Subchapter V:
How Is It Going So Far?

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Part I: Getting Acquainted With the Sub V Process

Part II: Issues Arising in Subchapter V: Eligibility, Sales, and the Sub V Plan

Part III: Subchapter V from a Secured Creditor's Perspective

Getting Acquainted with the Sub V Process

Step 1 Filing

- Ensure Debtor meets Sub V requirements
- Select Sub V on filing petition

Step 2 Case Progress

- Upon filing, a Sub V Trustee is assigned
- Debtor, creditors and Sub V Trustee work in tandem

Step 3 Plan

- Plan must be filed within 90 days unless extension is approved

Benefits Observed

Pros

- Intent to be a cost-effective approach to bankruptcy
- Debtor remains as debtor-in-possession
- Eliminates automatic appointment of a creditors' committee
- No UST quarterly fees
- Consensual and non-consensual plans are being confirmed
- Confirmed consensual plan = debtor makes plan distribution payments
- Elimination of absolute priority rule

CONS

- 90 days to file plan (are you prepared or are you not?)
- Subchapter V debtors are more likely to have fewer resources for adequate bankruptcy reporting and drafting plan budgets.
- If debtor's financial books and records are incomplete or disorganized, it could have an immediate impact on the success of the case and potentially lead to dismissal or conversion.
- Debtor must file Sub V Status Report no less than 14 days prior to mandatory status hearing before the Court (usually within 60 days after filing)
- Confirmed non-consensual plan = Sub V Trustee or third party may be elected to make plan distribution payments (additional costs to the estate)

Issues Observed

Issues

- CHAPTER 11 RULES!
- § § 362 etc. Litigation
    - Lift Stay/Adequate Protection
    - Cash Collateral
- Assumption/Rejection of Leases
- Discovery Disputes
- Professional Fees

CONSEQUENCES

- Confirmation Delays
- Unlimited Administrative Costs
- Disproportionate Professional Fees

Debtor and Creditor Tips

Debtor

- Sub V Trustee can be as involved or less involved as needed – debtor’s relationship in creditor negotiations is key
- Ensure familiarity with Subchapter V process, reporting guidelines and timeframes, especially cash collateral and MOR reporting
    - Debtor bank account statements must align with bankruptcy requirements

Creditor

- 90-day process reduces administrative expenses and process that is dedicated and focused on reaching a consensual plan
- Utilizing Subchapter V Trustee to review and opine on pre-bankruptcy areas of concern and how it translates post-petition and ultimately into a confirmable plan

The Role of the Sub V Trustee

- Generally, similar to the role of chapter 12 and 13 trustees, but with the unique duty to “facilitate the development of a consensual plan of reorganization.”
  - What does “facilitate the development of a consensual plan of reorganization” mean?

Other Duties

- be accountable for all property received (704(a)(2));
- if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper (704(a)(5));
- if advisable, oppose the discharge of the debtor(704(a)(6));
- unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest (704(a)(7));
- make a final report and file a final account of the administration of the estate with the court and with the United States trustee (704(a)(9));
- appear and be heard at the status conference under section 1188 and any hearing that concerns: (A)the value of property subject to a lien; (B)confirmation of a plan filed under this subchapter; (C)modification of the plan after confirmation; or (D)the sale of property of the estate;
- ensure that the debtor commences making timely payments required by a plan confirmed under this subchapter;
- if the debtor ceases to be a debtor in possession, perform the duties specified in section 704(a)(8) and paragraphs (1), (2), and (6) of section 1106(a) of this title, including operating the business of the debtor;
- if there is a claim for a domestic support obligation with respect to the debtor, perform the duties specified in section 704(c) of this title
- Only if the court orders:
    - investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan
    - file a statement of any investigation conducted
    - after confirmation of a plan, file such reports as are necessary or as the court orders

When is the trustee paid?

- A non-standing trustee’s compensation is allowable as an administrative expense, which has priority under 507(a)(2) subject only to claims for domestic support obligations:
  - In a consensual plan, trustee must be paid at the effective date of the plan, unless the trustee agrees otherwise.
  - In a non-consensual plan, the trustee is paid through the plan.

How are Trustees compensated?

- If a case-by-case trustee, the trustee is entitled to fees and reimbursement of expenses under the provisions of 330(a), without regards to the limitation in 326(a).
  - Courts have interpreted these sections to impose no limitations on trustees' compensations

Questions that may arise:

1. Does the lack of quarterly UST fees and unsecured creditors' committee fees make up for the need to pay the sub V trustee?
2. What is reasonable compensation?
3. Do we have statistics on fees in the first 365 days?

American College of Bankruptcy Panel: Subchapter V: How is it going so far?

Issues arising in Subchapter V: Eligibility, Sales, and the Sub V Plan

Speaker: **James D. Sweet**, Steinhilber Swanson LLP, Madison, WI[1]

I. Eligibility

To proceed under Subchapter V, a person must be a "debtor" within the meaning of section 1182(1). This Sub V definition assumes the prospective "debtor" is initially eligible to file under Chapter 11 pursuant to section 109(d), and then narrows that definition further to who might qualify as a "debtor" under Sub V.

(1) Debtor.—For purposes of Sub V, the term 'debtor'—

(A) subject to subparagraph (B), means a person ***engaged in commercial or business activities*** (including any affiliate of such person that is also a debtor under this title and ***excluding a person whose primary activity is the business of owning single asset real estate***) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief ***in an amount not more than $7,500,000*** (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor; and

(B) does not include—

(i) any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $7,500,000 (excluding debt owed to 1 or more affiliates or insiders);

(ii) any debtor that is a corporation ***subject to the reporting requirements*** under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)); or

(iii) any debtor that is ***an affiliate of a corporation described in clause (ii).***[2]

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[1] Co-authored by Elizabeth L. Eddy, Steinhilber Swanson LLP.

[2] Note that section 1182(1)(B)(iii) was amended by PL 117-151 effective June 21, 2022. Before this amendment, section 1182(1)(B)(iii) read "any debtor that is an affiliate of an issuer, as defined in section 3 of the Security Exchange Ac of 1934 (15 U.S.C. 78c)."

A. Debt Limit

1. Legislative History

- When the Small Business Reorganization Act took effect on February 19, 2020, qualified small businesses with noncontingent, liquidated debts of less than or equal to $2,725,625 could elect to file a Sub V case.

- On March 27, 2020, the CARES Act (Public Law 116-136) became law and increased the debt limitation for Sub V to $7,500,000 until March 27, 2021.

- The extension of the CARES Act's bankruptcy provisions (Public Law 117-5, enacted March 27, 2021) extended the $7.5 million debt ceiling for another year.

- On March 28, 2022, the debt limit reverted to the prior $2,725,625 limit.

- Effective June 21, 2022, the Bankruptcy Threshold Adjustment and Technical Corrections Act (Public Law 117-151),[3] again extended the debt limit for Sub V eligibility to $7.5 million. This debt limitation increase applies retroactively to "any case commenced on or after March 27, 2020." The law includes another sunset provision, this time after two years (on June 24, 2024). Debate on the house floor[4] indicates the reluctance towards a permanent increase to $7.5 million:

  - "We just don't have certain data about some of these bankruptcy policy changes or their likely long-term effects. That is why these changes to our Bankruptcy Code should be temporary";

  - "An additional 2 years of normal post-pandemic bankruptcy activity will give us a better understanding of the underlying policy issues and will help guide the future design of our bankruptcy system"; and

  - "This bill did not go through regular order in the Judiciary Committee, so it did not benefit from robust oversight or

[3] Full text available at: https://www.congress.gov/117/plaws/publ151/PLAW-117publ151.pdf

[4] Full text available at: https://www.congress.gov/congressional-record/volume-168/issue-97/house-section/article/H5260-1

> legislative hearings. Americans are best served when Federal policy is made after careful and focused congressional deliberation, something that would have occurred in regular order."

- The authors believe this process will play out to be similar to the evolution of Chapter 12 from "temporary" to "permanent", over a series of renewals, and that Sub V will eventually be made permanent with the only issues being the revision from time to time of the debt limits.

