. Fla. 1997] (citing Collier on Bankruptcy, 15th Ed. At 1109.06[2][c] (March 1997)). Ordinarily, debts of a contractual nature are "subject to ready determination and precision in computation of the amount due" and, therefore, are considered liquidated, even if subject to a substantial dispute. *Barcal v. Laughlin (In re Barcal)*, 213 B.R. 1008, 1014 (B.A.P. 8th Cir. 1997). By contrast, tort claims are generally unliquidated if not reduced to judgment. *Id.* The nature of "the process for determining the claim" dictates whether the claim is liquidated or unliquidated, not the magnitude of the dispute or the length of the trial required to resolve the dispute. *See id.*; *Nicholes v. Johnny Appleseed (In re Nicholes)*, 184 B.R. 82, 91 (B.A.P. 9th Cir. 1995) ("So long as a debt is subject to ready determination and precision in computation of the amount due, then it is considered liquidated and included for eligibility purposes under § 109(e), regardless of any dispute."); *see also In re Robinson*, 535 B.R. 437, 448 (Bankr. N.D. Ga. 2015) ("Generally, when a debt is owed pursuant to a contractual obligation it is liquidated.").

#### **D. Debt limit: debtor's liability for future rent under a real estate lease**

A debtor often has an unexpired lease for its business premises under which substantial future rent is due. For purposes of determining whether the debtor's debts exceed the debt cap, two questions arise with regard to the obligation for future rent. The first is whether the obligation is contingent or unliquidated. The second is whether the amount for eligibility purposes is the total future rent that is due (*i.e.*, the entire rent reserved under the lease for its remaining term) or the amount that is allowable under § 501(b)(6) (*i.e.*, the greater of future rent for one year or 15 percent of future rent, not to exceed three years).

In *In re Parking Management, Inc.*, 620 B.R. 544 (Bankr. D. Md. 2020), the court concluded that claims for damages arising from the rejection of unexpired leases were contingent because they did not arise unless the debtor rejected the leases. Excluding those debts from the debt eligibility calculation, the court ruled that the debtor was eligible for subchapter V.

In *In re Macedon Consulting, Inc.*, 2023 WL 400484 (Bankr. E.D. Va. 2023), the court ruled that the entire, uncapped liability of the debtor for rent for the remainder of the lease term was noncontingent and liquidated. The court reasoned, *id.* at \*4:

In this case, the debt at issue is liability under the Leases, and that liability arose prepetition, on the dates the Leases were fully executed. For example, it could not be said that if the Debtor vacated the premises on the 31st of one month during the lease term, that it would not still owe the landlord for the next month and the remainder of the lease term. While it may be argued that the timing of payments is the future extrinsic event that may never occur, the Court disagrees. The timing of lease payments is simply that – timing. Absent the end of the world, we know the future date will occur. As a result, liability under the Leases must be considered noncontingent and liquidated, and the Debtor in this case is therefore above the debt limits for subchapter V, which are capped at \$7.5 million of aggregate noncontingent liquidated debts.

The court in *In re Zhang Medical P.C.*, 2023 WL 8286372 (Bankr. S.D.N.Y. 2023), declined to follow *Macedon Consulting* and concluded that claims for future rent were contingent and unliquidated. The court observed that an executory contract “represents both an asset (the debtor’s right to performance) and a liability (the debtor’s own obligation to perform).”<sup>32</sup> Accordingly, the court continued, § 365(a) gives the debtor the option to assume or reject the executory contract or unexpired lease. *Id.* at \*6.

If the debtor assumes the executory contract or unexpired lease, the court reasoned, the debtor’s future obligations should not be considered “debts” for purposes of subchapter V eligibility because assumption means that the contract or lease is a net asset, *i.e.*, its benefit to the estate outweighs the debtor’s future liability. *Id.* at \*6. The court then explained that, until the debtor elects to assume or to reject, the amount and nature of the debtor’s obligations are contingent and unliquidated. The court stated, *id.*:

Because the amount and nature of the debtor’s obligations, as well as these are even “debts” depend on an uncertain event – the debtor’s election to either assume or reject – any eventual debt is both contingent and unliquidated prior to that election.

Although the court thus determined that the debtor’s obligations for future rent were not included in determining the amount of the debtor’s debts, the court held that the existence of other debts made the debtor ineligible for subchapter V.

#### **E. Debt limit: determination of amount of debt**

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<sup>32</sup> *Zhang Medical*, 2023 WL 8286372 at \*5, quoting *Mission Product Holdings, Inc. v. Tempnology, LLC*, \_\_\_ U.S. \_\_\_, 139 S.Ct. 1652, 1658 (2019).

In *In re Zhang Medical P.C.*, 2023 WL 8286372 at \* 4 (Bankr. S.D.N.Y. 2023) (citations omitted), the court stated:

The court may look both to the debtor’s schedules and to creditors’ proofs of claim. Proofs of claim are *prima facie valid*. Because the debtor bears the ultimate burden of proving its eligibility for subchapter V, proofs of claim that the debtor does not challenge may be deemed to be valid for subchapter V eligibility purposes.

