

Subchapter V Reorganization for Individuals: Eliminating the Absolute Priority Rule

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Subchapter V Reorganization for Individuals: Eliminating the Absolute Priority Rule

Panelists:

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- Leon S. Jones, Jones & Walden, LLC
- Thomas T. McClendon, Jones & Walden, LLC

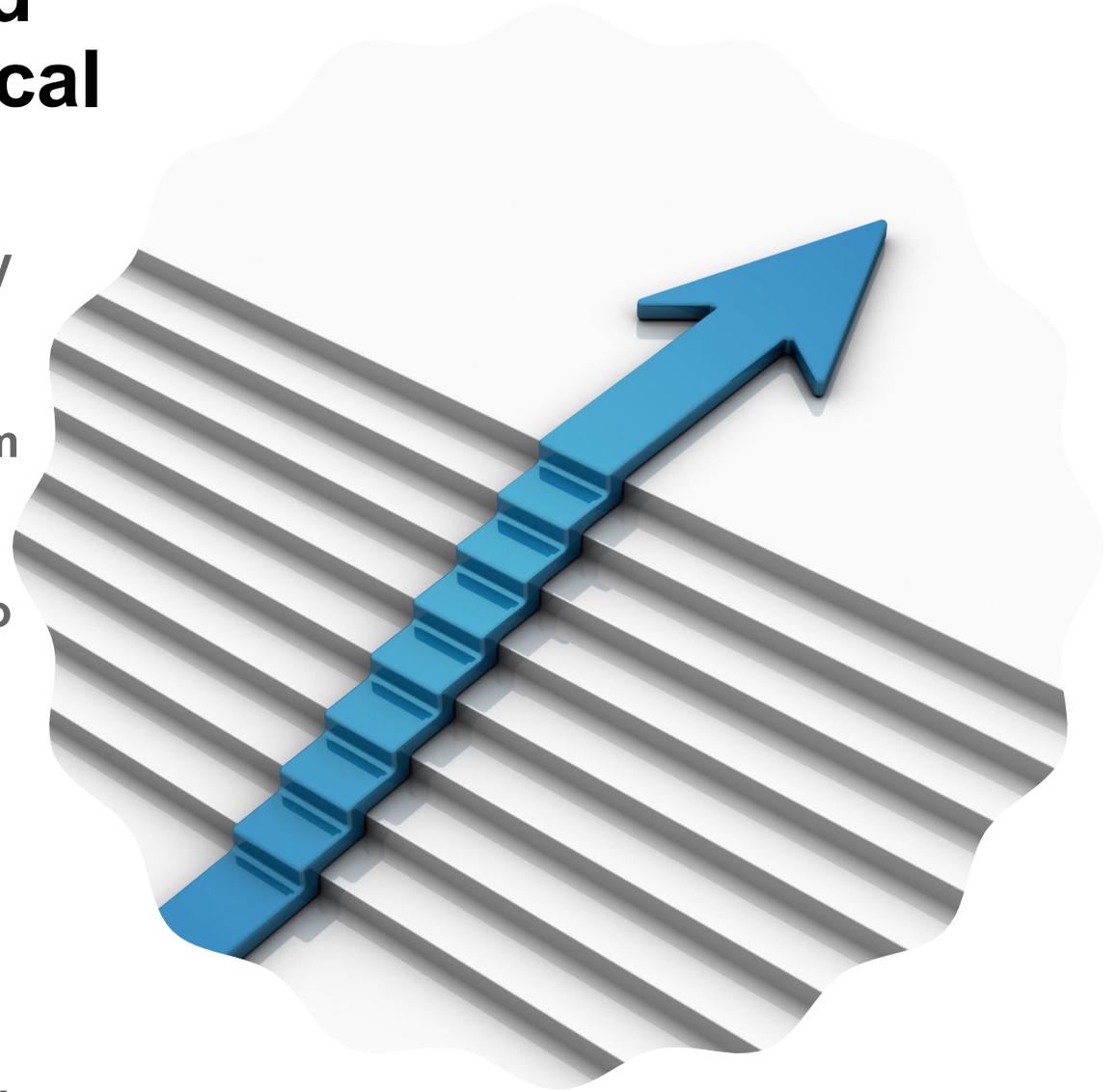


OUTLINE

1. Primary advantages of Subchapter V over Chapter 11
2. Limitations on eligibility
3. Role of Sub V trustee
4. Plan deadlines and other mandatory procedures
5. Confirmation issues
6. Remedies upon plan default

Bankruptcy Threshold Adjustment and Technical Corrections Act

- -extends the increase in the subchapter V debt limit for eligible businesses to \$7.5 million for another two years
- -Small Business Reorganization Act created subchapter V contained a maximum debt cutoff for eligibility of \$2.7 million.
- -As the COVID-19 pandemic raged, Congress made a significant change to subchapter V in an effort to provide relief to a greater number of businesses, specifically small businesses.
- -As part of the CARES Act passed in 2020, Congress raised the debt limit for subchapter V eligibility from the original \$2.7 million to \$7.5 million.
- -Increased debt limit expired in March.
- -The Bankruptcy Threshold Adjustment and Technical Corrections Act became law June 21, 2022, and raised the debt limit for subchapter V eligibility back to \$7.5 million.



Who qualifies as a Subchapter V Debtor?

- Available to any entity or individual with aggregate noncontingent liquidated debts not more than \$2,725,625 of which not less than 50% of the debt is commercial or business. The CARES ACT raised the debt limit to \$7,500,000 for one year (until March 27, 2021).
- SARE debtors excluded: debtor who derives substantially all of its gross income from the operation of a single real property cannot elect under Subchapter V.
- COVID-19 Bankruptcy Relief Extension Act extended the \$7.5 million debt limit until March 27, 2022
- On March 27, 2022, the temporary debt limit extension expired, then automatically increased to \$3,024,725 on April 1, 2022 per routine adjustments. Then Congress passed and the President signed on June 21, 2022 a bill that retroactively returned the debt limit to \$7.5 million and sunset two years after its enactment.
- Publicly traded companies subject to reporting requirements of Securities Exchange Act of 1934, and their affiliates, are excluded.
- Small business debtor operates in chapter 11 as a debtor-in-possession.

Primary advantages of Subchapter V over Chapter 11

- Plan exclusivity
- Reduced administrative expenses
- Easier retention of counsel
- Modification of mortgages
- No creditors' committee.
- No disclosure statement.
- Subchapter V Trustee serves different role than traditional Chapter 11 Trustees.
- More flexibility in path to confirmation.
- Designed to streamline the process for small business debtors to reorganize and rehabilitation their financial affairs.
- Fewer disclosure requirements
- No quarterly United States Trustee fees

Limitations on eligibility



Introduction: Eligibility

The eligibility rules are pretty straightforward. They are an amalgamation of terms we've historically seen under the Code but just repackaged/repurposed in a new way. This has turned into a litigation point in many Subchapter V cases.

1. It's a gate-keeping issue. A debtor generally has more leverage and a better ability to confirm a plan in subchapter V. And remember, it was the debtor's election to begin with. The debtor chooses the chapter, and then elects subchapter V.
2. So a diligent creditor may see a need to block the debtor at the gate to subchapter V. The United States Trustee actually has been the objecting party – and not an actual creditor – in many cases (both published and unpublished).
3. The litigation of the eligibility issue will not subside because: (a) it's largely fact intensive, and (b) there will be scant ability to obtain circuit-level authority for guidance.



Who was a Small Business Debtor: Definition (pre- SBRA)

§ 101(51D) defines a “small business debtor”

Person engaged in commercial or business activities

Excludes debtor whose principal activity is the business of owning or operating single asset real property

Aggregate noncontingent liquidated secured and unsecured debts of (now) \$3,024,725 or less (excluding debts to insiders)

Who is a Small Business Debtor: Revised Definition (Under Threshold Act)

Same requirement that the debtor be “engaged in commercial or business activities”

Aggregate debt limit (currently \$7,500,000)

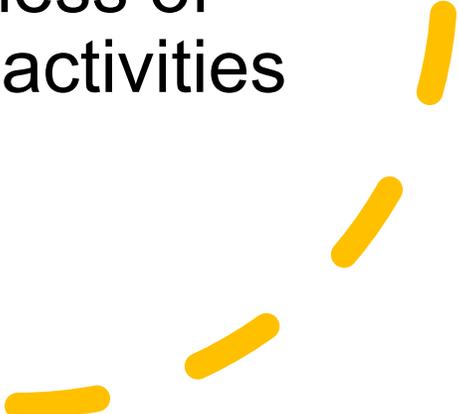
50 percent (or more) of the debt must arise from debtor’s commercial or business activities

Small business debtor may be engaged in owning or operating real property

Exception: debtor whose primary activity is owning or operating single asset real estate ≠ small business debtor

Definition of Single Asset Real Estate

11 U.S.C. § 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 ... 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.”