2. Interpretation in the Courts

InfoW LLC, et al., No. 22-60020 (Bankr. S.D. Tex. April 17, 2022). This case illuminates the need for specificity concerning what it means for a debtor to have "noncontingent" and "unliquidated" debts of $7.5 million to meet the jurisdictional standard for Sub V. In the "InfoWars" case, the debtors filed their subchapter V case just days before the damages phase of certain state court litigation commenced. According to the motion to dismiss filed by the office of the U.S. Trustee, this timing allowed the debtors to qualify for Sub V jurisdiction by avoiding a state court ruling that would have liquidated the value of the litigation liability (presumably in an amount sufficient to disqualify the debtor from Sub V eligibility) so they could then claim, for purposes of their bankruptcy filing, that the value of their aggregate liquidated debt fell below the Sub V eligibility limits. The court did not provide a definitive ruling on the timing issue because the debtors stipulated to dismissal of the case before a decision was made on the motion to dismiss.

The timing of filing and whether debts are liquidated are contingent is an issue that arises in Chapter 13 cases (see 11 U.S.C. § 109(e)).[5] *In re Pantazelos*, 540 B.R. 347 (Bankr. N.D. Ill. 2015), shared a similar fact pattern with the above-cited *InfoW* case. In *Pantazelos*, the Chapter 13 trustee filed motion to dismiss, arguing that debtor's scheduled debts, in particular, a debt attributed to the FDIC in connection with pre-petition litigation it brought against debtor, were above the debt limit. The debt at issue was for damages based on theories of negligence, gross negligence, and breach of duty. The debtor listed the value of debt as "unknown," no proof of claim was filed on behalf of FDIC, and neither party adduced any evidence indicating that formula for damages in the case was easily calculable. Accordingly, the bankruptcy court

[5] Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated debts of less than $2,750,000 or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated debts that aggregate less than $2,750,000 may be a debtor under chapter 13 of this title. 11 U.S.C. § 109(e).

found that "the value of the debt in this case cannot be readily determined absent an extensive hearing or trial to determine the extent or value of Debtor's liability," finding the debts are unliquidated, rendering her unsecured debt not above the debt limit under 11 U.S.C. § 109(e).

Compare this to Chapter 12 cases, in which the amount of debt, for eligibility depends not on whether a debt is liquidated or contingent. *See* In Matter of Clark, 550 B.R. 429, 433 (Bankr. N.D. Ind. 2016): "Eligibility for chapter 12 is determined by a debtor's aggregate or total debt. The terms debt and claim are synonymous. This leads to a broad interpretation of the aggregate debt limit. In other words, eligibility is determined by all the claims against the debtor, regardless of whether the claims are secured, unsecured, liquidated, unliquidated, contingent, matured, unmatured or disputed, etc." *Id*. at 433 (citations omitted). In the *Clark* case, the bankruptcy court found the debtor ineligible for chapter 12 relief because the filed claims – regardless of whether such claims were disputed – exceeded the "aggregate debts" limit for Chapter 12 eligibility (11 U.S.C.A. § 101(18)).

In re 305 Petroleum, Inc., 622 B.R. 209 (Bankr. N.D. Miss. 2020). Six affiliated debtors filed petitions under chapter 11: five elected Sub V and the sixth, a single asset real estate ("SARE"), proceeded under a standard chapter 11 procedure. Including the SARE's debt, the affiliate group's noncontingent liquidated debts exceeded $7,500,000. The court held that the exclusion from the definition of "debtor" under section 1182(1)(B)(i) requires the Court to include the debt of all affiliates, including the SARE, to determine the eligibility of the other five affiliates for Sub V treatment. While subsection (A) of the section excludes single assets real estate debtors entirely from the definition of "small business debtor," subsection (B) does not exclude the debts of a single asset real estate debtor from the definition of "affiliates" for the purposes of determining the aggregate debt for all affiliated companies under (B)(i). Accordingly, the five affiliated non-SARE debtors could not proceed in Sub V.

B. Engaged in Commercial or Business Activities

Subchapter V has an "engaged in commercial or business activities" criterion for eligibility (§ 1182(1)(A)), not unlike the Chapter 12 requirement that a family farmer be "engaged in a farming operation" (§ 101(18)) as one criterion of being eligible to file under Chapter 12. And just like Chapter 12, the issue of what it means to be "engaged" contains a temporal and scienter component that can be vexing at times.

One such instance is found in *In re RS Air, LLC*, 638 B.R. 403 (B.A.P. 9th Cir. April 26, 2022). NetJets, the debtor's largest, non-insider creditor, objected to the debtor's Sub V election, arguing that the debtor was ineligible because it was not, "engaged in commercial or business activities," pursuant to § 1182(1)(A). In support of this claim, NetJets argued that the debtor:

- has had no flight operations, since at least 2017;
- has received no revenue or income, since as early as 2012;
- has had no employees;
- has never been a revenue-generating business; and,
- has as its sole purpose enabling its owner to acquire and use private jets.

In opposition, the debtor argued that Sub V eligibility does not require ongoing operations, employees, or historical profitability. Instead, claimed the debtor, the following activities are sufficient, in combination, for it to be "engaged in commercial of business activities" sufficient for eligibility:

- litigating with NetJets;
- negotiating with NetJets to sell fractional jet interests back to NetJets;
- paying its aircraft registry fees;
- remaining in good standing as a Delaware LLC;
- keeping its state and federal tax obligations current; and,
- intending to resume normal flight operations when able.

The BAP held that the bankruptcy court properly confirmed the debtor's chapter 11 plan, and denied NetJets' objection to the debtor's Sub V election, in so finding that:

- the term "engaged in" is not inherently contemporary in focus and is not retrospective. Thus, a debtor need not be maintaining its core or historical operations on the petition date, but it must be "presently" engaged in some type of commercial or business activities to satisfy § 1182(1)(A). *Id.* at 410.
- The only persons Congress excluded from Sub V eligibility (other than by debt limitations) are: (1) those whose primary activity is the business of owning single asset real estate; (2) corporate debtors subject to reporting requirements under certain sections of the Securities Exchange Act; and, (3) any debtor that is an affiliate of an issuer under 15 U.S.C. § 78c. *See* § 1182(1)(A) & (B).[6]

[6] Note that numeral (3) here, representing the then-reading of § 1182(1)(B)(iii), was amended by P.L. 117-151. Effective June 21, 2022, section 1182(1)(B)(iii) reads "any debtor that is an affiliate of a corporation described in clause (ii)."

- Accordingly, no profit motive is required for a debtor to qualify for Sub V relief. To hold otherwise would wrongfully exclude nonprofit corporations and other persons that lack such a motive.

Seventh Circuit precedent is lacking on the "engaged in commercial or business activities" criterion for eligibility (§ 1182(1)(A)).

C. The Single Asset Real Estate Debtor

Section 1182(1) limits those who can file a Sub V case to a "small business debtor" who does not own "single asset real estate." The Bankruptcy Code 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 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.

11 U.S.C. § 101(51B).

1. <u>No substantial business . . . other than the business of operating the real property</u>

Much of the authority discussing SARE centers on the issue of whether a debtor conducts "substantial business . . . other than operating the real property." This eligibility restriction can often cause problems for traditionally structured closely-held companies, where there are two separate but related entities, often with common ownership – the Real Estate Holding company that owns the real estate premises, and that leases the premises to the Operating Entity which carries on the actual business operations unrelated to leasing the real estate. And the debt of one is often guaranteed by the other. Clearly, the Real Estate Holding company in our example is ineligible for Sub V treatment, even if the Operating Entity is eligible, and it is really the same entity. The issue was confronted in a recent decision described below:

<u>In re Palace Theater, LLC</u>, No. 3-21-11714-RMB (Bankr. W.D. Wis., March 31, 2022). This was a case involving related entities Palace Theater, LLC (the debtor), which owned real estate and the improvements thereon, and 94 North Productions, LLC, an entity that operated a dinner theater business on said real property. Pre-petition, the debtor purchased all of 94 North's equipment and fixtures subject to all liens and encumbrances, and the debtor agreed to pay all expenses related to payroll and hospitality operations. The primary secured creditor objected to the Debtor's

eligibility for Sub V, arguing that the Debtor's primary activity on the petition date was the business of owning single asset real estate. Judge Blise wrote that, as to the debtor's eligibility to proceed under Sub V, "this case involves a novel question: whether a debtor whose primary activity was once the business of owning single asset real estate can change the nature of its single asset real estate property by purchasing assets of its lessee and assuming the lessee's business operations mere hours before filing its bankruptcy petition." The Court held that the debtor did not prove that its primary activity on the Petition Date was not the business of owning single asset real estate, and was found not eligible to be a debtor under Sub V. [Editorial disclosure: this case was one filed by the authors' law firm, and the authors' attitudes toward the outcome of this case are predictable.]

