POSTCONFIRMATION ISSUES IN SUBCHAPTER V

Judge Mary Jo Heston
United States Bankruptcy Court, Western District of Washington

I. POSTCONFIRMATION PROPERTY OF THE ESTATE

Subchapter V replaces § 1115 with § 1186.[1] Section 1186(a) uses substantially the same language as § 1115, and §§ 1206 and 1307, which § 1115 is based upon.[2] These sections effectively state that property of the estate includes (1) postpetition § 541 property and (2) postpetition earnings of the debtor. However, § 1186(a) differs significantly from the other provisions in two aspects. First, § 1186(a) only applies if the plan is confirmed under § 1191(b), the cramdown provision.[3] Second, § 1186(a) applies to entities and individuals alike, which differs from § 1115 but closely mirrors the language in § 1207.[4]

Section 1115(a) does not apply to an entity, so its inapplicability in a subchapter V case does not affect the property of the estate. In other words, property of the estate is only governed by § 541 unless a plan is confirmed under § 1191(b), which triggers § 1186(a).

a. Property of the estate for plans confirmed under § 1191(a).

Consensual plans under § 1191(a) result in all property of the estate vesting in the debtor unless the plan or the order of confirmation provides otherwise.[5] The same rule governs cases under chapters 12 and 13.[6] Of course, this means that upon confirmation of a plan under § 1191(a), the automatic stay terminates unless the plan or order confirming the plan preserves the estate and provides for the vesting of the property of the estate under § 1141(b) at some later time.[7] This appears to be an uncontested reading of the provisions. I found nothing in the caselaw in any circuit suggesting otherwise.

b. Property of the estate for plans confirmed under § 1191(b).

Confirmation of a plan under § 1191(b), a cramdown plan, triggers the application of § 1186(a), regardless of whether the debtor is an entity or an individual.[8] Section 1186(a) provides that property of the estate consists of property of the estate under § 541 and

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[1] § 1181(a).
[2] *See generally* § 1115(a); § 1207(a); 11 U.S.C. § 1306(a).
[3] §§ 1186(a)(1), (2).
[4] § 1115(a) (applies "[i]n a case in which the debtor is an individual . . ."); *See* § 1207.
[5] § 1141(b) ("Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor."); In re Abri Health Servs., LLC, No. 21-30700 (SGJ), 2021 WL 5095489, at *10 (Bankr. N.D. Tex. Oct. 26, 2021); *In re Associated Fixture Mfg., Inc.*, No. BR 22-23317, 2023 WL 1931301, at *3 (Bankr. D. Utah Feb. 10, 2023).
[6] *See* §§ 1227; 1327(Same exact language as § 1141(b).)
[7] § 362(c)(1) ("[t]he stay of an act against property of the estate under [§ 362(a)] continues until such property is no longer property of the estate.")
[8] § 1186(a) (Applies only "[i]f a plan is confirmed under section 1191(b).").

postpetition § 541 property and earnings "before the case is closed, dismissed, or converted to another chapter."[9]

1. What remains property of the estate postconfirmation of a cramdown plan?

In a cramdown plan, § 1186 provides that property of the estate consists of property of the estate under § 541 (which covers all the debtor's property at the time of confirmation, as earlier text explains) and any postpetition assets and earnings.[10] However, § 1186(a) directly conflicts with the vesting provisions of § 1141(b), which the SBRA does not amend or abrogate with another provision.[11] Thus, it creates an open question as concerning the bankruptcy estate. The caselaw and secondary sources suggests several different possible outcomes.

1. All property, including property of the estate under § 1186(a), revests in the debtor under 1141(b), absent language in the plan or confirmation order stating otherwise.[12]

2. When § 1186(a) is triggered by § 1191(b), the bankruptcy estate is preserved with postpetition property and earnings for administration throughout the plan commitment period.[13]

3. All property revests in the debtor "except property required to perform obligations under the Plan."[14]

This appears to be an open dispute, with cases and secondary sources arriving at incompatible results.[15]