Debtor's Election of Subchapter V

Subchapter V applies in cases in which a small business debtor elects it

If a small business debtor does not make the election, the provisions of Chapter 11 governing small business cases apply

Proposed FRBP amendment (enacted by local rule) requires that the debtor state in the petition whether the debtor elects application of Subchapter V [Rule 1020(a)]

Case proceeds as Sub V case unless the court finds that election was incorrect after objection by UST or party-in-interest within 30 days of conclusion of 341 or amendment.



Cases on Eligibility Activities

- “Commercial or Business Activities” – Generally Construed Broadly
 - Although early cases held otherwise, case law now consistently looks at “activities” at the petition date.
 - On-going winddown or liquidation generally accepted, but factually intensive analysis.
 - In re Ikalowych, 629 B.R. 261 (Bankr. D. Colo. 2021).
 - In re Offer Space, LLC, 629 B.R. 299 (Bankr. D. Utah).
 - Contra In re Thurmon, 625 B.R. 417 (Bankr. W.D. Mo. 2020) (retired couple with defunct business not eligible).



Cases on Eligibility Activities

- “Commercial or Business Activities” – Generally Construed Broadly
 - Salaried employee generally does not apply
 - In re Johnson, 2021 WL 825156 (N.D. Tex. 2021).
 - Contra In re Ikalowych, 629 B.R. 261 (Bankr. D. Colo. 2021).
 - But part-time independent contractor or rental house does.
 - In re Blue, 630 B.R. 179 (Bankr. M.D.N.C. 2021).

Cases on Eligibility – Debt Limit

- “Aggregate noncontingent liquidated secured and unsecured debts” less than \$7,500,000.
 - Chapters 12 and 13 cases on eligibility applicable.
 - Disputed debt still counts. *See United States v Verdunn*, 89 F.3d 799, 802, n. 9 (11th Cir. 1996) (13 case)
 - Lease rejection claims and PPP loans anticipated to be forgiven are contingent and not counted. *In re Parking Mgmt. Inc.*, 620 B.R. 544 (Bankr. D. MD 2020)

Cases on Eligibility – Majority of Debt

- At least 50% of debt must “arise from” business or commercial activity
 - Test is whether debt incurred with an eye toward profit and looks at the substance of the transaction and borrower’s purpose. *In re Ventura*, 615 B.R. 1 (Bankr. E.D.N.Y. 2020)
 - Tax debt may be neither business nor consumer debt (§707(b) approach) or look at the underlying tax obligation. *National Loan Invs., L.P. v. Rickerson (In re Rickerson)*, 636 B.R. 416 (Bankr. W.D. Pa. 2021).
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Role of Sub V trustee

Appointment of Subchapter V Trustee

- Subchapter V provides for a trustee in all cases
- Court has no role in the appointment of the trustee
- UST Program selected pools of persons who are appointed on a case-by-case basis in Sub V cases. UST did not appoint standing trustees.

The Sub-V Trustee: Like a Chapter 12 Trustee

- Subchapter V trustee resembles Chapter 12 trustee
- A trustee appointed while leaving the debtor in possession of assets and control of the business
- Trustee has oversight and monitoring duties
- In some (but not all) cases, the trustee may make disbursements to creditors

Sub V Trustee's
Duties:
Supervise and
Monitor the
Case and
Facilitate
Confirmation

- Duty to “facilitate the development of a consensual plan of reorganization.”

§ 1183(b)(7)

- Chapter 13 trustee has the duty to “advise, other than on legal matters, and assist the debtor in performance under the plan.”

§ 1302(b)(4)

Sub V Trustee's Role at Specified Hearings

Trustee must appear and “be heard” at certain hearings:

1. The value of property subject to a lien
2. Confirmation of the plan
3. Modification of the plan after confirmation
4. The sale of property of the estate.
5. The status conference

§ 1183(b)(3)

Subchapter V Trustee

- Operates business if debtor is removed from possession
- Trustee terminated:
 - A. Consensual plan confirmation → upon substantial consummation of the plan
 - B. Cramdown plan confirmation → SBRA is not clear, but trustee makes plan payments unless plan or confirmation order provide otherwise

Compensation of Subchapter V Trustee

Nonstanding Trustee (from a pool – not a panel)

Trustee receives compensation under § 330 without regard to limitations in § 326



Subchapter V Trustee's Employment of Professionals

- Query: Courts will not routinely permit employment of professionals

Debtor as Debtor in Possession

- Debtor as DIP remains in possession of assets of the estate
- A Sub V DIP has the rights, powers, and duties of a trustee that a standard Chapter 11 DIP has - including the operation of the debtor's business. § 1184.
- Court may terminate the debtor's status as DIP
- If court terminates the DIP, trustee's duties are expanded to include operation of the debtor's business
- Trustee cannot file a plan because only the debtor may do so. § 1189(a).

Removal of Debtor as DIP

- Court may remove debtor as DIP “for cause”
- “Cause” includes “fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after commencement of the case.”
- SBRA: DIP removal “for failure to perform the obligations of the debtor” under a confirmed plan. § 1185(a).

Removal of Debtor as DIP (Continued)

§ 1185(a) states that the court *shall* remove the DIP if a specified ground exists

§ 1183(b)(5) specifically directs the Sub V trustee to operate the debtor's business when the debtor is not in possession

Query: whether removal of the debtor for failure to perform under a confirmed plan is mandatory if the failure is not material or if the debtor has or can cure defaults

Trustee's Additional Duties Upon Removal of Debtor as DIP

- Sub V trustee must perform the duties of a trustee under § 704(a)(8), (10), (11), and (12):
 1. To file unfiled schedules & SOFA
 2. To file any unfiled tax returns which are due
 3. To file reports regarding business operations (including MOR)
 4. To provide required notices re any DSO
 5. To perform any obligations as the administrator of an employee benefit plan
 6. To use reasonable and best efforts to transfer patients from a health care business that is being closed

Reinstatement of the DIP



Court has power to reinstate the DIP.



§ 1185(b).

Compare Chapter 12: court has power to both remove and reinstate the DIP. § 1204 (Same language as in SBRA).

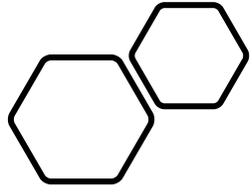
Payments Under the Plan

Consensual confirmation:

- Debtor makes plan payments
- Trustee terminated upon substantial consummation

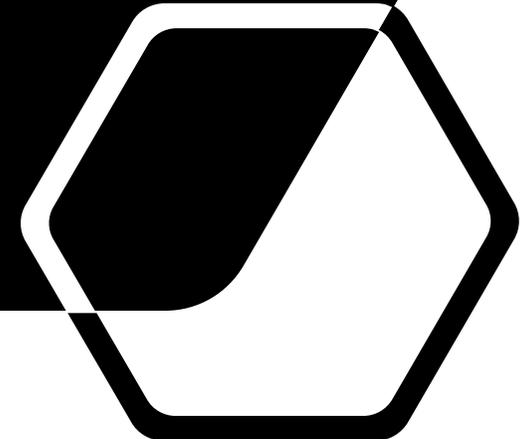
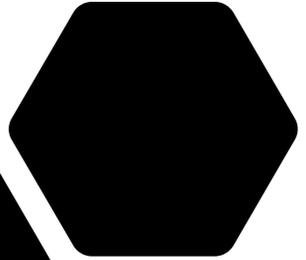
Cramdown confirmation:

- Trustee makes plan payments unless plan or confirmation order provide otherwise
- Trustee not terminated automatically (but plan or confirmation order may so provide)