The issue here, just as the issue before the "InfoWars" Court is whether a business may undertake an otherwise legal transaction for the purposes of structuring its affairs so that it may qualify for the advantages the law affords such a business so reconfigured. And, just as in the *RS Air* case, whether the passage of time is important, or as noted in *RS Air*, whether it is the engagement-in-business intention of the debtor post-filing that should control.

The *Palace Theatre* case leaves unanswered these questions and ignores the prevailing trend of cases to look at the enterprise on the petition date to determine eligibility and not some undefined retrospective review. A few cases following the prevailing trend to look at the petition date status of the enterprise, and whether it is a SARE excluded from Sub V eligibility, follow.

In re ENKOGS1, LLC, 626 B.R. 860 (Bankr. M.D. Fla. 2021). Like the Palace Theater case, this case centers on the issue of whether the debtor conducts any substantial business other than operating the real estate. Here, the debtor owns and operates a 79-room hotel. The court overruled a secured creditor's objection to Debtor's eligibility, finding that the debtor was not an SARE debtor because it: employed approximately 15 individuals; provided room cleaning services, laundry, internet/wi-fi services, phone, bus and trailer parking; served complimentary breakfast; and maintained a gym and swimming pool for its guests. The court concluded that the debtor provided more services than simply renting rooms. Such amenities are intended to attract guests and compete with other hotels for business. The court concluded that it was sufficient for the debtor to simply provide these extra services and it was not required to show that it earned income from these services, separate from the room rentals. Accordingly, the court held that hotels do not qualify as "single asset real estate," and are therefore not precluded from Sub V on such grounds.

2. Real property constituting **a single property or project**

In re 218 Jackson LLC, No. 21-00983, 2021 WL 3669371 (Bankr. M.D. Fla. June 3, 2021). In *218 Jackson*, the court analyzed the "single property or project" aspect of section 101(51B). A secured creditor objected to the debtor's Sub V designation on the grounds that the debtor was a SARE debtor where: (1) the debtor acquired two parcels of real estate by a single warranty deed; (2) both parcels were financed under a single loan and mortgage; and (3) the debtor derived all of its income from the developed parcel, a single commercial building; and (4) the second parcel was undeveloped. The court found that because one parcel was developed and income producing, and the second parcel was vacant and the debtor had no intention of developing it for commercial purposes, the debtor did not manage both parcels "with a common purpose." Thus, the two parcels of property did not constitute a "single project" under section 101(51B), and the debtor is not a SARE debtor and eligible to proceed under Sub V.

3. Real property which generates **substantially all of the gross income of a debtor**

An case covered by my co-presenter as it relates to cash collateral,[7] presents an intriguing decision on Sub V eligibility (manipulation?) by the debtor and his desire to avoid a SARE treatment.

In re Richard Archibald McGrath and Jane McGrath, No. 3: 20-BK-03689-RCT, 2021 WL 1784079, (Bankr. M.D. Fla. Mar. 16, 2021). Debtors Mr. and Mrs. McGrath filed a Chapter 11 petition on New Years' Eve 2020, electing to proceed under Sub V. The primary secured creditor filed an objection to the debtors' Sub V election, asserting the circumstances of their business renders them SARE debtors and thus ineligible to proceed pursuant to Sub V.

The debtors' Schedule A/B listed three pieces of real property: (1) a single-family residence in Florida, where the Debtors reside; (2) a single-family rental residence in Pennsylvania that does not generate any income; and (3) a warehouse property located in Pennsylvania (the "Commercial Property"). The Commercial Property is leased to commercial tenants and generates gross revenue of $27,000 per month. The debtors listed this $27,000 as income on their Schedule I and filed a

[7] The case is presented by Mr. Klein at a different procedural posture. The *McGrath* court issued an order regarding the debtors' Sub V election on March 15, 2021 (2021 WL 1784079); this March 15 order is the decision analyzed herein. The *McGrath* court later considered a motion for relief from stay, issuing an amended findings of fact and conclusions of law on June 10, 2021 (2021 WL 2405722). The June 10 decision is that analyzed by Mr. Klein as it relates to cash collateral.

motion seeking to use the $27,000 rental income, which debtors asserted was cash collateral of the secured creditor.

In an agreed order denying debtors' motion to use cash-collateral, debtors and the Bank stipulated that the revenue from the Commercial Property is "not property of the Debtors' bankruptcy estate under 11 U.S.C. § 541 as [the Bank] exercised its [property] rights in the rents *prepetition* pursuant to certain assignment[s] of rent"(emphasis in original). The agreed order also provided that "[the Bank] owns the rents [from the Commercial Property]" and has held such property rights for some time since before the bankruptcy was filed. This agreed order was submitted and entered after the Bank filed its objection to Sub V eligibility.

In analyzing the debtors' eligibility, the court concluded that the dispositive issue was whether the Commercial Property "generates substantially all of the gross income" of the Debtors. Given that the Bank and debtors stipulated that the revenues generated by the Commercial Property have been "owned" by the Bank since before the petition was filed, the rental revenue cannot be "gross income" of the Debtors. The only other income of the debtors was social security. Thus, the court concluded, the debtors do not own "single asset real estate" because they own no real property that "generates substantially all of [their] gross income." The court overruled Bank's objection and found the debtors eligible to proceed under Sub V.

D. Revocation of a Debtor's Sub V Designation

When the authors looked at this next topic, we were surprised to learn it even was a topic. The question of revocation of Sub V designation was raised in *In re Nat'l Small Bus. All., Inc.*, No. 21-00031-ELG, 2022 WL 2347699 (Bankr. D.C. June 29, 2022). In the first opinion reported on this subject, Bankruptcy Judge Elizabeth L. Gunn revoked the debtor's Sub V designation and appointed an "ordinary" chapter 11 trustee when the debtor was unable to confirm plan.

Judge Gunn, "look[ed] to chapter 11 and the Bankruptcy Code as a whole to determine [whether] the election by a debtor to proceed under Subchapter V may be revoked post-petition." "[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," Judge Gunn said. She found "[v]arious sections of the Bankruptcy Code [that] allow for a debtor to seek conversion from one chapter to another if the debtor is an eligible debtor under such chapter."

Judge Gunn found that "the ability to revoke a Subchapter V election is consistent with the Bankruptcy Code but also the Congressional goals of ensuring that Subchapter V cases provide a quicker reorganization process." Further, the court pointed out that if a debtor were to discover, post-petition, that it is unable to meet the accelerated Sub V deadlines, the debtor could elect to revoke its designation and still have "the ability to continue to attempt to reorganize under the rigors and requirements of standard chapter 11."

II. Sales

A. The sale process in Subchapter V appears to be unaffected by a Sub V election and is the same as in regular Chapter 11 Section 363 sale process.

B. Recent 7th Circuit caselaw on § 363:

In re: Norrenberns Foods, Inc., No. 21-30825, 2022 WL 2657213 (Bankr. S.D. Ill. July 8, 2022).[8] The reasoning in this decision appears to be unrelated to the debtor's Sub V election. The Sub V debtor filed a Motion to Sell under 11 U.S.C. § 363(f) seeking an order from the Court approving the sale of substantially all of the debtor's assets used in the operations of its grocery business, "free and clear of any interest," including successor liability claims. The United Food and Commercial Workers Unions and Employers Midwest Pension Fund objected to the sale, arguing that its successor liability claims were not an interest in the property being sold so could not be extinguished by the sale order. The Court agreed with the majority of courts that the term "interest" should be interpreted broadly. Because section 363(f) permits a sale of property "free and clear" of an "interest in such property" and because the claims arose from the assets being sold, the Court held that the Fund's successor liability claims are an "interest" for purposes of Section 363(f), and the Debtor was authorized to sell its assets free and clear of the successor liability claims. A sale under Section 363(f) can extinguish the Fund's potential successor liability claims against the buyer of the Debtor's assets.

III. The Sub V Plan

A. Consensual Confirmation.

Sub V sets up a confirmation scheme that confirmation differs materially from the scheme found in section 1129 (a) and (b). The first major difference relates to how "consensual" appears to be defined under Sub V. Section 1191(a) provides that "[t]he Court shall confirm a plan under this subchapter only if all of the requirements of section 1129(a), ***other than paragraph (15) of that section***, of this title are met." (emphasis supplied). Section 1129(a)(15) relates to objections by unsecured creditors

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[8] Opinion available at: http://www.ilsb.uscourts.gov/sites/default/files/opinions/NorrenbernsFoodsInc%2821-30825%29.pdf

in an individual debtor case—individuals also being eligible to elect Sub V. These are cases where the debtor either with or without the Sub V Trustee's assistance has negotiated (or orchestrated) acceptance by all impaired class to the plan. But, what about the case where an impaired class has accepted, but there are classes where no votes have been cast?