See also *In re Hall*, 650 B.R. 595, 600 (Bankr. M.D. Fla. 2023); *In re Port Arthur Steam Energy, L.P.*, 629 B.R. 233, 235 (Bankr. S.D. Tex. 2021).

#### **F. What debts “arise from” commercial or business activities**

One of the requirements for subchapter V eligibility is that not less than 50 percent of the debtor’s debts arise from the debtor’s commercial or business activities.

In *In re Bennion*, 2022 WL 3021675 (Bankr. D. Idaho 2022), the court ruled that medical debts arising from injuries sustained by a debtor engaged in a “tree-felling” business while doing such work for his mother without charge did not arise out of commercial or business activities. The debtor, therefore, was not eligible for subchapter V because those debts exceeded his business debts.

In *In re Reis*, 2023 WL 3215833 (Bankr. D. Idaho 2023), the U.S. Trustee challenged debtor’s eligibility because almost all of her debt was for student loans incurred to enable her to go to medical school.

The debtor had graduated from medical school in 2009, completed her residency in 2012, and worked as an employee before creating a limited liability company in 2020 and opening her practice in 2021.

The court agreed with the courts that reject the proposition that working as an employee constitutes “commercial or business activities.”<sup>33</sup> The court reasoned, *id.* at \* 6:

Here, the gap between incurring the debt and actually engaging in any sort of commercial or business activity as an owner is simply too great to find that the student loans at issue arose from Debtor’s commercial or business activities. While it is clear that Debtor hoped to earn income from the use of her medical degree, it was entirely unclear for a decade whether she had borrowed to follow a career path as an employee working for a hospital, as a business owner, or even in public service.

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<sup>33</sup> *E.g.*, *In re Rickerson*, 639 B.R. 416, 426 (Bankr. W.D. Pa. 2021); *In re Johnson*, 2021 WL 825156, at \*7-8 (Bankr. N.D. Tex. 2021). *But see In re Ikalowych*, 629 B.R. 261 (Bankr. D. Colo. 2021). SBRA Guide § III(C)(2) discusses the cases.

Accordingly, the court concluded that the student loans did not qualify as business debts and that she was ineligible for subchapter V.

The court observed that its holding did “not foreclose all debt which arises prior to a business opening, as supplies, product, and a space for the business often must be acquired prior to the actual opening, and there is the possibility that a debtor may open more than one business during his or her lifetime and incur debt in doing so.” *Id.* at \*7.

The court also noted that it was not establishing a *per se* rule that student debt can never qualify as a debt arising from commercial or business activities. Rather, the court stated, “[T]he student loan debt at issue here, incurred over ten years prior to opening the medical practice, is simply too far removed for Debtor to qualify for Sub V relief.” *Id.* at \*7.

### **G. “Nexus” between current commercial or business activities and debts arising from previous activities**

SBRA Guide § III(E) discusses the debate over whether a nexus must exist between the debtor’s current commercial or business activities and debts arising from previous activities.

Other courts addressing the issue have reached opposite conclusions. The court in *In re Reis*, 2023 WL 3215833, at \*4-5 (Bankr. D. Idaho 2023), concluded that no nexus is required but found the debtor was ineligible because the debt in question was not a business or commercial debt. The court in *In re Fama-Chiarizia*, 655 B.R. 48 (Bankr. E.D.N.Y. 2023) and *In re Fama*, 2023 WL 6131466 (Bankr. E.D.N.Y. 2023) (discussed *supra* § XVII(A)), held that a nexus is not required and that the debtor was eligible.

*In re Hillman*, 2023 WL 3804195, at \*4-5 (Bankr. N.D.N.Y. 2023), concluded that a nexus is required and that it existed in the case.

### **H. Single asset real estate debtor**

A debtor is not eligible for subchapter V if its primary activity is the business of owning “single asset real estate.” § 1182(1)(A). Section 101(51B) defines “single asset real estate” as “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 thereto.”

The court in *In re Evergreen Site Holdings*, 2023 WL 4503880 (Bankr. S.D. Ohio 2023), found from the evidence that a debtor who owned two adjacent properties was not using the properties together in a common scheme and that the debtor would likely conduct substantial business on the properties other than leasing them and collecting rent. Accordingly, the court concluded that the debtor had established its eligibility for subchapter V.

In *In re CYMA Cleaning Contractors Inc.*, 2023 WL 7117445 (Bankr. D. P.R. 2023), a single-asset real estate debtor filed a subchapter case shortly after an affiliate filed its own subchapter V case. The debtor argued that, although it was an excluded single asset real estate debtor, it was nevertheless eligible for subchapter V as an affiliate of an eligible subchapter V debtor. The court concluded that the plain language of the statute “expressly excludes SARE debtors, regardless of whether they are affiliates of Subchapter V debtors.” *Id.* at \*6.