Results of Consensual Confirmation

- Trustee is terminated upon substantial consummation of the plan
- Debtor makes plan payments
- Discharge: upon confirmation



Payment of Professionals Over the Plan Term

A subchapter V cramdown plan may provide for payment of administrative expense claims and involuntary gap claims through the plan

Result: a plan may propose for payment of compensation of the trustee and the debtor's attorney through postconfirmation payments

Consensual Plan: Administrative Expense Compensation under § 503(b)(3) entitled to priority under § 507(a)(2) & payment on effective date under § 1129(a)(9)(A)

Sub V Trustee: No Broad Duty to Investigate

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Sub V trustee (like a Chapter 12 trustee) does not have the duty to investigate the financial affairs of the debtor

02

Chapter 7 trustee has duty to investigate under § 704(a)(4)

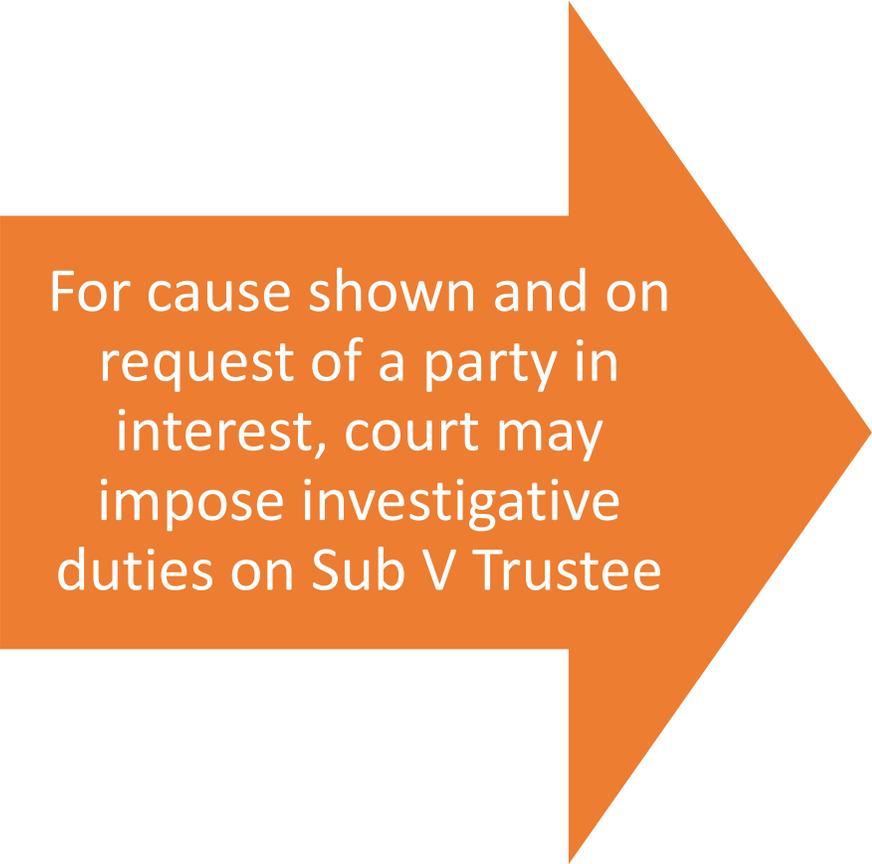
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Chapter 13 trustee has investigative duty under § 1302(b)(1)

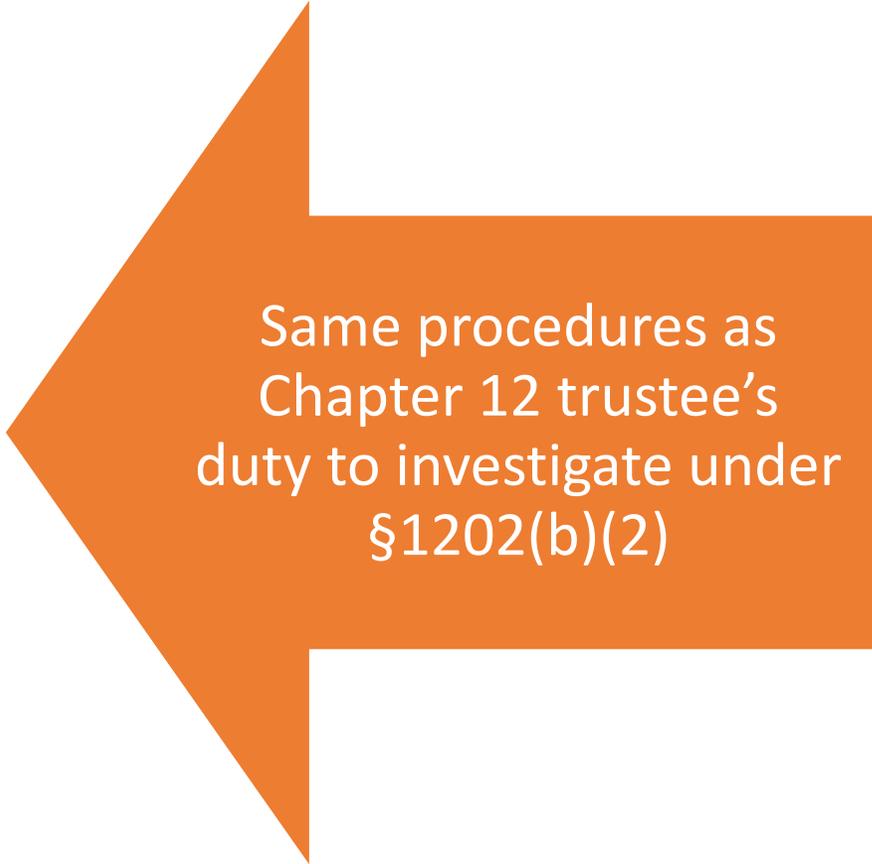
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Trustee in a standard or non-sub V case has a broad duty to investigate under § 1106(a)(3) unless the court orders otherwise

Court May Impose Investigative Duties



For cause shown and on request of a party in interest, court may impose investigative duties on Sub V Trustee



Same procedures as Chapter 12 trustee's duty to investigate under §1202(b)(2)

Sub V Trustee Investigative Duties: Only “For Cause”

- Court (for cause) may order Sub V trustee to perform certain duties of a Chapter 11 trustee under § 1106(a):
 1. To investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, operation of debtor’s business, desirability of its continuance, any other matter relevant to the case of formulation of a plan
 2. To file a statement of the investigation, including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity

Other Duties of the Sub V Trustee

Sub V trustee has duties of a trustee under § 704(a):

1. To be accountable for all property received [§ 704(a)(2)]
2. To examine proofs of claim and object to allowance of any claim that is improper [§ 704(a)(5)]
3. To oppose the discharge of the debtor (if advisable) [§ 704(a)(6)]
4. To furnish information concerning the estate and the estate's administration to parties in interest [§ 704(a)(7)]
5. To file a final report [§ 704(a)(9)]

Developing Case Law

- The trustee's duty to appear and be heard regarding confirmation gives the trustee standing to object to confirmation. In re Topps's Mechanical, Inc., 2021 WL 5496560 at *1 n. 1 (Bankr. D. Neb. 2021)
- In re 218 Jackson LLC, 631 B.R. 937, 947 (Bankr. M.D. Fla. 2021). Given (1) the trustee's duty to facilitate a consensual plan, (2) the fact that the debtor remains in possession of estate property, and (3) the absence of a requirement that the trustee investigate the financial affairs of the debtor unless the court orders otherwise, "It is not a stretch then to conclude that the subchapter V trustee's role was intentionally designed to be less adversarial."
- Nevertheless, when circumstances in the case raise significant questions such as the debtor's true financial condition, what property is property of the estate, the debtor's management of the estate as debtor-in-possession, and the accuracy and completeness of the debtor's disclosures and reports, a court may expect parties who have identified potential issues – including creditors, the U.S. Trustee, or the subchapter V trustee – to request an order under §1183(b)(2) requiring the trustee to investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, as well as other matters relevant to the case or formulation of a plan.
- In re Oscelebi, 2022 WL 9902883 at *8 (Bankr. S.D. Tex. 2022) ("The responsibility of the subchapter V trustee to participate in the plan process and to be heard on the plan and other matter cloaks the subchapter V trustee with the statutory right to obtain information about the debtor's property, business, and financial condition").