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[9] §§ 1186(a)(1), (2).
[10] § 1186(a).
[11] § 1141(b).
[12] *In re ActiTech, L.P.*, 2022 WL 6271936 (Bankr. N.D. Tex. 2022) (Court confirmed the plan under § 1191(b) because all impaired classes did not accept it, and the confirmation order provided for (1) the revesting of property in the reorganized debtor; and (2) termination of the trustee's services as of the effective date of the plan, which occurred upon entry of a final confirmation order.
[13] Paul W. Bonapfel, A Guide to the Small Business Reorganization Act of 2019, 93 AM. BANKR. L.J. at 255-257 (2019) (22AD).
[14] *In re Bronson*, 2022 WL 3637566, at *2 (Bankr. D. Or. Aug. 23, 2022) (Plan provided that all property, except property required to perform obligations under the Plan, would revest in the Reorganized Debtor.) (The time from case filing to plan confirmation or other ultimate disposition of the case usually takes months, at best, and many times will take longer. During this interim period, neither the court nor interested parties know whether a subchapter V debtor's assets acquired post-petition and post-petition earnings are going to be property of the estate or not. Interested parties should be able to know with clarity, at any given time, whether an asset or specific earnings are property of the estate or not. Thus, in this court's view, the better rule is that subchapter V debtor's assets acquired post-petition and post-petition earnings should not be treated as property of the estate unless and until the debtor confirms a plan under 1191(b).)
[15] Bonapfel, supra note 13, at 242-247.; Jonathan M. Seymour, The Limited Lifespan of the Bankruptcy Estate: Managing Consumer and Small Business Reorganizations, 37 Emory Bankr. Dev. J. 1, 1 (2020) (Advocating for estate termination theory for subchapter V reorganization).

2. What happens to the Automatic Stay after confirming a cramdown plan?

The status of the bankruptcy estate would determine whether the stay remains in place and in what capacity.[16] If § 1186(a) creates or preserves the estate, then that means the automatic stay does not terminate at confirmation under § 362(c)(1) because all property of the debtor and all its earnings remain property of the estate.[17] The ramifications of this are whether the debtor must seek approval for sale of property outside the ordinary course of business or a compromise of a dispute.

II. POSTCONFIRMATION MODIFICATION

a. Modifications of a consensually confirmed plan under § 1193(b).

Section 1193(b) contemplates how the debtor may modify a consensually confirmed plan. The provision states:

> 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, with the exception of subsection (a)(8) of such section 1123. 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.[18]

In other words, the debtor may modify post-confirmation, but only (1) before substantial consummation occurs, (2) the plan is confirmable, and (3) the circumstances warrant postconfirmation modification. Notice and hearing to confirm the modified plan under § 1191(a) is required.

1. Substantial Consummation

Section 1193(b) does not permit modification of a plan after consensual confirmation under § 1191(a) once "substantial consummation" has occurred. In *In re National Tractor Parts, Inc.*, the debtor and the U.S. Trustee disagreed about whether the Plan has been "substantially consummated."[19] The definition of "substantial consummation" is found in § 1101(2):

> (2) "substantial consummation" means--

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[16] § 362(c)(1).
[17] Bonapfel, *supra* note 13, at 255-257.
[18] § 1193(b).
[19] 640 B.R. 916, 919–20 (Bankr. N.D. Ill. 2022).

> (A) transfer of all or substantially all of the property proposed by the plan to be transferred;
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> (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; **and**
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> (C) commencement of distribution under the plan.[20]

Section 1101(2)(C) of the Code states that a plan is substantially consummated[21] when commencement of distribution under the plan has occurred or when distribution under the plan has begun. The plain language of this Code section does not require commencement of distribution to every creditor, every class, or even substantially all creditors or classes. **It simply means that the process contemplated in the confirmed plan is underway.**[22]

2. Permitting modification throughout the entire Commitment Period

All impaired classes accepted the plan in *In re North Richland Hills Alamo, LLC*.[23] The debtor received a discharge upon the plan's effective date because the plan was confirmed under § 1191(a).[24] However, the confirmation order permitted post-confirmation modification at any time within the "Commitment Period."[25] In this case, the plan seems to conflict with § 1193(b), which limits when a debtor may modify postconfirmation.

b. Modifications of a cramdown plan under § 1193(c).