### **I. Time for objecting to eligibility; authority of court to raise eligibility issue *sua sponte***

In *In re CYMA Cleaning Contractors Inc.*, 2023 WL 7117445 (Bankr. D. P.R. 2023), discussed in the preceding subsection, the court concluded that it had the authority to raise the question of the eligibility of a debtor *sua sponte* even after expiration of the deadline for objections to eligibility under Bankruptcy Rule 1020(a).

### **J. A determination of ineligibility does not “revoke” the election**

In ruling that a debtor is not eligible for subchapter V, some courts have stated that the election is “revoked.” *E.g.*, *In re Carter*, 2023 WL 9103614 (Bankr. N.D. 2023); *In re CYMA Cleaning Contractors Inc.*, 2023 WL 7117445 (Bankr. D. P.R. 2023). The terminology is inaccurate.

Interim Bankruptcy Rule 1020(a) provides that the debtor must state on the petition whether it is a debtor as defined in § 1182(1) and whether it elects to proceed under subchapter V. The rule further provides that the case proceeds in accordance with the debtor’s statement “unless and until the court enters an order finding that the debtor’s statement is incorrect.”

Section 103(i) provides that subchapter V applies “only in a case under chapter 11 in which a debtor (as defined in section 1182) elects that subchapter V of chapter 11 shall apply.” Official Forms 101 and 201 each require a debtor to state (by checking the appropriate box) that the debtor is a debtor “according to the definition in § 1182(1) of the Bankruptcy Code.”

If a court determines that the debtor is incorrect in its statement that the debtor is a debtor as defined in § 1182, therefore, the provisions of subchapter V are inapplicable under § 103(i). As a result, the proper remedy for the debtor’s incorrect statement is for the court to determine that the provisions of subchapter V do not apply and that the case will proceed as a non-subchapter V case.

## **XVII. Conversion of Chapter 12 Case to Subchapter V; Creditor Request for Conversion of Chapter 7 Case**

In chapter 12 cases, § 1208 governs conversion or dismissal to another chapter. Section 1208(a) permits the debtor to convert the case to chapter 7, and § 1208(b) provides for dismissal of the case at the request of the debtor, if the case has not previously been converted from chapter 7 or chapter 11. Section 1208(c) permits dismissal for cause, and section 1208(d)

provides for dismissal or conversion to chapter 7 for cause. Section 1208(e) prohibits conversion to another chapter if the debtor may not be a debtor under such chapter.

Section 1208 does not have any provision that permits conversion to chapter 11. Some courts have held that a debtor may not convert from chapter 12 to chapter 11, while others have permitted it. *See, e.g., In re Cardwell*, 2018 WL 4846520 (Bankr. N.D. Tex. 2018) (permitting conversion and collecting cases); *In re Colon*, 2016 WL 35498821 (Bankr. D. P.R. 2016) (not permitting conversion and collecting cases); W. Homer Drake, Jr., and Karen D. Visser, *BANKRUPTCY PRACTICE FOR THE GENERAL PRACTITIONER* § 14:8 & nn. 9 & 10.

The court in *In re Leonaggeo* 2023 WL 3638053 (Bankr. S.D.N.Y. 2023), denied the chapter 12 debtor's request to convert to subchapter V, which she sought as an alternative to dismissal based on ineligibility for chapter 12. The court reasoned, *id.* at \*4:

In the Second Circuit, when the plain meaning of the statute fails to clarify ambiguity, Courts look to legislative history. *United States v. Jones*, 965 F.3d 190, 195 (2d Cir. 2020). While some Courts read the statute to be permissive, there is nothing in the legislative history suggesting that Congress intended for a chapter 12 debtor to convert to chapter 11. *See In re Orr*, 71 B.R. 639 (Bankr. E.D. N.C. 1987); *Matter of Bird*, 80 B.R. 861 (Bankr. W.D. Mich. 1987); *In re Johnson* 73 B.R. 107 (Bankr. S.D. Ohio 1987). This Court declines to accept the permissive reading and finds that conversion from chapter 12 to chapter 11 subchapter V is not possible under section 1208 of the Bankruptcy Code.

The *Leonaggeo* court noted that the debtor might choose to file a new case under subchapter V and cautioned that the automatic stay would not go into effect under § 362(c)(4) because it would be the debtor's third case within a year.

The court in *In re Powell*, 2022 WL 10189109 (Bankr. M.D. Pa. 2022), noted that it had denied the chapter 12 debtor's motion to convert to subchapter V in connection with its dismissal of the case.

A creditor sought conversion of a corporate debtor's chapter 7 case to subchapter V in *In re Roberson Cartridge Co., LLC*, 2023 WL 2393809 (Bankr. N.D. Tex. 2023). Acknowledging that § 706(b) permits conversion of a chapter 7 case to a chapter 11 case on request of a creditor or other party in interest, the court concluded that it could not order conversion to a case under subchapter V because only the debtor may elect its application.