1. The apathetic creditor problem.

The issue about what to infer (or not) from one or more classes of creditors who fail to submit any ballot regarding a proposed plan constitutes a split among jurisdictions. For those jurisdictions that infer rejection from silence, the plan subject to the apathetic creditor issue must be decided in a cramdown. But, in those districts that permit "deemed acceptance" of the plan when the creditor class fails to vote, this inference is a powerful tool to get to consensual confirmation. *In re Robinson*, 632 B.R. 208 (Bankr. D. Kan. 2021), allowed "deemed acceptance" of non-voting, non- objecting creditors to satisfy section 1191(a)'s consensual confirmation requirement under applicable 10th circuit law. *Compare In re Cheerview Enterprises, Inc.*, 586 B.R. 881, 894 (Bankr. E.D. Mich. 2018) (in an ordinary chapter 11 case, "[t]he statute [1129(a)(8)] and the rule [3018(c)] make clear that a claimant's acceptance of a plan of reorganization requires an affirmative act – a written acceptance on the prescribed form. The statute and the rule do not authorize the Court to infer a claimant's acceptance just because the claimant did not vote to reject a plan.").

2. The goal of consensual confirmation.

"Consensual confirmation is a goal of subchapter V, and the trustee should take steps to encourage that outcome." U.S. Department of Justice, Handbook for Small Business Chapter 11 Subchapter V Trustees, at Page 3-10.[9] Or is it? As noted below, lack of consensus opens options for the debtor post-confirmation that might not be available to debtors whose plans are consensually confirmed. *See also*, *In re Louis*, No. 20-71283 (Bankr. C.D. Ill. June 7, 2022).[10] Extolling the virtues of consensual plans: "Here, the Subchapter V Trustee apparently agreed with the Debtor's attorney to forego any efforts at obtaining consensual confirmation notwithstanding published guidance to the contrary from

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[9] Full text available at: https://www.justice.gov/ust/file/subchapterv_trustee_handbook.pdf/download

[10] Full text opinion available at: https://www.ilcb.uscourts.gov/sites/ilcb/files/opinions/Louis%20Opinion.pdf

the UST Program. Whether the decision was made due to lack of willingness to put in the effort or because of an incorrect belief that the affirmative vote of the IRS on plan confirmation would be required, *the failure to even try to obtain consensual confirmation cannot be justified*." (unless, of course, that was the goal.)

B. Cramdown.

So, what happens if a consensual plan cannot be achieved? Are the interest divestiture rules of section 1129(b) still in effect? In fact, the cramdown provisions of Sub V may be the most attractive feature of Sub V to the troubled small business.

If the debtor cannot achieve a consensual confirmation because any of subsections (8), (10), or (15) are not satisfied, then "the court, on request of the debtor, shall confirm the plan …. if the plan [a] does not discriminate unfairly and [b] is fair and equitable, with respect to each class of interests that is impaired under, and has not accepted, the plan." 1191(b).

1. <u>"Discriminate unfairly" under section 1191(b)</u>

While there is no case law discussing what "discriminate unfairly" means under 1191(b), it appears there is no good policy reason why the provisions of section 1129(b), which includes similar language, should not guide the inquiry. Under section 1129(b), "[t]he requirement that a plan not discriminate unfairly means that the class must 'receive treatment which allocates value to the class in a manner consistent with the treatment afforded to other classes with similar legal claims against the debtor'". *<u>In re Monarch Beach Venture</u>*, 116 B.R. 428, 437 (C.D. Cal. 1993). A plan does not discriminate unfairly within the meaning of the Bankruptcy Code if a dissenting class is treated equally with respect to other classes of equal rank." *<u>In re Art & Architecture Books of the 21st Century</u>*, 2016 Bankr. LEXIS 859, *66-*67 (Bankr. C.D. Cal. Mar. 18, 2016). So, until caselaw evolves under section 1191(b), it is reasonable to assume Courts will be guided by existing section 1129(b) jurisprudence.

2. <u>"Fair and equitable" is defined in section 1191(c):</u>

a. As to secured claims, use 1129(b)(2)(A) (see 1191(c)(1)):

i. *<u>In re Young</u>*, No. 20-11844, (Bankr. D. NM Nov. 26, 2021) (holding that allowing state-law foreclosure of secured asset was not the "indubitable equivalent" of surrender under section 1129(b)(2)(A)).

ii. <u>*In re Topp's Mech*</u>, 2021 Bankr. LEXIS 3235 (Bankr. D. Neb. Nov. 23, 2021) (finding that plan was not "fair and equitable to unsecured creditors where secured creditor was overpaid as a result of the section 1111(b) election)

b. As to unsecured claims, however, use 1191(c)(2):

All of the projected disposable income of the debtor to be received in a 3- year period, or such longer period not to exceed 5-years as the court may fix, beginning on the date that the first payment is due under the plan will be applied to make payments under the plan. If this standard is satisfied, then the fair and equitable test of section 1191(c)(2) will be satisfied. And, most importantly to a closely held small business, the provisions of section 1129(b)(2)(B) will not apply. But, 1191(c) contains a couple provisions ripe for debate:

i. The first issue is devotion of projected disposable income as part of meeting the fair and equitable test. "Projected disposable income" is defined in section 1191(d). Section 1191(d)(2) defines projected disposable income as "the income that is received by the debtor and that is not reasonably necessary to be expensed . . . for the payments of expenditures necessary for the continuation, preservation, or operation of the business of the debtor." At first blush, projected disposable income would appear to be synonymous with "profit" in an accounting sense. But as most business owners and many judges know, without retention of some level of profit, it is only a matter of time before the business is so destabilized by paying out all its profit that its continued existence (i.e., "preservation") will be jeopardized. So, caselaw will need to define for us how much of the business' profits may be retained under this test. For individual chapter 11 debtors, a least one court has clarified that calculating "projected disposable income" under 1191(b) is not calculated under section 707(b)(2)'s means test. <u>*In re*</u>

Young, 2021 Bankr. LEXIS 765 (Bankr. D. NM Nov. 26, 2021).

ii. The second issue needing clarification is when is a three-year plan acceptable, and when must a plan term be extended for to up to five years? While it is clear that a three-year plan is satisfactory under section 1191(c)(2), a couple cases have sought to extend the term to five years:

1. *In re Walker*, 628 B.R. 9 (Bankr. E.D. Pa. 2021) (overruled creditor's section 1129(a)(3) (Good Faith) objection to the plan's three-year term, arguing for a five-year term, because under the totality of the circumstances (i) the unsecured creditors accepted the plan and (ii) debtor contributed more than required under section 1191(c)(2)(B)).

2. *In re Urgent Care Physicians, Ltd*., 2021 Bankr. LEXIS 3466 (Bankr. E.D. WI 2021) (considering legislative history of SBRA, which recognized that small businesses generally have shorter lifespans than large businesses and, absent unusual circumstances, a three-year term properly balances "the shorter life-span of small businesses and the timely cost-effective benefits to debtors, against the benefits to creditors." In making this balancing, the court considered (i) the deduction from projected disposable income for anticipated capital needs, (ii) the insiders' financial contributions to the success of the plan, against (iii) the higher payment to creditors under a five-year plan.)

3. *In re Orange Cnty. Bail Bonds, Inc.,* 638 B.R. 137 (B.A.P. 9th Cir. April 27, 2022). The BAP found that the debtor's proposed five-year plan failed to satisfy the fair and equitable standard under section 1191(c)(2)(A) because

the plan only committed actual disposable income, not projected disposable income as required by the 1191(c)(2)(A), but found that the plan, with a three-year commitment period, satisfied the confirmation requirements set by section 1191(c)(2)(B) based on the debtor's projected disposable income for a three-year commitment period.[11]

C. Plan Modification

Possibly the least intuitive portion of Sub V is found in section 1193 concerning post-confirmation plan modifications. If forced to guess, the authors might have viewed a plan confirmed by consensus the most easily modified post-confirmation, but we would be wrong.