Removal of the Dip and Then What?

- Section 1104 does not apply in Sub-V per Section 1181(a). § 1181 is the section of the SBRA which states which sections of chapter 11 do not apply in Sub-V. So traditionally, the Bk Court may appoint a trustee in a chapter 11 for two reasons under 1104. “For cause” including fraud, dishonesty, incompetence or gross mismanagement. 1104(a)(1). OR under the “best interests” of creditors test. Sec 1104(a)(2)
- § 1185 (Removal of DIP) in a Sub-V: The court shall order that the debtor shall not be a DIP “for cause” INCLUDING fraud, dishonesty, incompetence, etc. And like in a traditional 11, this cause may be based on pre or post-petition actions. But § 1185 does not have the 2nd “best interests” prong.
- Courts may find that “cause” exists for removal of the DIP if it’s in the best interest of creditors even in the absence of fraud, etc. Because, “incompetence” (pre or post-petition) seems like a pretty low bar.
- Sub-V does not provide for the appointment of a trustee. It does provide for removal of the DIP. And it does provide for the expansion of the Sub-V trustee’s powers.

Expanding the Sub-V Trustee's Powers



§ 1183(b)(5): if the debtor “ceases to be a DIP”, the trustee shall perform the duties of Sec 704(a)(8) and 1106(a)(1),(2) & (6). 1183(b)(5) also expressly authorizes the trustee to “operate the business of the debtor.” These are the “expanded powers” of the Sub-V trustee. Note: it has to be the sub-v trustee absent conversion. Can't be another 11 trustee appointment.



In re Pittner, 638 B.R. 255 (E.D. Mass. 2022). Section 1112 provides for dismissal or conversion, whichever is in the best interests of creditors. In Pittner, the debtor deliberately refused to obey the court's order, and the court found that removal of the dip and expanding the Sub-V trustee's powers was in the best interests of creditors and preferable to conversion or dismissal.

Expanding the Sub-V Trustee's Powers

- Nat'l Small Bus. Alliance, 2022 WL 2347699 (Bankr. D.D.C. 2022)
 - Revoked Sub V election sua sponte after denial of fifth proposed plan by debtor.
 - Cited as support cases whether debtors with currently pending cases in 2020 could “opt-in” to Sub V.
 - Query: actual support in voluntary versus involuntary amendment of petition.
 - Did not cite Rule 1020.
 - Also revoked small business election.
 - Since now in regular Chapter 11, appointed trustee under § 1104 (presumably to propose a plan of reorganization).

Plan deadlines and
other mandatory
procedures





Procedures: The Status Conference

- § 1188(a) requires a status conference
- A status conference is not required in any other type of case
- The Sub V trustee must appear and be heard at the status conference

Required Status Conference and Debtor Report

Section 105(d) permits, but does not require, the court to convene a status conference

Status conference is mandatory in Subchapter V cases

Must be held within 60 days after the entry of the order for relief

Court may extend the time for holding the status conference if the need for an extension is “attributable to circumstances for which the debtor should not justly be held accountable”

Debtor must file and serve a report that “details the efforts the debtor has undertaken and will undertake to attain a consensual plan of reorganization”

Report is due 14 days prior to status conference

Filing (& Timing) of Subchapter V Plan



Only the debtor may file a plan. § 1189(a).



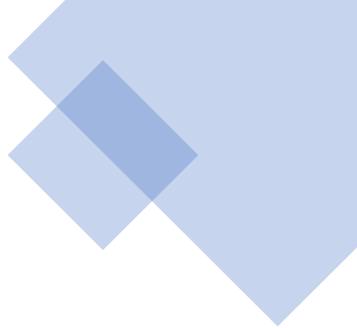
Deadline for the plan is 90 days after the order for relief



Court may extend the deadline if the need for extension is attributable to circumstances for which the debtor should not justly be held accountable

Compare: Standard Small Business Case Plan Deadlines

- Plan must be filed within 300 days of the filing date
- Confirmation must occur within 45 days of the filing of the plan
- These requirements do not apply in a subchapter V case
- Continue to apply in the case of a small business debtor who does not elect subchapter V
- Sub V debtor must file a plan much more promptly than a non-sub V debtor – 90 days instead of 300
- Sub V debtor faces no deadline for obtaining confirmation after the filing of the plan



Elimination of Disclosure Statement

- Standard Chapter 11: requires approved disclosure statement to solicit votes on a plan
 - In a small business case: court can conditionally approve a disclosure statement and combine the hearing with confirmation
 - § 1125 is inapplicable in Subchapter V unless the court orders otherwise. New § 1181(b).
 - Result: No disclosure statement required in connection with a subchapter V plan unless the court requires it
 - If court orders a disclosure statement then the provisions of § 1125(f) apply
- 

Subchapter V Plan: Required Disclosures

- Subchapter V plan must contain certain information that a disclosure statement typically contains
- Plan must include:
 1. A brief history of the business operations of the debtor
 2. A liquidation analysis
 3. Projection with respect to the ability of the debtor to make payments under the proposed plan



Plan Contents

§ 1123(a) applies except for:

- (a)(8) – rule in individual case that debtor must submit all or portion of earnings and income as is necessary for execution of plan
 - New § 1190(2) requires submission of future earnings or income *to the trustee* as necessary for execution of the plan.
 - Applies in entity cases as well as individual cases
- § 1123(c) – prohibition on use, sale, or lease of exempt property under a plan without debtor's consent. Not needed because only debtor can file plan

Contents of Subchapter V Plan: Requirements of New § 1190

- 3 new provisions governing the content of the plan:
 1. Plan must include some of the information that would otherwise be included in a disclosure statement (operational history, liquidation analysis, & feasibility projections)
 2. Plan must provide for the submission of “all or such portion of the future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan”
 3. Modifies the rule that a plan may not modify the rights of a claim secured only be a security interest in real property that is the debtor’s principal residence.

See Chapter 13 [§ 1322(b)(2)] & Chapter 11 [§ 1123(b)(5)].

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Modification of Residential Mortgages

Plan may provide for modification of claim secured only by security interest in real property that is debtor's principal residence if new value received by debtor in connection with granting of security interest was not used to acquire it and was primarily in connection with the small business of the debtor. § 1190(3).

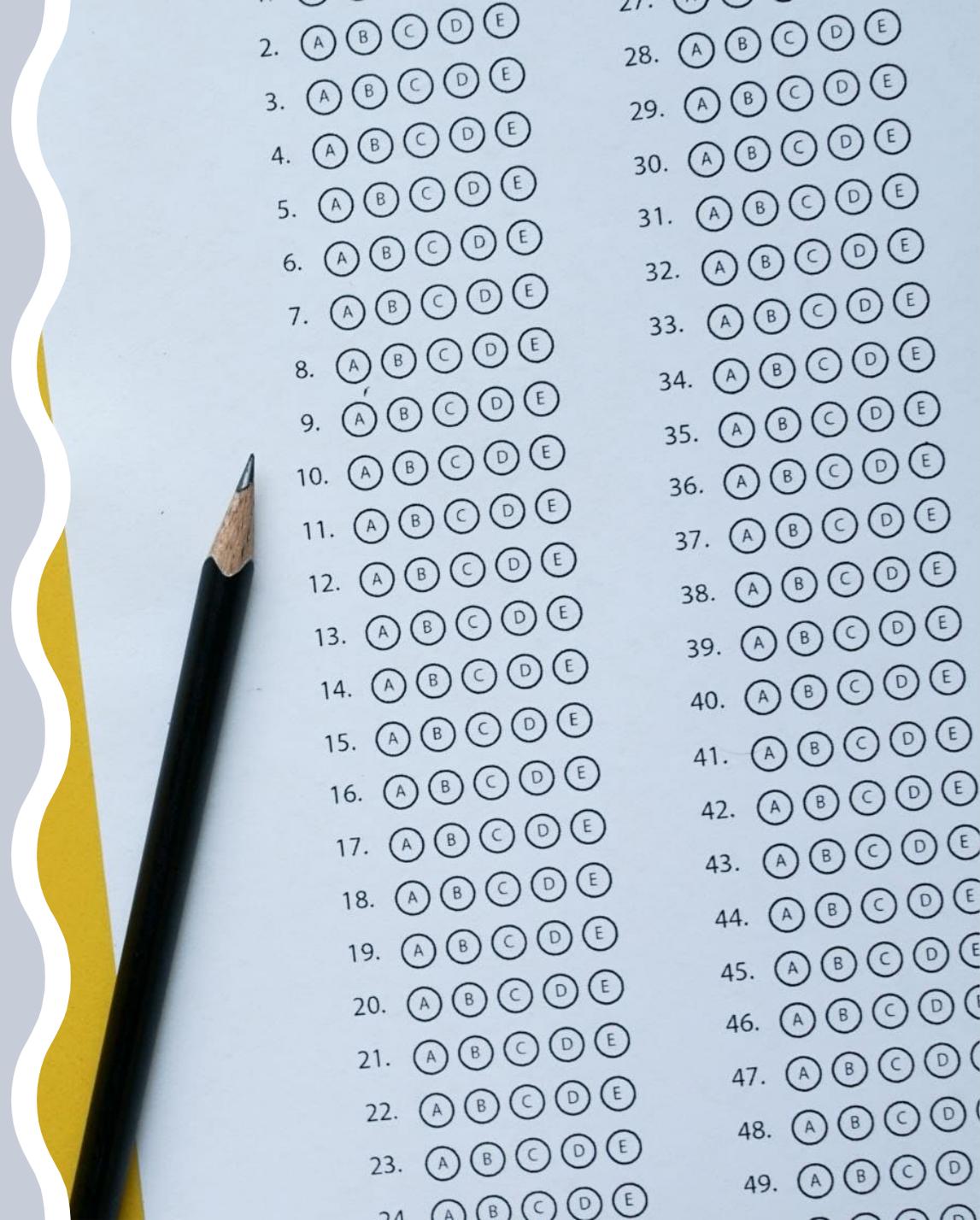
Confirmation Issues Section 1191(b) & (c)