## **XVIII. Property of the estate and automatic stay after cramdown confirmation**

Section 1186(a) provides that, after cramdown confirmation under § 1191(b), property of the estate includes, in addition to property specified in § 541, postpetition earnings and property that the debtor acquires postpetition. *See* SBRA Guide Part XI.

In *In re Chesney*, 2023 WL 8855242 (Bankr. W.D.N.C. 2023), the court considered the request of a creditor with a nondischargeable debt for relief from the automatic stay after

confirmation of a cramdown plan to collect its judgment from a substantial commission that the debtor could become entitled to as the personal representative of the estate of a friend who had died about four months after the filing of the subchapter V case. (The court rejected the creditor's contention that the commission was a bequest or devise within six months after the filing of the case that was property of the estate under § 541(a)(1) that the debtor failed to disclose.)

The court noted that the debtor's receipt of a commission during the plan term would be property of the estate under § 1186(a) that she would have to disclose on an amendment to her schedules<sup>34</sup> but that only the debtor may seek postconfirmation modification of a plan and that it was "doubtful" that she would have an obligation to modify her plan to increase plan payments. *Id.* at \*4. (The court observed that § 363(b) continued to apply so that "any out of the ordinary uses of estate property" would require notice to creditors and court approval. *Id.* at \*6 n. 3.)

Because the commission would be property of the estate and the debtor would not receive her discharge until completion of payments under the plan under § 1192, the court explained, the automatic stay continued to apply to protect the commission. *Id.* at \*6. The court declined to lift the stay to permit the creditor to enforce its claim against the commission, concluding that it would be inequitable to do so because it would give the creditor "an unfair advantage over other creditors."

The court reasoned, *id.* at \*6:

One might reasonably ask why, if the plan cannot be modified to claim the newly received asset, what is the harm in permitting a creditor with a nondischargeable debt to seek it outside of bankruptcy? Certainly, it is not to permit the Debtor a windfall. Rather, it has to do with the success of the Confirmed Plan. For creditors with dischargeable debts, payment is dependent on the success of [the Debtor's] plan. And while these prospective monies were not in prospect at the time of confirmation, before that three-year plan is completed, these monies may be necessary to fund plan payments.

[The Debtor] is currently 71 years old. At her age, one cannot gainsay that she will be able to continue to work for the entire plan term, nor that her employer . . . will continue to be able to pay her. If not, [the Debtor] may need the decedent's estate commission to pay living expenses and to fund plan payments. Many individual debtors fund plan payments out of monies which are exempt and otherwise unreachable by creditors. Given

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<sup>34</sup> Courts consistently state that a debtor must file an amendment to disclose postpetition assets or income despite the fact that no such requirement exists in the Bankruptcy Code or Bankruptcy Rules. Bankruptcy Rule 1007(h), which requires a debtor to disclose the postpetition acquisition of an interest in property, applies only to interests in property under § 541(a)(6). *See generally* W. Homer Drake, Jr., Paul W. Bonapfel, and Adam M. Goodman, CHAPTER 13 PRACTICE AND PROCEDURE § 16:7 at 362-63.

this possibility, it would be improvident at this point in time to afford one unsecured creditor exclusive rights to these potential funds.

The court stated that its order was without prejudice to renewal of the request for stay relief if and when the Debtor received the commission.

### **XIX. Modification of Residential Mortgage in Subchapter V Cases**

SBRA Guide § VII(B) discusses the provisions of § 1190(3), which provides an exception to the rule of § 1123(b)(5) that a plan in a chapter 11 case may not modify the rights of a claim secured only by a security interest in real property that is the debtor's principal residence. Section 1190(3) permits modification if the debtor received new value in connection with the granting of the security interest that was not used primarily to purchase or acquire the real property and the new value was used primarily in connection with the small business of the debtor.

Chapter 13 also contains a prohibition on modification of a residential mortgage in § 1322(b)(2). Section 1322(b)(5), however, permits a chapter 13 plan to provide for the cure of arrearages, maintenance of installment payments during the case, and reinstatement of the maturity of the mortgage.

If § 1190(c)(3) is inapplicable, then the usual rule of § 1123(b)(5) governs. In a non-subchapter V case, the court in *In re Jacobs*, 644 B.R. 883 (Bankr. D. N.M. Oct. 14, 2022), considered whether a chapter 11 plan, like a chapter 13 plan, can provide for the postconfirmation cure of arrearages and reinstatement of maturity. Noting that courts have disagreed on this issue, the court concluded that the only way for a chapter 11 plan to deal with defaults under a residential mortgage subject to § 1123(b)(5) is for the claim to be unimpaired under § 1124, which requires the cure of all arrearages prior to the effective date of the plan. The court discussed and rejected the view of some courts that permit the postconfirmation cure of arrearages under a residential mortgage in a chapter 11 case.