1. Post-Confirmation, Consensual Plan.

   a. 11 U.S.C. § 1193(b) governs when a chapter 11 debtor, proceeding under subchapter V, wishes to modify a plan after a consensual confirmation:

      > (b) Modification After Confirmation.--If a plan has been confirmed under section 1191(a) of this title, the debtor may modify the plan ***at any time after confirmation*** of the plan and ***before substantial consummation*** of the plan but may not modify the plan so that the plan as modified fails to meet the requirements of sections 1122 and 1123 of this title (classification of claims and contents of the plan), with the exception of subsection (a)(8) of such section 1123 (earnings dedication by an individual Chapter 11 debtor). The plan, as modified under this subsection, becomes the plan only if circumstances warrant the modification and the court, after notice and a hearing, confirms the plan as modified under section 1191(a) of this title.

      In re Nat'l Tractor Parts, Inc., No. 20- 20833 (Bankr. N.D. Ill. June 6, 2022) (denying Debtor's motion to modify a

[11] *See also* Brian Shaw and David Doyle, *9th Circ. Subchapter V Case Clarifies Commitment Periods*, LAW 360 (July 6, 2022). A copy of this helpful analysis is appended to these materials.

consensual plan, post-confirmation, and finding that a plan is substantially consummated[12] once any payment to any creditor was made).

b. Additionally, § 1193(d) --

> **(d)** Holders of a claim or interest.--If a plan has been confirmed under section 1191(a) of this title, any holder of a claim or interest that has accepted or rejected the plan is deemed to have accepted or rejected, as the case may be, the plan as modified, unless, within the time fixed by the court, such holder changes the previous acceptance or rejection of the holder.

2. <u>Post-confirmation, non-consensual plan</u>. Modification governed by 11 U.S.C. § 1193(c)

> (c) Certain other modifications.--If a plan has been confirmed under section 1191(b) of this title, the debtor may modify the plan at any time ***within 3 years, or such longer time not to exceed 5 years***, as fixed by the court, but may not modify the plan so that the plan as modified fails to meet the requirements of section 1191(b) of this title. The plan as modified under this subsection becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan, as modified, under section 1191(b) of this title.

3. <u>Comparison and commentary:</u>

For reasons that might become obvious with the passage of time, Sub V prohibits revisions to a consensually confirmed plan at any time prior after "substantial consummation." But, once the plan is consummated, it appears that section 1193(b) prohibits any modifications to the plans terms. On the other hand, a plan that is crammed down may be modified any time during the life of the plan—even up to five years later. This anomaly is ripe for strategizing.

[12] The topic of when a plan under Sub V is substantially consummated will be dealt with in a companion outline.

> Assume that the debtor is not quite sure how feasible his/her plan might be. Negotiating hard for consensus and achievement of a consensual plan confirmation may *not* be in this debtor's best interest. Engineering a cram down, with little or no consequences (unlike those under section 1129(b)(2)(B)), leaves all the debtor's options open in case it happens that the feasibility of the plan proposed was a bit unsure. Indeed, a debtor could afford to be overly aggressive in the promises he/she made in an original plan and leave the door wide open for an extended period to modify the plan if the promises made cannot be kept.
>
> The authors suspect this opportunity for strategizing may be taken back in later amendments to Sub V.

<u>Summary</u>

I. <u>Eligibility</u>

To proceed under Subchapter V, a person must be a "debtor" within the meaning of section 1182(1). This Sub V definition assumes the prospective "debtor" is initially eligible to file under Chapter 11 pursuant to section 109(d), and then narrows that definition further to who might qualify as a "debtor" under Sub V.

A. Debt limit

1. Legislative History

The $7.5 million debt limit is – again – subject to a two year sunset, expiring on June 24, 2024. Perhaps the additional two years of "normal post-pandemic bankruptcy activity" will demonstrate to Congress that this increased debt limit ought to be permanent.

2. Interpretation in the Courts

The timing of filing and whether debts are liquidated are contingent is an issue ripe for legislative or court interpretation. For example, the public policy implications of the "Infowars" case – may a debtor's unliquidated judgment remain "uncounted" towards the Sub V debt limit? This issue has analogies arising in Chapter 13 cases (see 11 U.S.C. § 109(e)) and in Chapter 12.

B. Engaged in Commercial or Business Activities

Is the term "engaged in" not inherently contemporary in focus and not retrospective? Need a debtor be maintaining its core or historical operations on the petition date, or "presently" engaged in some type of commercial or business activities to satisfy § 1182(1)(A)? *See <u>In re RS Air, LLC</u>*, 638 B.R. 403 (B.A.P. 9th Cir. April 26, 2022).

C. The Single Asset Real Estate Debtor

The definition in 101(51B) is being revisited by courts analyzing eligibility in Subchapter V. Should this code interaction be amended to permit more typical small businesses to utilize Sub V? For example, ought a holding company and operating company qualify, despite courts' finding that pre-petition reorganization still effects a SARE designation as of the petition date? *See* In re Palace Theater, LLC, No. 3-21-11714-RMB (Bankr. W.D. Wis., March 31, 2022). Or should courts read the "substantial business" requirement as having an income requirement? *See* In re ENKOGS1, LLC, 626 B.R. 860 (Bankr. M.D. Fla. 2021). Finally, what is the effect of a pre-petition creditor's assignment of rents on the SARE analysis, and is this counter intuitive? *See* In re McGrath, No. 3: 20-BK-03689-RCT, 2021 WL 1784079, (Bankr. M.D. Fla. Mar. 16, 2021)).

D. Revocation of a Debtor's Sub V designation

May the court *sua sponte* revoke a Sub V election and appoint an "ordinary" chapter 11 Trustee if the debtor is unable to confirm plan. *See* In re Nat'l Small Bus. All., Inc., No. 21-00031-ELG, 2022 WL 2347699 (Bankr. D.C. June 29, 2022).

II. Sales

§ 363 applies and, as of yet, appears to be applied in Sub V cases just as in all Chapter 11 and other cases.

III. Plan Issues

A. Consensual Confirmation

1. The Apathetic Creditor Problem
2. The Goal of Consensual Confirmation

B. Cramdown

1. Discriminate unfairly under § 1191(b)

While there is no case law discussing what "discriminate unfairly" means under 1191(b), it appears there is no good policy reason why the provisions of section 1129(b), which includes similar language, should not guide the inquiry.

2. "Fair and equitable," section 1191(c). As to **secured** claims, use 1129(b)(2)(A) (see 1191(c)(1)), and as to ***unsecured*** claims, use 1191(c)(2). Under (c)(2), the projected disposable income test stands for the fair and equitable test, but this area of law has many issues ripe for clarification. Does "disposable income" mean "profit"? Furthermore, when is a three-year plan acceptable and when must it be extended to five years?

C. Plan Modification

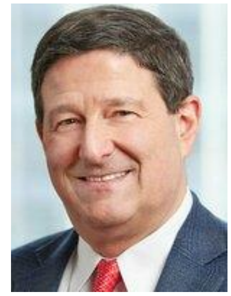
1. Post Confirmation Consensual Plan

"Substantial consummation," as provided in section 1193(b), creates challenges for post-confirmation modification of a consensual plan. (The concept is addressed in greater detail in a companion outline.)

2. Post Confirmation Non-Consensual Plan modification is governed by 11 U.S.C. § 1193(c)

9th Circ. Subchapter V Case Clarifies Commitment Periods

By **Brian Shaw and David Doyle** (July 6, 2022)



Brian Shaw

David Doyle

Over two years have passed since the Small Business Reorganization Act and its seminal achievement, Subchapter V of the Bankruptcy Code, became effective.[1]

Available solely to small business debtors, Subchapter V provides a scaled down and streamlined alternative to a traditional Chapter 11 reorganization.[2]

One of the most radical changes in Subchapter V involves its standards on cramdown, or confirming a plan over the objection of a dissenting class of creditors.

Unlike in a traditional Chapter 11, the absolute priority rule does not apply in a case under Subchapter V.[3][4] A business owner may retain its equity interest in the debtor even if every impaired class of creditors rejects the plan.

For a cramdown plan to be confirmed, however, the debtor must commit its projected disposable income to funding plan payments over a period of time.[5] The shortest length of this commitment period is three years, yet it can be as long as five years.[6]

So how is the appropriate length of a commitment period decided?

In most instances, it seems obvious that the small business debtor, as the plan proponent, would propose the shortest possible commitment period — three years. And if the plan is consensual, there will likely be no issue with the three-year time period.