DEBTOR CAN CONFIRM A CONSENSUAL PLAN UNDER SECTION 1191(a) OF THE CODE, BUT ALSO ...

INCREASED ABILITY TO CRAMDOWN UNSECURED CREDITORS, MAY DO SO AS LONG AS THE PLAN IS "FAIR AND EQUITABLE" AND DOES NOT DISCRIMINATE UNFAIRLY

PLAN IS PURSUANT TO THE USUAL CRITERIA OF SECTION 1129(a) OF THE BANKRUPTCY CODE, BUT SECTIONS 1129(b)(1) (ALL CLASSES ACCEPTS), (b)(10) (ONE IMPAIRED CLASS ACCEPTS), AND (b)(15) (INDIVIDUAL 11, DISPOSABLE INCOME FOR 5 YEARS) DO NOT APPLY TO SBRA CASES

REMOVES THE ABSOLUTE PRIORITY RULE



Confirmation

Two types of confirmation:

- Consensual - § 1191(a) (not a defined term)
 - All impaired classes accept
 - Plan otherwise complies with applicable sections of § 1129(a)
- Cramdown - § 1191(b)
 - Confirmation permissible even if all classes do not accept
 - (the § 1129(a)(8) requirements)
 - Confirmation even if no impaired class of claims accepts
 - (the § 1129(a)(10) requirement)

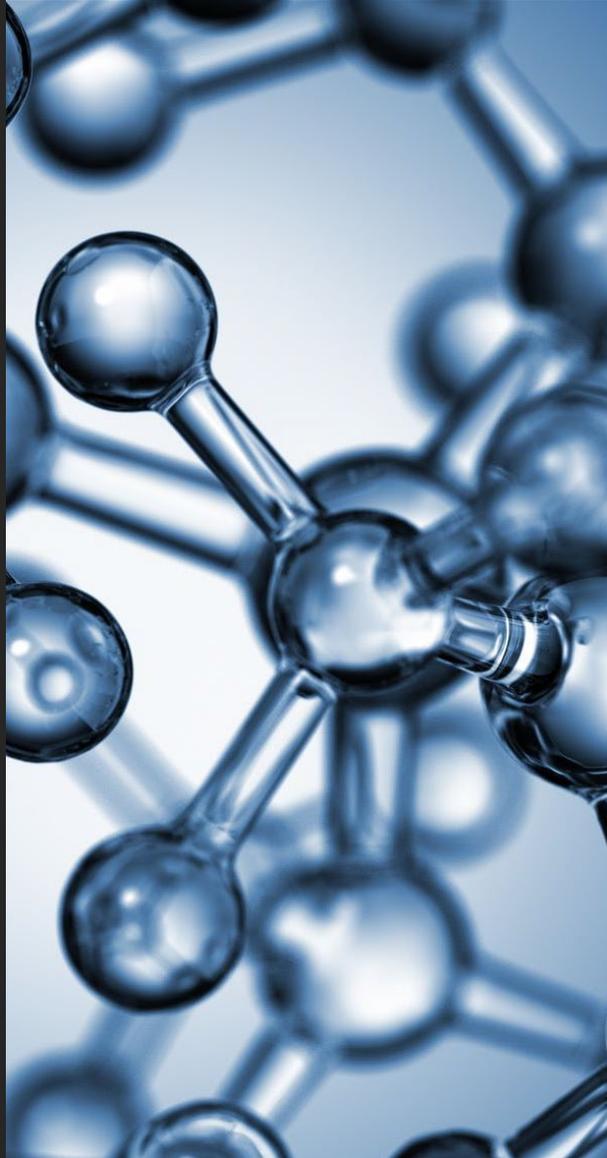
Subchapter V: Consensual Plan Confirmation

§ 1129(a) applies in a sub V case - except paragraph (a)(15)

§ 1129(a)(15) states the projected disposable income rule for individual Chapter 11 debtors

Subchapter V imposes a projected disposable income rule: expanded to apply to all debtors in the cramdown context (discussed later)

Court must confirm a plan under new § 1191(a) if it meets all the applicable requirements of § 1129(a)



Cramdown Confirmation (Pre- SBRA)

Existing law: cramdown confirmation is possible under § 1129(b) notwithstanding the failure of all impaired classes to accept the plan

At least 1 impaired class must have accepted the plan

[§ 1129(a)(10) requirement]

If the nonaccepting class is unsecured creditors: absolute priority rule prohibits holders of equity interests from retaining their interests unless unsecured creditors receive full payment (subject to the new value exception). § 1129(b)(2)(B).

Cramdown Confirmation Under New § 1191(b)

-
- SBRA changes subchapter V cramdown rules
 - Starting point: § 1129(b) does not apply
 - New § 1191(b) states revised cramdown rules that:
 1. Permits cramdown confirmation even if all impaired classes reject plan
 2. Eliminates the absolute priority rule



Confirmation Issues Cramdown

- **WITH RESPECT TO SECURED CLAIMS, CRAMDOWN IS THE SAME AS AN ORDINARY BUSINESS ENTITY CHAPTER 11 CASE.**
- **EQUITY HOLDERS CAN RETAIN THEIR INTERESTS IN THE BUSINESS EVEN IF THE PLAN DOES NOT PAY UNSECURED CLAIMS IN FULL, AND THE APR IS NOT MET (BECAUSE THE CLASS DID NOT ACCEPT THE PLAN). AS LONG AS THE PLAN “DOES NOT DISCRIMINATE UNFAIRLY, AND IS FAIR AND EQUITABLE” WITH RESPECT TO IMPAIRED UNSECURED CREDITORS, THE COURT MUST CONFIRM THE PLAN.**

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Confirmation: Fair & Equitable

- ***TO BE “FAIR AND EQUITABLE” AS TO UNSECURED— DEBTOR MUST PAY ALL OF ITS PROJECTED DISPOSABLE INCOME FOR THE FIRST 3 OR 5 YEARS OF THE PLAN (OR DISTRIBUTE VALUE EQUIVALENT TO THAT AMOUNT)***
- **DISPOSABLE INCOME IS INCOME RECEIVED THAT IS NOT NECESSARY FOR**
 - **MAINTENANCE OR SUPPORT OF DEBTOR OR DEPENDENT OF DEBTOR**
 - **DOMESTIC SUPPORT OBLIGATION FIRST PAYABLE AFTER DATE OF FILING**
 - **PAYMENT OF EXPENDITURES NECESSARY FOR CONTINUATION, PRESERVATION, OR OPERATION OF THE BUSINESS OF THE DEBTOR**