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### **XX. Technical Amendments to Eligibility Requirements (CARES Act and BTATCA)**

As originally enacted by SBRA, paragraph (B)(iii) of the eligibility requirement for subchapter V (then § 101(51D), now § 1182(1) until June 20, 2024) excluded any corporation that was subject to the reporting requirements of the Securities and Exchange Act and was an affiliate of the debtor. SBRA § 4(a)(1)(B). Paragraph (B)(ii), however, already excluded a corporation subject to the reporting requirement. For a discussion of the issues relating to this provision, see Ralph Brubaker, *The Small Business Reorganization Act of 2019*, 39 Bankr. Law Letter, no. 10, Oct. 2019, at 7.

It appears the intent of the provision was to exclude from eligibility a public company and any of its affiliates. The CARES Act made a technical correction to (B)(iii) in an effort to

accomplish this. The revised (B)(iii) excluded “any debtor that is an affiliate of an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. § 78c)).”

The Cares Act amendment created problems. Section 3(8) of the Securities Exchange Act defines an “issuer” as “any person who issues or proposes to issue any security.” 15 U.S.C. § 78c(a)(8). Section 3(10) broadly defines “security” as including, among other things, any “stock,” “certificate of interest or participation in any profit-sharing agreement,” or “investment contract.” 15 U.S.C. § 78c(a)(10).

Read broadly, the exclusion for the affiliate of an issuer under the CARES Act version of (B)(iii) would render ineligible any debtor that is an affiliate of any corporation or other limited liability entity. By definition, stock in a corporation or an interest in a limited liability entity is a “security.” Thus, for example, if an individual has a sufficient equity interest in two or more such entities to qualify as an “affiliate” under § 101(2), all of the affiliates would be disqualified. Similarly, if one entity is an affiliate of another, neither could be a small business or subchapter V debtor.

The court in *In re Phenomenon Marketing & Entertainment, LLC*, 2022 WL 1262001 (Bankr. C.D. Cal. 2022), applied this reading of the statute to conclude that a limited liability company was not eligible to be a subchapter V debtor because affiliates of the debtor were “issuers.” One of the affiliates was the sole member of the debtor, and another affiliate was the sole member of the debtor’s member.

The court ruled that the affiliates were “issuers” under the Securities Exchange Act even though the securities were not publicly traded. *Id.* at \*3-4. The court ruled that the plain meaning of the statute required the result and that it was not absurd. *Id.* at \*5.

Congress could not have intended this result. The appropriate interpretation of the CARES Act version of (B)(iii) would limit its application to an affiliate of an issuer that is subject to the reporting requirements specified in (B)(ii). See Mark T Power, Joseph Orbach, and Christine Joh, et al., *Not so Technical: A Flaw in the CARES Act’s Correction to “Small Business Debtor”*, 41-Feb. Amer. Bankr. Inst. J. 32, 33 (2022) (“It is evident that Congress intended to exclude from subchapter V eligibility public companies, including affiliates.”).

The Bankruptcy Threshold Adjustments and Technical Corrections Act, Pub. L. No. 117-151, 136 Stat. 1298 (June 21, 2022) made a further technical amendment to subparagraph (B)(iii). As amended, the statute excludes an affiliate of a public company rather than an affiliate of an issuer. Because the amendment applies retroactively, the *Phenomenon Marketing* court later entered an order, *In re Phenomenon Marketing & Entertainment, LLC*, 2022 WL 3042141 (Bankr. C.D. Cal. 2022), permitting the debtor to proceed under subchapter V, thus replacing its earlier ruling.

BTATCA also amended subparagraph (B)(1) to make it clear that application of the debt limit to the aggregate debts of affiliates applies only to affiliates that are debtors in a bankruptcy case.

## XXI. Miscellaneous Matters of Interest

**1. Good faith; minimal distributions.** A subchapter V plan providing for minimal distributions to unsecured creditors may establish lack of good faith that § 1129(a)(3) requires for confirmation. *In re Hao*, 644 B.R. 339, 348. (Bankr. E.D. Va. 2022).

**2. Death of debtor.** Death of debtor prior to confirmation may result in conversion to chapter 7. *In re Landau*, 2022 WL 4647473 (Bankr. D. Kan. 2022). The court discusses standards for determining whether a subchapter V case might continue upon the death of the debtor.

**3. Plan must provide for prosecution of potentially valuable claims.** If potentially valuable avoidance or other claims exist that could be prosecuted for the benefit of the estate, the “best interests of creditors” test of § 1129(a)(7) requires that a plan provide for their prosecution or grant derivative standing to other interested parties to pursue them if the debtor does not. *In re Lapeer Aviation, Inc.*, 2022 WL 7204871 (Bankr. E.D. Mich. 2022).

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**4. Payment of debtor’s counsel upon dismissal.** In *In re Bartley*, 2023 WL 1768415 (Bankr. W.D. Okla. 2023), the court allowed attorney’s fees to debtor’s counsel and “authorized and directed” the debtor to pay them in connection with the dismissal of the debtor’s case. When the debtor did not pay the fees, the lawyer sought to collect the fees by filing a motion for the court to hold the debtor in contempt for failure to pay the fees. The court abstained from considering the motion, concluding that the order was essentially a monetary judgment for which contempt is not an appropriate remedy and that enforcement was more appropriately a matter for the state courts.