However, it is also not too difficult to envision a Subchapter V case in which a creditor demands that the commitment period be longer than three, and as long as five years.

Similarly, a debtor may want to extend the commitment period to five years if, during those five years, the debtor wishes to put some of its otherwise disposable income into growth-focused capital expenditures, which could result in a creditor objecting and demanding a shorter commitment period.

In those instances where there is a dispute about the appropriate commitment period, the applicable statutory language becomes relevant and provides that the commitment period is a "three-year period, or such longer period not to exceed five years as the court may fix."[7]

Until recently, there were few decisions that touched on the appropriate length of a commitment period. However, that changed in April when Legal Service Bureau Inc. v. Orange County Bail Bonds Inc. (In re: Orange County Bail Bonds Inc.), tackled the question and provided some helpful guidance on the topic of the commitment period under Section 1191(c)(2) of the Bankruptcy Code.[8]

Subchapter V Cramdown of Unsecured Creditors — Section 1191(c)(2)

In a traditional Chapter 11 bankruptcy case, the court may not confirm a plan that impairs creditors unless at least one impaired class of creditors votes to accept the plan.[9] In Subchapter V, however, a debtor may cram down its plan even if all impaired nonpriority classes vote to reject the plan, so long as the plan is fair and equitable.[10]

The meaning of fair and equitable represents a further distinction between traditional Chapter 11 cases and Subchapter V. In a traditional Chapter 11, a plan is fair and equitable to dissenting unsecured creditors only if the plan satisfies the absolute priority rule or falls within the new value corollary's limited exception to the absolute priority rule.[11][12]

However, the SBRA eliminated the absolute priority rule for small business debtors. In its place, Congress enacted Section 1191(c)(2), which permits cramdown by the debtor even when every single class of impaired creditors has rejected the plan if the debtor commits to making payments tied to its projected disposable income.

Specifically, Section 1191(c)(2) provides that a plan is fair and equitable if the plan either "commit[s] the debtor's projected disposable income [for the commitment period], or pledge[s] distributions of property having a value of at least that amount."[13]

If the debtor proceeds under subsection (A) of Section 1191(c)(2), the plain language of the statute refers to the debtor's projected, not actual, disposable income during the commitment period.

Thus, if the debtor's actual disposable income turns out lower than projected, the debtor will still be required to make the minimum projected payments unless the plan can be modified.[14] Likewise, if a debtor has a particularly profitable year, it is only required to contribute its projected disposable income as set forth in the plan.[15]

A debtor can avoid making periodic payments of disposable income by satisfying subsection (B) of Section 1191(c)(2). Under this subsection, the debtor may buy the cramdown by committing property to the plan on the effective date that has a present day value of its projected disposable income.

A debtor can satisfy subsection (B) by funding its plan with proceeds from asset sales, available cash, insider loans or capital contributions. This approach provides the debtor with the benefit of certainty regarding its discharge, as it would be otherwise tied to the debtor's successful completion of its required plan payments at the end of the commitment period.

Finally, rather than set a fixed period during which projected disposable income must be committed to the plan, Section 1191(c)(2) provides a range: A "three-year period, or such longer period not to exceed five years as the court may fix."[16]

In re: Orange County Bail Bonds

In Orange County Bail Bonds, the Bankruptcy Appellate Panel of the Ninth Circuit highlighted the flexibility of Section 1191(c) and provided insight into how courts may apply its provisions to determine the appropriate commitment period.[17]

The debtor in Orange County was a bail bond company that entered into a bail bond agreement with a criminal defendant.[18] Global Fugitive Recovery was a skip tracer who was owed by and obtained a judgment against Orange County in the amount of

$327,000.[19]

Orange County subsequently commenced its Chapter 11 bankruptcy case, which it later converted to one under Subchapter V.[20] In its bankruptcy case, Orange County ultimately brought its third amended plan of reorganization and disclosure statement to confirmation, which committed to pay $127,000 payment to Global on its effective date.[21]

The plan further provided that Global would receive additional payments of at least $181,000 from the debtor's actual disposable income produced during a proposed five-year, post-confirmation commitment period.[22] The debtor did not, however, commit finite projected amounts, or their present value, to pay creditors under the plan.

Instead, the debtor committed its actual disposable income earned during the commitment period to make such payments.[23] Global objected to confirmation, including on the basis that the plan did not meet the fair and equitable test under Section 1191(c)(2)(A).

The bankruptcy court confirmed the plan over Global's objection, holding that the plan satisfied Section 1191(c)(2)(A).[24] In the confirmation order, however, the court added that no discharge would be entered unless the aggregate of the pro rata disposable income paid to Global over the commitment period was at least $181,000.[25]

Global appealed the confirmation order to the Ninth Circuit BAP, which affirmed, but did so on other grounds. While the BAP agreed confirmation was appropriate, it disagreed with the bankruptcy court that the plan had satisfied Section 1191(c)(2)(A).[26]

The BAP noted that the plan failed to satisfy the fair and equitable standard under Section 1191(c)(2)(A) because the plan only committed actual disposable income, not projected disposable income as required by the statute.[27] Moreover, the plan never committed to pay its actual or projected disposable income for any particular time period.

Essentially, the BAP refused to let the debtor get the benefit of Section 1191(c)(2)(A) while avoiding the required financial commitment of a sum certain over a time certain.

The BAP also noted that the requirement for Global to receive at least $180,000 from its pro rata share of the debtor's disposable income was not a confirmation requirement, but rather was merely an agreed upon between the parties condition to the debtor receiving a discharge.

As a result, the plan failed to meet Section 1191(c)(2)(A).[28]

On the other hand, because it may affirm a bankruptcy court's decision "on any ground fairly supported by the record," the BAP next considered whether the plan satisfied Section 1191(c)(2)(B).[29]

First, the BAP rejected the debtor's argument that the plan committed value greater than its five-year projection of disposable income of $490,000.[30] The plan only called for a payment on the effective date of $432,000, and nothing in the plan required the debtor to make payments beyond that amount, nor does it appear that the Orange County argued that this amount was equal to the present value of $490,000.

Further, as noted above, while the plan contained projected disposable income for three- and five-year periods, it did not commit the debtor to make such payments over a finite commitment period.

Therefore, in a twist of irony for the parties, the BAP then held that the plan satisfied the confirmation requirements set by Section 1191(c)(2)(B) based on the debtor's projected disposable income for a three-year commitment period.[31]

Specifically, the BAP held that the debtor, by committing a $432,000 payment on the effective date, was committing for payment property of a greater present value than the debtor's projected three-year disposable income of $287,000.

The BAP noted that, under Section 1191(c)(2)(B), the minimum commitment period was three years.[32] And while the bankruptcy court used its discretion to set a five-year commitment period to satisfy Section 1191(c)(2)(A), the BAP held that the record "does not indicate that the bankruptcy court set a longer commitment period" than three years for purposes of Section 1191(c)(2)(B).[33]

Of course, this was in part because no time period was committed to by the debtor. Accordingly, the plan satisfied Section 1191(c)(2)(B) by committing $432,000 on the effective date of the plan — more than the debtor's projected disposable income for the minimum three-year period — and the debtor actually benefited from its omission.

Conclusion

So, what does this early decision on the Section 1191(c)(2) and the length of a commitment period teach us?

First, creditors should review and confirm that the language of a proposed Subchapter V plan properly mimics the language in Section 1191(c)(2) — including utilizing the debtor's projected disposable income for distributions, rather than actual, and setting forth a finite commitment period of between three and five years.

As Global learned, a debtor's failure to do so correctly can adversely affect creditors too.

Second, do not assume that the debtor wants the shortest possible commitment period and the creditors want the longest period, because it translates into more money. In the context of a consensual plan, a debtor may want to spread payments out over five years in order to use capital expenditures to expand and strengthen the business.

In contrast, creditors may be willing to forego two extra years of payments for a little more certainty, and less risk of time.

Third, as a debtor, remember your baseline economic commitment to achieve cramdown — which is the debtor's projected disposable income for a period of three years, not to exceed five years after confirmation — because it is this baseline against which all of your negotiations with creditors for a consensual plan will be based. This baseline establishes what a debtor would be able to force the creditors to take.