Confirmation:
Fair &
Equitable

- **FOR SECURED CLAIMS, PLAN MUST STILL MEET THE REQUIREMENTS OF 1129(b)(2)(A)**
- **THAT IT WILL MAKE ALL PAYMENTS UNDER THE PLAN, OR THAT THERE IS A “REASONABLE LIKELIHOOD” THAT IT WILL BE ABLE TO MAKE ALL PAYMENTS UNDER THE PLAN AND THE PLAN MUST PROVIDE “APPROPRIATE REMEDIES” TO PROTECT CREDITORS IN THE EVENT PAYMENTS ARE NOT MADE**
- **PLAN CAN PROVIDE FOR SALE OF NONEXEMPT ASSETS, FOR EXAMPLE**
- **BECAUSE THE ABSOLUTE PRIORITY RULE IS ELIMINATED, THERE IS NO NEW VALUE EXCEPTION**

Confirmation Issues

- **IF A CONSENSUAL PLAN IS CONFIRMED UNDER 1191(a):**
 - **THE DISCHARGE IS ENTERED UPON CONFIRMATION AND THE TRUSTEE IS RELIEVED OF HIS/ HER DUTIES UPON SUBSTANTIAL CONSUMMATION, WHICH IS DEFINED AS COMMENCEMENT OF PLAN PAYMENTS UNDER THE PLAN (UNLESS OTHERWISE PROVIDED IN THE CONFIRMED PLAN)**
- **IF PLAN IS CONFIRMED UNDER 1191(b) and THE DEBTOR MAKES USE OF THE CRAMDOWN PROVISIONS:**
 - **A DISCHARGE IS ENTERED AS SOON AS PRACTICABLE AFTER DEBTOR COMPLETES PLAN PAYMENTS WITHIN THE INCOME COMMITMENT PERIOD, AND THE TRUSTEE WILL REMAIN AND MAKE PAYMENTS UNDER THE CONFIRMED PLAN (UNLESS OTHERWISE PROVIDED IN THE CONFIRMED PLAN)**

Confirmation: Orientation

The starting point for confirmation of a subchapter V plan is the same as the one in a traditional chapter 11, and that is Bankruptcy Code § 1129(a) & (b). A subchapter V debtor must satisfy all of the elements of § 1129 except for the ones that are carved out of subchapter V. The most common break point for a subchapter V debtor in § 1129(a) is the liquidation test of § 1129(a)(7). This is common to both subchapter V debtors and “traditional” small debtors. The debtor’s plan must propose to pay the creditors the liquidation value of the debtor’s assets. And for an individual debtor, this should mean the non-exempt value. The other big hurdle for a debtor is the disposable income test. This test is triggered differently in a subchapter V and a traditional chapter 11, but if the debtor is facing an objecting unsecured creditor, then the result may look very much the same in subchapter V and a non-subchapter V case. The debtor is going to have to commit its disposable income to the plan for a term. And subchapter V puts brackets on the terms of the plan. It must be at least three years but no more than five years (for dischargeable debts). A traditional chapter 11 does not have these brackets on the plan term. Another similarity regarding application of the disposable income test is that both a subchapter V debtor’s plan and a traditional plan may commit the value of the projected disposable income rather than the payment stream itself. § 1129(a)(15)(B) and 1191(c)(2)(B).

The APR

Subchapter V does away with the Absolute Priority Rule codified at § 1129(b)(2)(B)(ii). This impacts the whole case because it affects the bargaining power of all the parties. It affects the large under-secured creditor (which was common) in small traditional chapter 11 cases. These creditors no longer control the plan process with a blocking vote that triggers the application of the Absolute Priority Rule. From the debtor's perspective, the elimination of the Absolute Priority Rule in subchapter V cases does away with what can otherwise be a real problem, and that is finding a new value contribution necessary to confirm a plan in a traditional chapter 11. As for the unsecured creditor body, a single creditor in a subchapter V case has no voice in the creation of an APR problem, and even has no ability to trigger the application of a disposable income requirement as in a traditional chapter 11 case. Bankruptcy code § 1129(a)(15). But on the other hand, the disposable income requirement exists as a matter of course in every subchapter V case.

Cramdown: The Disposable Income Requirement

- New disposable income requirement in § 1191(c)(2)
- Plan must provide that all of the projected disposable income of the debtor to be received in the 3 year period after first payment under the plan is due, or in such longer period not to exceed 5 years as the court may fix, will be applied to make payments under the plan.
New § 1191(c)(2)(A).
- Statute contains no standard to govern how the court determines whether to extend the 3 year period

Compare: Subchapter V Disposable Income & Chapter 13 Disposable Income

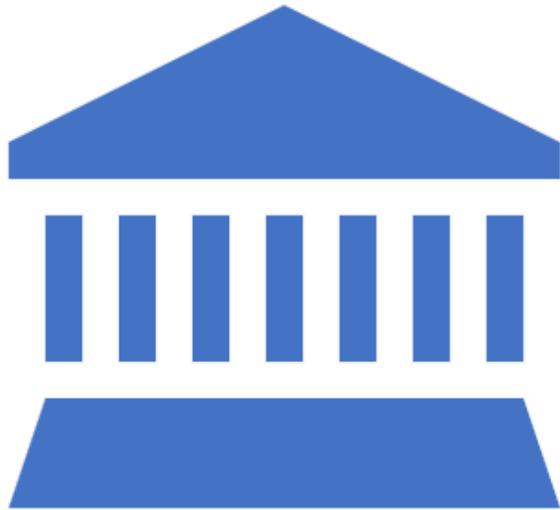
Disposable income definition in § 1191(d) is substantially the same as the definition of “disposable income” in Chapter 13 with two qualifications. Compare § 1325(b)(2).

1. New § 1191(d) does not include a deduction for charitable contributions in determining disposable income
2. The so-called “means test” standards that govern expenses in a Chapter 13 case of an “above-median” debtor do not apply in a sub V case

Compare § 1325(b)(3)

The Projected Disposable Income (or “best efforts”) Test

- Section 1191(c)(2) states two alternatives for satisfying the test. The same payments that satisfy the projected disposable income test may also satisfy the “liquidation” or “best interest of creditors” test of §1129(a)(7).
- In re Orange County Bail Bonds, Inc., 2022 WL 1284683 (B.A.P. 9th Cir. 2022). The court did not discuss the issue, but the point is implicit in its holding. See *also* Homer Drake, Jr., Paul W. Bonapfel, & Adam M. Goodman, Chapter 13 Practice and Procedures § 7:2 (In a chapter 13 case, “[t]he plan must meet each of the best interest and projected disposable income tests, but the same payments may satisfy both of them. Thus, the debtor must pay the greater of the amount that the best interest test or the projected disposable income test requires.”).



What levers does a creditor have to use at confirmation to oppose a debtor's plan?

- The two primary levers are the liquidation analysis and the disposable income test. The liquidation analysis is value driven. What is the value of the property the debtor is proposing to retain? The disposable income test will need to focus on historical income and expenses – what is a reasonable projection. A creditor may also assert a bad faith objection to the plan.