**5. Bad faith bankruptcy filing.** The filing of a subchapter V case on the eve of a hearing on damages in state court litigation to stay the litigation and to obtain release of the debtor from jail without complying with the state court’s civil contempt orders in a two-party case is a “textbook example” of a bad faith bankruptcy filing, resulting in its conversion to chapter 7. *In re Roberts*, 644 B.R. 220, 229 (Bankr. D. Col. 2022).

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**6. Adequacy of debtor’s financial projections.** “Nothing in the Code requires an audit or independent verification of a debtor’s financial projections. ‘The creation of a liquidation analysis and financial projections is not an exact science, so the Courts typically defer to the debtors’ projections, subject to cross-examination and/or a competing set of projections.’” *In re Channel Clarity Holdings, LLC*, 2022 WL 3710602, at \* 6 (Bankr. N.D. Ill. 2022), quoting *In re Lost Cajun Enters., LLC*, 634 B.R. 1063, 1073 (Bankr. D. Colo. 2021).

**7. Plan must deal with nondischargeable claims.** In *In re Jaramillo*, 2022 WL 4389292, at \* 3 (Bankr. D. N.M. 2022), the debtor converted his case from chapter 13 to

subchapter V in order to deal with nondischargeable debts, including student loans. In identifying numerous classification problems in the plan, the court noted that a plan cannot lump student loan debt with general unsecured claims and discharge it. If that were not the intent, the court indicated, the failure to separately classify and treat the student loan prevented confirmation. *Id.* at \*3.

**8. Reported confirmation orders entered after resolution of objections.** A number of confirmation orders have been reported that do not resolve objections but address confirmation requirements. Some include other provisions (such as releases and exculpations). \*\*\* *In re Gilbert*, 2023 WL 5123245 (Bankr. D. Utah 2023) (consensual confirmation; all impaired classes have accepted or did not vote or object to confirmation); *In re Raspberry Creek Fabrics, LLC*, 2023 WL 8606662 (Bankr. D. Utah. 2023) (same); *In re Little Road Co., LLC*, 2023 WL 7008981 (D. Utah 2023) (same); *In re KW Excavation, Inc.*, 2023 WL 7381529 (Bankr. D. Utah (same) *In re Gage's Granite LLC*, 2023 WL 5422253 (Bankr. N.D. Tex. 2023) (consensual confirmation); *In re Mulvadi Corp.*, 2023 WL 2023 WL 6798625 (Bankr. D. Hawaii 2023) (cramdown confirmation); *In re Matthews*, 2023 WL 6280219 (Bankr. E.D. Wash. 2023); *In re ATH Sports Nutrition, LLC*, 2023 WL 6284544 (Bankr. D. Haw. 2023). ### *In re Bitter Creek Water Supply Corp.*, 2023 WL 2962206 (Bankr. N.D. Tex. Apr. 14, 2023) (consensual plan confirmation; order provides that, if case is converted, all property will automatically vest in chapter 7 estate); *In re Jess Hall's Serendipity, LLC*, 2023 WL 3635068 (Bankr. N.D. Tex. 2023) (consensual plan confirmation order including provisions for third party releases and approval of insider settlement); *In re SRAK Corp.*, 2023 WL 2589252 (Bankr. N.D. Tex. 2023) (consensual confirmation); *In re Associated Fixture Manufacturing, Inc.*, 2023 WL 1931301 (Bankr. D. Utah 2023) (consensual confirmation); *In re Higgins AG, LLC*, 2023 WL 3745100 (Bankr. N.D. Tex. 2023) (consensual plan confirmation; includes provisions for third party releases); *In re iVidex*, 2022 WL 5264710 (Bankr. W.D.N.Y. 2022) (cramdown confirmation; trustee to make payments); *In re ActiTech*, 2022 WL 6271936 (Bankr. N.D. Tex. 2022) (plan attached to order; order provides for approval of settlement, releases, and exculpation); *In re North Richland Hills Alamo, LLC*, 2022 WL 2975121 (Bankr. N.D. Tex. 2022); *In re Logistics Giving Resources, LLC*, 2022 WL 2760126 (Bankr. D. Utah 2022).

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**9. Subchapter V's purposes and procedures may be a factor in resolving non-subchapter V issues.**

In *Hawkes v. Automated Recovery Systems of New Mexico, Inc. (In re Automated Recovery Systems of New Mexico, Inc.)*, 2022 WL 17184548 (Bankr. D. N. Mex. Nov. 2022), the subchapter V debtor removed from the state court a class action that alleged that its filing of collection actions in its own name, even though it did not own the claims, was the unauthorized practice of law. The plaintiffs requested that the bankruptcy court abstain. The court determined that the lawsuit was a core proceeding so that mandatory abstention was not required. The court decided that permissive abstention was not appropriate, in part because of the need for a prompt

resolution of the dispute. The court noted that subchapter V cases are intended to proceed expeditiously.