So, while not the intent of the debtor in Orange County, when the BAP reversed the bankruptcy court and held the plan with the longer commitment period failed to comply with Section 1191(c)(2)(A), the BAP went right to that baseline minimum and determined that while the plan failed to comply with Section 1191(c)(2)(A), it complied with and would be confirmed under Section 1191(c)(2)(B) — to the apparent benefit to the debtor.

And finally, while one case does not constitute a trend, the BAP's decision to fall back on a three-year commitment period rather than a five-year period when none was identified under Section 1191(c)(2)(B) in the plan is consistent with the common view that three years is the norm and a longer commitment period is for more extraordinary circumstances.

Brian L. Shaw and David Doyle are members at Cozen O'Connor.

[1] Small Business Reorganization Act of 2019, PL 116-54, August 23, 2019, 133 Stat 1079.

[2] 11 U.S.C. § 101(51D).

[3] 11 U.S.C. § 1129(b)(2).

[4] Compare 11 U.S.C. § 1129(b)(2)(A)(B) with 11 U.S.C. § 1191(c)(2).

[5] 11 U.S.C. § 1191(c)(2)(A), (B).

[6] Id.

[7] Id.

[8] Legal Service Bureau, Inc. v. Orange Cnty. Bail Bonds, Inc. (In re Orange Cnty. Bail Bonds, Inc.), 638 B.R. 137 (B.A.P. 9th Cir. 2022).

[9] 11 U.S.C. § 1129(a)(8).

[10] 11 U.S.C. § 1191(b).

[11] See 11 U.S.C. § 1129(b)(2)(B).

[12] See, e.g., Bank of America Nat. Trust and Sav. Ass'n. v. 203 N. LaSalle St. Partn., 526 U.S. 434 (1999)

[13] Orange Cnty. Bail Bonds, 638 B.R. at 146.

[14] See, e.g., 8 Collier on Bankruptcy ¶ 1191.04 (16th 2022) ("If the debtor's actual disposable income turns out to be less than the projected disposable income, unless the plan can be modified, the debtor must still pay the minimum amount. If, on the other hand, the actual disposable income turns out to be greater than the projected disposable income, unless the plan specifically provides otherwise, the additional income need not be applied to the plan.").

[15] See id.

[16] 11 U.S.C. § 1191(c)(2)(A), (B).

[17] Orange Cnty. Bail Bonds, 638 B.R. at 146.

[18] Id. at 142.

[19] Id.

[20] Id.

[21] Id. at 146.

[22] Id. at 145.

[23] Id.

[24] Id. at 145.

[25] Id.

[26] Id. at 146.

[27] Id.

[28] Id.

[29] Id. at 147.

[30] Id. at 146.

[31] Id.

[32] Id.

[33] Id.

SUBCHAPTER V FROM A SECURED CREDITOR'S PERSPECTIVE

A secured creditor, especially an oversecured creditor with some room to incur reasonable attorneys' fees in order to protect and preserve the right to payment, should be actively involved in any subchapter V case to assert rights to adequate protection, object to use of cash collateral where necessary, and be prepared to establish the value of its collateral for both adequate protection and confirmation purposes. Given the dollar amounts involved that, by design, will not be as large a typical chapter 11, secured creditors will need to decide when to incur fees to protect their rights to payment. Secured and, where applicable, unsecured creditor strategies include: (a) opposing eligibility, (b) relief from stay, (c) objecting to use of cash collateral/DIP financing, (d) strictly enforcing a timetable to file a plan and otherwise seeking to convert or dismiss, (e) proactively seeking valuation of collateral for adequate protection and confirmation purposes, (f) making an 1111(b) election (including waiver of potential distributions as an unsecured creditor) when appropriate, (g) seeking appointment of a trustee, (h) opposing cram-down of secured creditor based on interest rate and other terms, and (i) opposing confirmation based on non-compliance with the disposable income requirements of section 1191. Of course, all of the foregoing should be balanced against the speed of the case, the costs involved, the preservation of the net present value of collateral and negotiation for a prompt resolution and fair treatment under a plan.

CURATED CASE NOTES

We'll Leave the Light On for You. *In re Caribbean Motel Corp.*, No. 21-01831, ECF Nos. 126, 200 & 206 (Bankr. D. P.R. 2022). Debtor, the owner/operation of a 40-room "by the hour" motel, filed for relief under subchapter V of chapter 11 on June 15, 2021. Secured Creditor asserted a claim of greater than $3,000,000 and promptly opposed the use of cash collateral. Debtor scheduled the value of the collateral at $550,000. By September 2021, Secured Creditor made its section 1111(b) election and five days later Debtor filed its plan and thereafter opposed the 1111(b) election. First, nearly six months after Secured Creditor's motion to prohibit the use of cash collateral based on a mortgage and assignment of rents, the Court ruled that the hourly room rentals were not "rents," but were revenue streams under section 552(b)(2) otherwise governed by article 9 of the Puerto Rico Commercial Transactions. It seems that Secured Creditor should have expanded its granting clause beyond "rents" to cover hourly occupancy payments and have filed a UCC-1 Financing Statement. The Court did not cite any case law in support of its conclusion, but secured creditors are well-served to avoid this result by easily perfecting under the UCC.

Separately, Secured Creditor argued that Debtor was ineligible under subchapter V because it should be designated as a single asset real estate (SARE) debtor. The Court focused on the motel nature of the business and concluded that Debtor was not a SARE because it provided additional goods and services, including food service, prophylactics, aspirin and change of linens, while employing a staff of around ten people.

Secured Creditor did win one battle. It accepted Debtor's scheduled valuation of the motel at $550,000, but also made its section 1111(b) election. The opinion did not discuss Debtor's proposed plan treatment. Under section 1191(c)(1), in order to confirm its plan, Debtor would be required to meet the requirements under section 1129(b)(2)(A). The section 1111 election, therefore, would have required deferred cash payments under the plan greater than $3,000,000. It is hard to see how this Debtor's motel (valued at $550,000) would be able to generate sufficient cash over a reasonable time period in order to meet the "fair and equitable" cram-down requirements of 1129(b)(2)(A). In fact, after the ruling, Debtor and Secured Creditor reached a settlement pursuant to which Debtor transferred the property to Secured Creditor in satisfaction of its claim, with a month-to-month lease terminable by either party upon notice.

You Talkin' to Me? In a separate case involving section 1111(b), *In re VP Williams Trans, LLC*, No. 20-10521, 2020 WL 5806507 (Bankr. S.D.N.Y. Sept. 29, 2020), the court also overruled Debtor's objection to Secured Creditor's election. In that case, Debtor operated a taxi business and owned a single taxi medallion. Secured Creditor asserted an approximately $575,000 claim and alleged the extent of its interest in the collateral (the medallion) to have a value of approximately $200,000. Debtor countered that the value was only $90,000 and separately proposed plan treatment for unsecured claims that would amount to only a 3% distribution. Debtor filed its plan on May 19, 2020, and Secured Creditor made its 1111(b) election on September 4, 2020. First, Debtor argued that no election could be made because the secured interest in the medallion was of "inconsequential value." The Court examined various chapter 11 cases for the meaning of "inconsequential value" without deciding on any particular test. Based on the facts of the case, the Court found the value of the medallion to be consequential to Debtor as its primary asset and that the value was also consequential as a percentage of the secured claim. The Court rejected the notion that "inconsequential value" should have a different meaning under subchapter V than under an ordinary chapter 11 case. Note, however, that here Secured Creditor made its 1111(b) election months after the plan was filed. Under ordinary chapter 11, pursuant to Rule 3017, the election must be made prior to the *hearing* on the disclosure statement (or a date fixed by the court). There is no disclosure statement under subchapter V so it would seem that the earlier date could be the *hearing* on the plan. Debtor argued that the election should have been made before the plan was filed, and before any treatment of the secured claim could have been known to the creditor. The Court rejected that argument as making "no sense." The Court also was not asked to set an 1111 election deadline. Accordingly, because the 1111(b) election in this case was made before any action to solicit votes or other substantive steps were taken in contemplation of confirmation, the election was deemed to be timely. Secured creditors would be well-advised to make their 1111 election, if ever, promptly after the plan is filed. The Court concluded its opinion without a discussion of the plan treatment and whether it could be confirmed notwithstanding the 1111(b) election; however, the Court urged the parties to "try to work out their differences."