Additional Fair & Equitable Requirements



New § 1191(c)(3) states a feasibility test as part of the “fair and equitable” analysis

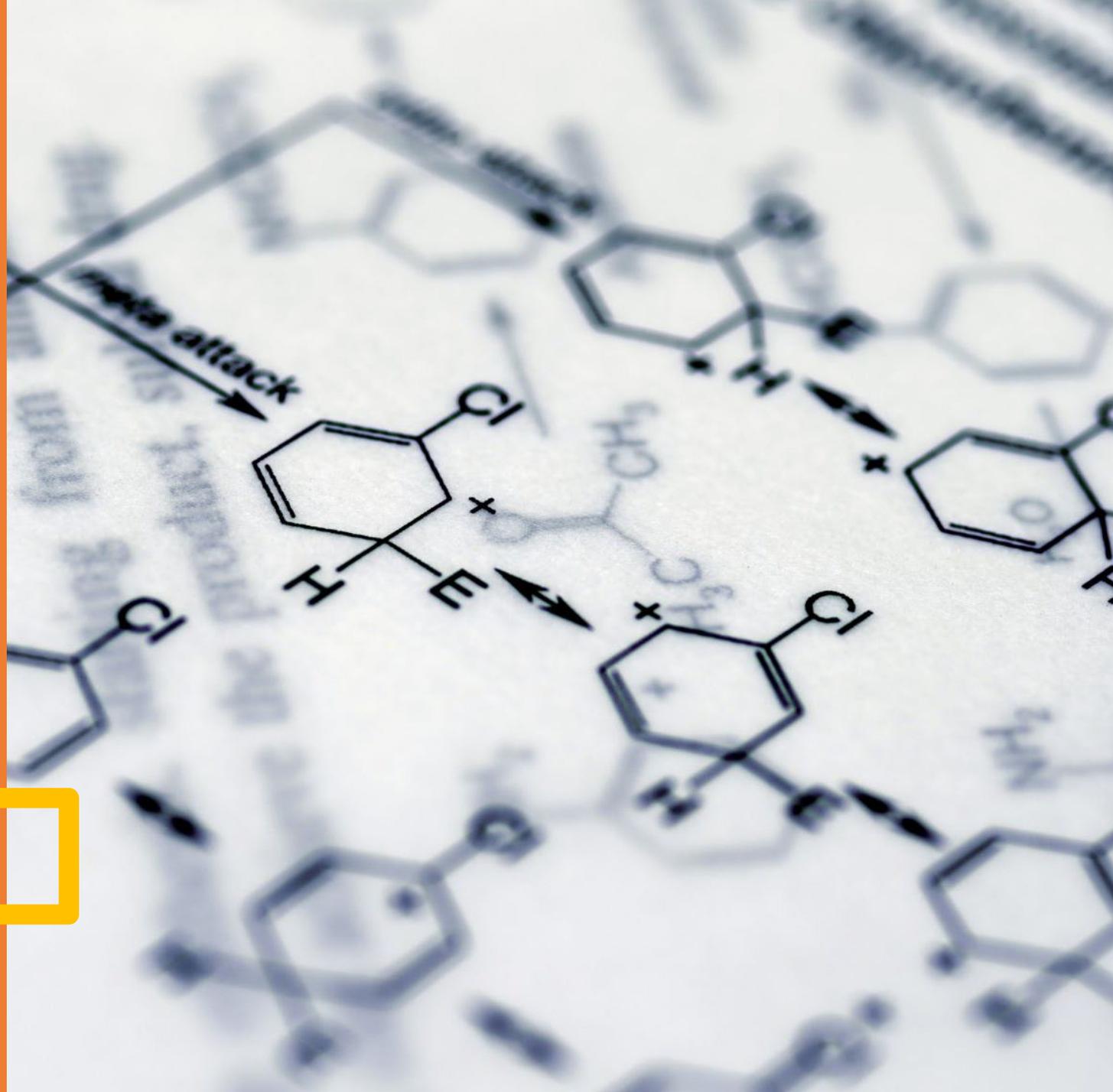


Debtor must be able to make all payments under the plan [§ 1191(c)(3)(A)(i)] or there must be a reasonable likelihood that the debtor will be able to make all payments under the plan [§ 1191(c)(3)(A)(ii)]



Plan must provide appropriate remedies to protect creditors if the debtor does not make the required plan payments

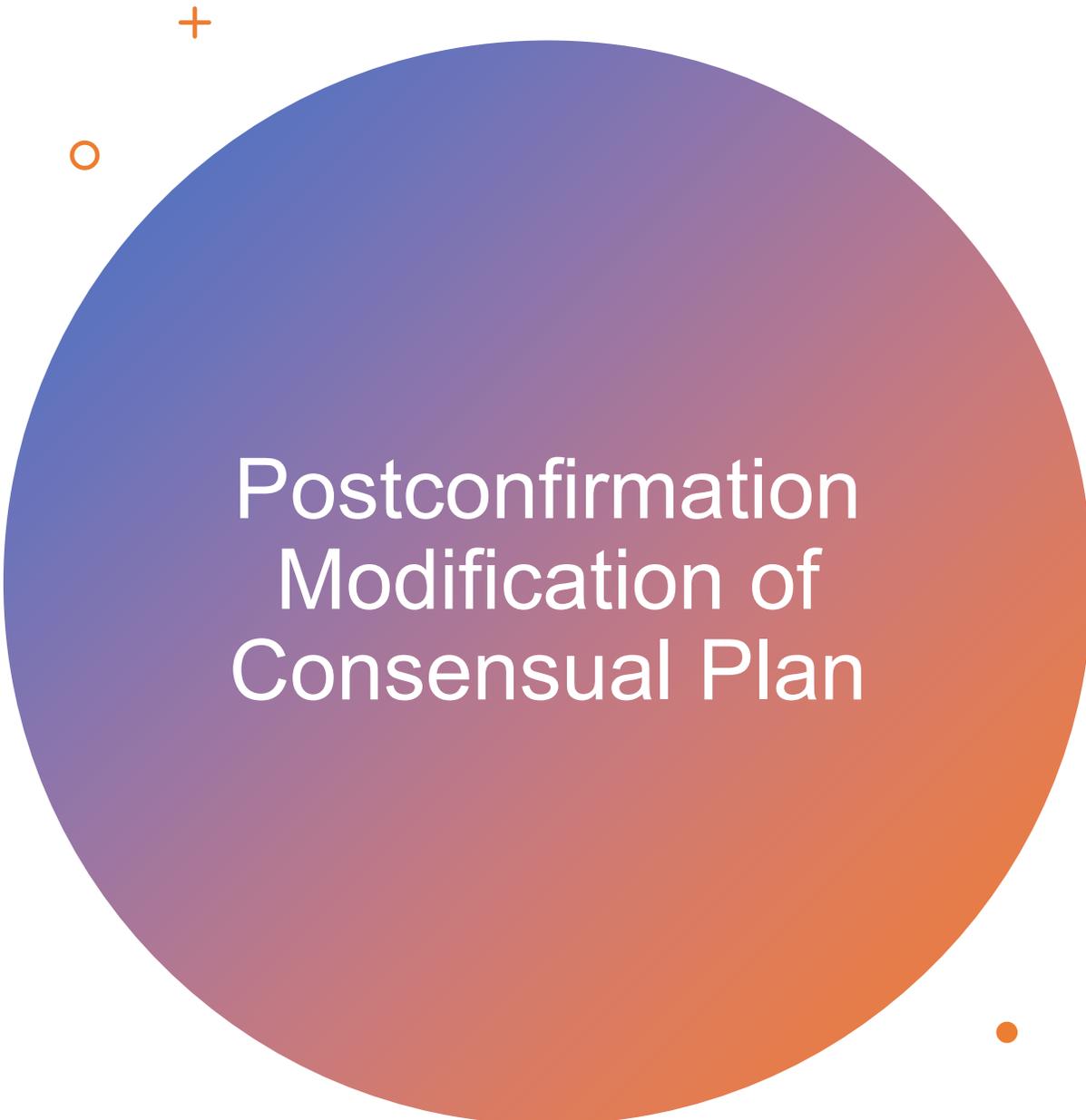
Remedies upon
plan default



Postconfirmation Plan Modification

Postconfirmation modification rules in new § 1193 differ depending on whether the court confirmed:

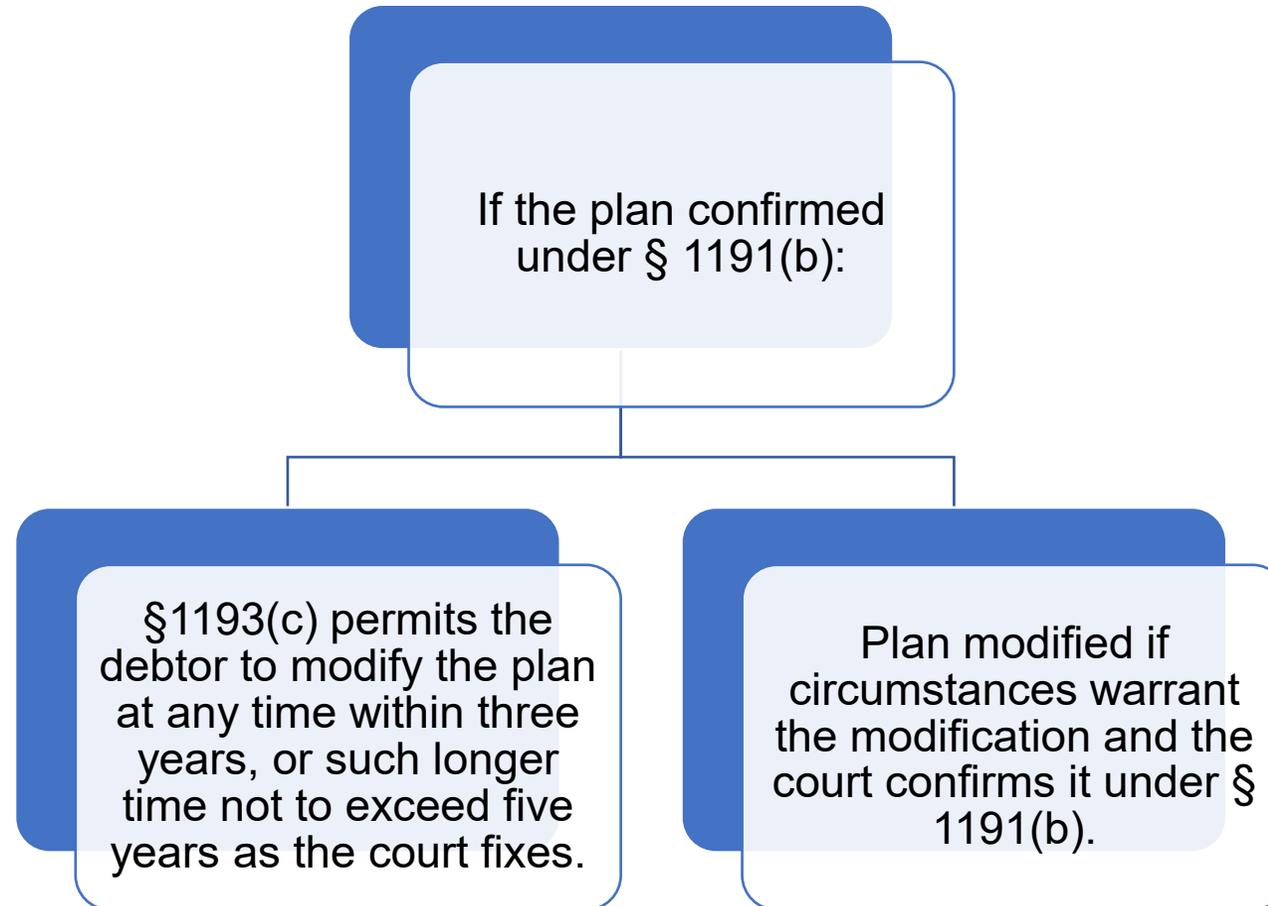
- A. A consensual plan under new § 1191(a) or
- B. A cramdown plan under new §1191(b)



Postconfirmation Modification of Consensual Plan

1. New § 1193(b) does not permit modification after substantial consummation.
2. Plan modification only if circumstances warrant the modification and the court confirms it under new § 1191(b). *(this provision is subordinate to bullet point 1)*
3. Holder of any claim who voted to accept or reject the confirmed plan is deemed to have voted the same way unless the holder changes the vote. New § 1193(d).

Postconfirmation Modification of Cramdown Plan



Discharge Rules

Differ depending on whether court confirms:

- Consensual plan under § 1191(a), or
- Cramdown plan under § 1191(b)



Discharge: Consensual Plan

If the plan is consensual, discharge occurs upon confirmation

1. The discharge is under § 1141(d)
2. Delayed discharge in standard individual case (§ 1141(d)(5)) does not apply. § 1181(a)
3. § 523(a) discharge exceptions apply to individual
4. No § 523(a) exceptions to discharge in entity case
5. § 1141(d)(6) exception to discharge applies – debts excepted (1) under 523(a)(2)(A) or (B) (fraud) due to a domestic governmental unit and (2) taxes where corporation made fraudulent return or willfully attempted to evade or defeat tax.

Discharge: Timing of Cramdown Discharge

- Under cramdown confirmation, the discharge provisions of § 1141(d) do not apply except as provided in new §1192
- New § 1192 delays discharge until the debtor completes payments under the plan
- This plan term may be 3 to 5 years

Discharge: Cramdown Plan

- Discharge under new §1192 discharges the debtor from all debts provided in § 1141(d)(1)(A) and allowed administrative expenses provided for in the plan, with two exceptions:
 1. No discharge of debt on which the last payment is due after the first 3 years of the plan or such other time not to exceed 5 years as fixed by the court
 2. No discharge of any debt “of the kind specified in section 523(a)”

Discharge: Cramdown Plan

- Does the language “of the kind specified in section 523(a)” apply to entities?
 - No: (1) Congress does not hide elephants in mouseholes and (2) amended § 523(a) itself to include the § 1191 discharge, which would otherwise be superfluous.
 - In re Satellite Restaurants, Inc., 626 B.R. 871 (Bankr. D. Md. 2021) (Chavez-Ruark, J.)
 - In re Cleary Packaging LLC, 2021 WL 2667735 (Bankr. D. Md. 2021) (Harner, J.) (reversed on appeal below)
 - In re Rtech Fabrications LLC, 635 B.R. 559 (Bankr. D. Idaho 2021)
 - In re Lapeer Aviation, Inc., 2022 Bankr. LEXIS 1032, at *4 (Bankr. E.D. Mich. Apr. 13, 2022)

Discharge: Cramdown Plan

- Does the language “of a kind specified in section 523(a)” apply to corporations?
 - Yes: “of the kind specified” language is used similar in § 1141(d)(6) and § 1228(a)(2), which apply to corporations and § 1191 and 1228 focus on “debts” not “debtors”.
 - In re Cleary Packaging, LLC, 36 F.4th 509 (4th Cir. 2022).



Property of the Estate (Under BAPCPA)

- BAPCPA added § 1115 to chapter 11.
- Property of an individual's chapter 11 estate includes property that the debtor acquires after the commencement of the case and earnings from postpetition services. § 1115(a)(1).
- Section 1115 does not apply in subchapter V cases. New § 1181(a).

Property of the Estate and Automatic Stay Under Cramdown

New § 1186(a) provides that property of the estate includes postpetition assets and earnings from services if a plan is crammed down.



New § 1186(a) deals only with postpetition assets and earnings.



Section 1141(b) (which remains applicable in a sub V case) provides that confirmation vests all property of the estate in the debtor unless the plan or confirmation order provides otherwise.



Effect of Cramdown Confirmation on Postpetition Property

- Property of the estate includes postpetition assets and earnings if the court confirms a plan under the cramdown provisions of § 1191(b).
- Result: postpetition assets and earnings that were not property of the estate on the petition date become property of the estate upon cramdown confirmation.

SMALL BUSINESS DEBTOR QUALIFICATION:

1. >50% business debt
2. Engaged in business

Non-Sub-V Small Business Debtor

- No trustee appointed
- Retain DIP powers
- Pay UST fees
- No Committee (absent order)

Confirmation:

- Standard Chapter 11 Process including Absolute Priority Rule

Discharge (standard)

Entity:

Upon confirmation

Individual:

Upon completion

Plan Modification: standard

Plan Failure to Perform: standard

(No trustee may be appointed)

Sub-V Business Debtor

- Trustee automatically appointed
- Retain DIP powers
- No UST fees
- No Committee (absent order)

Confirmation:

- Standard secured claim cramdown
- No A.P.R. as to unsecured claims
- New disposable income requirement
- 3 to 5 year plan term

Discharge under Consensual Plan:

Upon confirmation
(No distinction between entity & individual)

Plan Modification:

None after substantial consummation

Plan Failure to Perform:

Trustee Appointed Debtor removed as DIP (upon motion and hearing)

Discharge under Cramdown Plan:

Upon plan completion
(No distinction between entity & individual)

Plan Modification:

Upon compliance with cramdown requirements

Post-Confirmation Defaults

Non-Sub-V Small Business Debtor

Plan Failure to Perform:

- No trustee may be appointed

Sub-V Business Debtor

Plan Failure to Perform:

- Trustee Appointed/Remains
- Debtor removed as DIP (upon motion and hearing)

Q&A

Thank you for attending

The Panelists



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