In *In re Major Model Management, Inc.*, 641 B.R. 302 (Bankr. S.D.N.Y. June 21, 2022), the court declined to permit the filing of a proof of claim on behalf of a class under Rule 23 of the Federal Rules of Civil Procedure. The court noted that an independent trustee serves in subchapter V cases to provide “oversight and guidance” to the court and the parties and agreed with the subchapter V trustee’s views at the hearing that the most efficient way to deal with the claims of the putative class members was through the claims objection process.

The court in *In re Hal Lufting Company, Inc.*, 2023 WL 8522603 (Bankr. S.D.N.Y. 2023), discussed *infra*, relied on subchapter V’s purposes in approving third-party releases.

**10. Debtor as disbursing agent after cramdown confirmation.** SBRA Guide § IX(C) notes that some courts permit the debtor to make plan payments after cramdown confirmation under § 1191(b). Section 1194(b) requires the trustee to make disbursements after cramdown confirmation, unless the plan or confirmation order provides otherwise. In *In re Creason*, 2023 WL 2190623 (Bankr. W.D. Mich. 2023), the court permitted the debtor to serve as the disbursing agent after cramdown confirmation.

**11. Third-party releases.** For a discussion of third-party releases and procedures in a subchapter V context, see *In re Arsenal Intermediate Holdings, LLC*, 2023 WL 2655592 (Bankr. D. Del. 2023) (discussing procedures for creditors to “opt in” or “opt out” of provisions for third party releases).

Two courts have approved provisions in a subchapter V plan for the release of claims of creditors against principals of the debtor in exchange for a contribution to the plan.

In *In re Kalos Capital, Inc.*, 2023 WL 7179265 (Bankr. N.D. Ga. 2023), the court confirmed a plan providing for the release of claims of certain creditors against the principals when affected creditors overwhelmingly supported the plan.

In *In re Hal Lufting Company, Inc.*, 2023 WL 8522603 (Bankr. S.D.N.Y. 2023), the court approved third-party releases over the objection of the only creditor covered by the release. The *Lufting* court concluded that the absence of “overwhelming support” for the release by affected creditors was of “little weight” in applying the factors governing third-party releases because subchapter V “itself contemplates the confirmation of a plan without the consent of any creditor” and because the plan was “the best possible means of enabling [the creditor’s] recovery. Put differently, [the creditor] has not identified – and the Court has not found – a tangible financial harm that would result from the approval of a third-party release.” *Id.* at \*27.

**12. Objection to chapter 7 discharge of individual based on alleged fraudulent conduct as sole member of subchapter V debtor during the subchapter V case prior to plan confirmation.** After the court confirmed a subchapter V plan without objection, the sole member of the subchapter V debtor filed a chapter 7 case. Creditors filed a complaint objecting

to his discharge based on his allegedly fraudulent conduct during the subchapter V case. The court denied the member's motion to dismiss the complaint. The court held that the confirmation order was not res judicata as to these issues because it dealt with different issues and that the court could not determine at this stage of the case whether collateral estoppel applied based on the finding of good faith in the confirmation order. The court also concluded that the exculpation clause in the plan by its terms did not shield the member from claims based on willful misconduct or gross negligence, as the complaint alleged. *Bleznick v. DePaolo (In re DePaolo)*, 2023 WL 2482723 (Bankr. D. N.J. 2023). See also *In re Keevers*, 2023 WL 4921566 (Bankr. D. N. H. 2023) (Objection to discharge in chapter 7 case of couple, converted from subchapter V, based on improper disclosures and reporting regarding real estate commissions received by entity owned by one of the debtors based on his services).

**13. Material default under confirmed plan.** The provisions of the debtor's plan, extensively negotiated with the creditor, provided for payments to be made electronically and received by a date certain. The debtor missed the first plan payment, and the creditor declared a default, which the debtor attempted to cure with a check. The subchapter V trustee and the debtor filed a motion for the court to require the creditor to accept the payment. The creditor stated it would agree to accept the payment if it received prompt payment of its attorney's fees. The debtor contended that attorney's fees should not be required because the default was not material.

The court determined that the default was material and awarded attorney's fees. *In re Ace Holding, LLC*, 2023 WL 4412184 (Bankr. N.D.N.Y. 2023). The court reasoned:

Based upon the prior defaulted payment agreements, unending state court litigation and multiple bankruptcy filings, the Debtor should have been ready, willing and able to commence both plan payments as well as maintain the ongoing monthly fees to this Creditor. Moreover, as previously noted, Schedule A's terms are the result of extensive negotiations and their attendant costs. Thus, any default based upon a late payment or a payment not made in the proper manner is material.

**14. A subchapter V case is a chapter 11 case.** Two cases serve as a reminder that a subchapter V case is a chapter 11 case.