Topping Off the Secured Claim. *In re Topp's Mech., Inc.*, No. 21-40038, ECF No. 181 (Bankr. D. Ne. May 27, 2022). In this third installment of subchapter V section 1111(b) cases, the Court confronted a plan pursuant to which the Secured Creditor made its 1111(b) election and asserted a secured claim of roughly $3,750,000, secured by collateral having a value of approximately $2,100,000. With respect to the unsecured claim balance (having opted out of general treatment for unsecured claims), Debtor proposed to pay approximately $1,650,000 over a 40-year amortization schedule, interest at 5.25%, and a balloon payment after 5 years. The subchapter V trustee objected on the basis that the plan treatment would give Secured Creditor more than it was entitled to under section 1129(b)(2) and, therefore, to the detriment of other unsecured creditors who would not be treated fairly and equitably under the plan. After analysis of other chapter 11 cases involving section 1111(b) elections, the Court sided with the majority rule that the electing creditor was only entitled to one stream of payments having an aggregate face amount equal to the allowed amount of the claim, and a present value of such payment stream equal to the present value of the secured claim. Accordingly, the plan was too generous to Secured Creditor.

All or Nothing Leasehold Estate. *In re HBL SNF, LLC*, No. 21-22623, 2022 WL 1612221 (Bankr. S.D.N.Y. May 20, 2022). Debtors commenced the case as operators of a nursing home facility, even though the landlord of the facility alleged that their primary lease had been terminated pre-petition. The lease also granted the landlord a security interest in personal property, but the landlord failed to file a UCC-1 Financing Statement. The landlord's construction lender, however, separately entered into a security agreement with the Debtors and filed a UCC-1 Financing Statement (but Debtors denied there being any indebtedness owed by Debtors under such security agreement). The landlord separately defaulted under, and has been engaged in litigation regarding, its financing with its lender. The Court subsequently approved a priming DIP loan for $4.0MM on all property of the estate (without determining whether the leasehold interest remained property of the estate), but did require adequate protection payments (in the form of rent) to be made to the lender to the landlord. During the case, the landlord's lender exercised its remedies to seek a state law receivership and foreclosure, while agreeing to permit Debtors to continue to operate the premises. The Court subsequently ruled that the lease had in fact been terminated pre-petition. It seems that the landlord's lender probably would prefer Debtors to continue to operate their facility on the premises. On the other hand, the landlord is presently seeking relief from the automatic stay in order to evict Debtors, and it remains to be seen how the DIP Loan will be repaid and how the lender to the landlord intends to handle the relationship with Debtors, as operators, under a terminated lease.

Real Estate Speculator. *In re McGrath*, No. 20-03689, 2021 WL 2405722 (Bankr. M.D. Fla. June 10, 2021). Debtors filed on December 31, 2020. Secured Creditor held a commercial mortgage secured by Pennsylvania commercial leases generating $27,000 per month. Pre-filing, Secured Creditor enforced its rights to collect rents in state court. Debtors initially sought to use rents collected post-petition as collateral but subsequently stipulated that the rents were not property of the estate under state law by reason of the assignment of rents pre-filing. For why that stipulation may have been strategic, read on. Because of the agreed upon stipulation and no rights to use the post-petition rents, the Court concluded that Debtors were not generating substantially all of their income by operating single asset real estate and, therefore, were eligible for subchapter V. The Court held a valuation hearing and found the value of the real estate to be $3MM, leaving Secured Creditor under-water. Due to not being a SARE (loss of use of rents), Debtors wanted to "spin out" under the plan and recapture the right to use the rents. "Debtors simply wish to hold the Bank at bay, spend the rents now owned by the Bank, and speculate (without any cost to them) that the Commercial Property may someday increase in value." Case was dismissed.

Smart Use of Subchapter V. *In re VTES, Inc.*, No. 20-12941, ECF No. 126 (Bankr. S.D.N.Y. Feb. 24, 2020). Debtors, in the business of "smart traffic" technology for cars, filed and were eligible for relief under subchapter V because $5MM of GM debt was excluded due to GM controlling 22% of the equity in the ultimate parent Debtor. DIP financing was provided by a potential purchaser, on a junior basis to Secured Creditor. Debtors filed their petitions on December 28, 2020 and filed their initial plan days later on December 31, 2020. The Court entered the Final DIP Order on February 7, 2021 and confirmed the plan on February 24, 2021. The plan provided for the sale of substantially all assets and contained a standard section 363-type "free and clear" order language incorporated into the plan. DIP claims were satisfied by credit bid; and the pre-petition secured claim was to be paid in full from the sale, leaving cash for proposed dividend to unsecured creditors of around $0.10. The Court authorized Debtors to be dissolved upon consummation of plan/distribution of sale proceeds. Assuming an adequate marketing period under the circumstances (beginning third quarter of 2020), not having a creditors' committee probably created value for the distribution that otherwise would have been eroded with professional fees. Would this case have been as quickly confirmed without a distribution to holders of unsecured claims?

Pining for Higher Value. *In re Twin Pines LLC*, No. 19-10295, 2021 WL 312674 (Bankr. D. N.M. Jan. 29, 2021). Debtor initially filed chapter 11 in February 2019 but amended its petition a year later to elect treatment under subchapter V. The Court overruled Secured Creditor's objection to the subchapter election and also denied Secured Creditor's request to dismiss the case. Debtor filed its subchapter V plan in June 2020. During the chapter 11 and subchapter V, the Court authorized the use of cash collateral multiple times, while also ordering adequate protection payments to Secured Creditor of $2,000 per month initially and later $2,500 per month. The Court also granted Secured Creditor a replacement lien on post-petition "net rents." Debtor operated a cash wash, but during the pendency of the case, the car wash equipment reached the end of its useful life and needed replacement; and Debtor obtained replacement equipment. Debtor also owned condominium units adjacent to the car wash. Secured Creditor filed a proof of claim for roughly $1,100,000 and asserted the value of its collateral to be roughly $1,365,000. Debtor initially scheduled the value of the collateral to be $1,265,000, but later amended its schedules to assert a value of $650,000. Debtor then filed a motion for valuation of two parcels of real property. The motion did not align with the collateral securing the claim, so the Court did Debtor a favor and deemed the motion amended to incorporate other personal property securing the claim. The Court held valuation hearings in October and November, 2020.

The Court admitted competing appraisals into evidence, over the objection of each other party. The Court evaluated different methodologies for valuation of income approach, replacement cost approach, and sale comparison approaches. As is typical with dueling appraisals, there were significant areas of disagreement and the Court discounted aspects of each appraisal and, after considering all of the evidence as a whole, determined the collateral to be worth $900,000, excluding the post-petition equipment. The Court acknowledged that Secured Creditor had a replacement lien as adequate protection in the post-petition equipment, but the Court did not attempt to determine the extent, if any, to which Secured Creditor suffered diminution. The Court also referenced post-petition income streams, but it does not appear that Secured Creditor made any claim to increase the value of its secured claim by the amounts of the "net rents."

Seeing the Light. *In re Moore & Moore Trucking, LLC*, No. 20-10925, ECF No. 232 (Bankr. E.D. La. Jan. 12, 2022). As expressly provided by the Code, subchapter V section 1191(c)(1) incorporates the existing rules for cram-down under section 1129(b)(2)(A). Debtor was in the business of repairing large-scale solar panel arrays. Two other classes of secured creditors accepted the plan treatment to be paid 100% of their claims with interest at 5% over 10 years. Under the proposed plan, a third Secured Creditor held a mortgage claim of approximately $220,000 (valued at $200,000). Debtor provided monthly payments of principal and interest of approximately $1,500 per month (at the contract rate of 5% on a twenty year amortization schedule) for ***ten years***, with a balloon payment at the end of ten years of $48,000, together with other earlier payments from the sale of unencumbered assets. Secured Creditor first argued that the plan was not fair and equitable because Debtor was "solvent" and, therefore, should not be permitted to extend the original maturity date. The Court swiftly overruled that objection and moved to "fair and equitable" analysis. However, here, the Court did not offer much analysis. The Court determined 5% to be appropriate based on the contract rate of 5% and by taking judicial notice of the bank prime rate of 3.25% as published by the Federal Reserve. The Court offered no finding as to why ten years was a fair and equitable term, other than a general observation that Debtor also offered any residual disposable income for three years and proceeds from the sale of unencumbered collateral. Further, in order to meet the "appropriate remedies" of section 1191(c)(3) if Debtor did not meet the plan payments, the plan offered expedited rights to move for relief from the stay if any default is not cured within 30 days. Based on that "avenue to foreclose," the Court found section 1191(c)(3) to be satisfied.