In *In re Ruby-Gordon, Inc.*, 2023 WL 8252356 (Bankr. W.D.N.Y. 2023), the court denied an ex parte application by the debtor for authority to use cash collateral filed seven days after the filing of the case because the request failed "in every respect" to comply with the requirements of Bankruptcy Rule 4001(b)(1)-(3). The court noted that the debtor had filed no "first day motions," which it described as a "troubling situation," and that the debtor's unauthorized use of cash collateral was "cause for much concern."

In *In re Golexis*, 2024 WL 134791 (Bankr. D. Utah 2024), the court declined to authorize compensation for debtor's counsel for services rendered prior to the filing of the application for approval of employment, which occurred almost two weeks after the filing of the petition. The

court ruled that retroactive approval of employment for services prior to the filing of the application is permissible only in “the most extraordinary circumstances” and found none.

**15. An order converting a case to chapter 7 is a final appealable order.** *In re California Palms Addiction Recovery Campus, Inc.*, 87 F.4th 734 (6th Cir. 2023).

**16. Absolute priority rule in traditional case of individual.** The court in *In re Joseffy*, 654 B.R. 747 (S.D. Fla. 2023), ruled that the absolute priority rule applies in a traditional chapter 11 case of an individual and explains why the absolute priority rule does not prohibit the individual from retaining exempt property under the plan. “Because a debtor does not retain exempt property under a plan on account of his or her junior claim or interest, an individual chapter 11 debtor does not violate the absolute priority rule by receiving or retaining exempt property.” *Id.* at 760-61.

**17. Objection to discharge of debtor not engaged in business.** In *In re Lucido*, 2023 WL 5962839 (Bankr. N.D. Cal. 2023), a creditor objected to the subchapter V discharge of an individual who had proposed a liquidating plan. In a traditional chapter 11 case, § 1141(d)(3) provides for denial of discharge upon confirmation of a plan providing for the liquidation of all or substantially all of the debtor’s assets if the debtor does not engage in business after confirmation.

The court stated that § 1141(d)(3) could deprive the debtor of a discharge regardless of whether consensual or cramdown confirmation occurred. The court concluded, however, that the provision was not applicable because the evidence showed that the debtor would have income from employment, consulting, and social security after confirmation. The court ruled that the debtor’s business after confirmation did not have to be the same as the debtor’s prepetition business and that income from engaging in business did not have to be sole source of funds for a debtor to be engaged in business in order to be engaged in business for purposes of § 1141(d)(3).

It is uncertain whether § 1141(d)(3) applies after cramdown confirmation. See COLLIER ON BANKRUPTCY ¶ 1192.03[3].

**18. Subchapter V cases involving cannabis.** In *In re Arts District Patients Collective, Inc.*, 2023 WL 5546920 (Bankr. C.D. Cal. 20223), the U.S. Trustee sought dismissal of the subchapter V case because the debtor’s business was the sale of cannabis. The debtor did not oppose dismissal of the case because reorganization was not possible. Without addressing whether ownership of cannabis-related assets required dismissal, the court dismissed it.

In *In re Hacienda Company, LLC*, 654 B.R. 155 (Bankr. C.D. Cal. 2023), the debtor had discontinued its own cannabis operations prior to the filing of the petition but retained a 9.4 interest in a Canadian company engaged in the cannabis business, including operations in the United States. The debtor proposed a plan for the liquidation of its interest.

The U.S. Trustee sought dismissal of the case on the ground that the debtor's ownership of an interest in the Canadian company involved the debtor in a conspiracy to violate federal law. The court denied the motion.

The court reasoned, *id.* at 166:

[T]his Bankruptcy Court does not interpret Congress' mandate that this Bankruptcy Court "shall" dismiss or convert a bankruptcy case for "cause" under § 1112(b) to mean that any violation of criminal law requires dismissal. Rather, this Court interprets the statute as giving discretion to determine whether dismissal is warranted based on all the facts and circumstances.

The court reasoned that it must "exercise its discretion to determine whether, given all of the facts and circumstances, a debtor's connection to cannabis profits and any past or future investment in cannabis enterprises warrants dismissal of this bankruptcy case." *Id.* at 166. The court ruled that the U.S. Trustee had not established sufficient cause for dismissal in view of the facts that (1) the debtor's connection with any violation of the Controlled Substances Act or any other law was indirect; (2) the debtor intended to liquidate its assets and pay creditors; and (3) the bankruptcy case benefitted all parties in interest, including creditors. *Id.*

**19. Appointment and compensation of subchapter V trustee.** Confirming what appears to be universal practice, the court in *In re Robert J. Armbruster, Inc.*, 653 B.R. 461 (Bankr. E.D. Mo. 2023), in an opinion denying a motion to reconsider various rulings, noted that it had awarded compensation to the subchapter V trustee based on 330(a)(1) and had overruled objections that U.S. Trustee should have appointed a standing trustee under 28 U.S.C. § 586(b) and that § 586(b) limits compensation to five percent of payments under confirmed plan.