Section 1193(c) contemplates how the debtor may modify a cramdown plan. Postconfirmation modification of a cramdown plan differs from a consensual plan significantly. The provision states:

> 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.[26]

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[20] § 1101(2)
[21] Assuming the other two requirements are met.
[22] 640 B.R. 916, 921 (Bankr. N.D. Ill. 2022).
[23] 2022 WL 2975121, at *8 (Bankr. N.D. Tex. 2022)
[24] *Id*. at 13.
[25] *Id*. at 13.
[26] § 1193(c).

In other words, substantial consummation does not matter. The debtor may modify the plan anytime within the commitment period, so long as (1) the plan is still confirmable under § 1191(b) and (2) circumstances warrant such modification.

1. "Only if Circumstances Warrant Such Modification" is informed by § 1127(b)

In *In re Samurai Martial Sports, Inc.*, the court, lacking any Fifth Circuit precedent discussing § 1193(c), looked to § 1127(b) for guidance on the phrase "only if circumstances warrant such modification."[27] The Court, starting with Collier's on § 1127(b), stated that such circumstances warranting modification may include "unforeseen circumstances [that] render the confirmed plan unworkable..." However, for circumstances to be unforeseen, they cannot be the result of any unjustifiable or culpable acts or omissions from the debtor.[28] In other words, a debtor's good faith and business judgment are relevant when considering if circumstances are unforeseeable. For circumstances to render the confirmed plan unworkable, there must be a material change in circumstances that prevents the debtor from adhering to the terms of the original plan.[29]

The Court held that to modify a plan under § 1193(c), the modified plan must (1) be warranted under the circumstances and that in assessing whether modification is warranted under § 1193(c), the debtor must show that the circumstances which gave rise to the modification were the result of an unforeseen circumstance that rendered the confirmed plan to be unworkable. Determination of unforeseen circumstances that render a plan unworkable, like in § 1127(b), is an issue of fact that the court must determine.[30] A debtor's good faith and business judgment are relevant facts to consider.[31]

III. POSTCONFIRMATION CONVERSION

Another issue not addressed in the caselaw in detail is the consequence of postpetition assets and earnings to the estate under 1186(a) in a nonconsensual case that converts to chapter 7. If conversion occurs after confirmation under § 1191(b), postconfirmation property and earnings may be property of the chapter 7 estate.[32] Conversely, confirmation of a consensual plan does not trigger § 1186(a), so such property may not be property of the estate because neither § 1115(a) nor §1186 apply.[33]

Traditional chapter 11 cases pre-subchapter V suggest that property of the estate vests back into the debtor, even when § 1115 applies.[34] However, courts disagree specifically on

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[27] 644 B.R. 667, 680 (Bankr. S.D. Tex. 2022).
[28] *Id.*
[29] *Id.*
[30] *Id.* at 681.
[31] *Id.*
[32] *See* § 1186(a)
[33] § 1186(a); See also Bonapfel, *supra* note 13, at 255-257; *but see* Seymour, Supra note 15 at 21-22.
[34] *Bell v. Bell* (*In re Bell*), 225 F.3d 203, 216 (2d Cir. 2000); *National City Bank v. Troutman Enterprises, Inc.* (*In re Troutman Enterprises, Inc.*), 253 B.R. 8, 13 (B.A.P. 6th Cir. 2002) ("Property which revested in a reorganized debtor at confirmation remains property of that entity; conversion does not bring that property into the converted case."); *Lacy v. Stinky Love, Inc.* (*In re Lacy*), 304 B.R. 439, 444-46 (D. Col. 2004); *In re Freeman*, 527 B.R. 780 (Bankr. N.D. Ga. 2015) (In chapter 11

what property the debtor owns at conversion.[35] The statutory text shows that consensual plans follow the same rules as traditional chapter 11 cases. However, it is entirely unclear what rule subchapter V cases should follow in cramdown cases.

One case that suggests the possible implications of the effects of § 1186 after converting a nonconsensual plan is *In re Akamai Physics, Inc.*[36] In that case, the court stated that property of the estate that vests in the debtor under a consensual plan in a subchapter V case confirmed under § 1191(a) is not property of the chapter 7 estate upon postconfirmation conversion.[37] However, considering the negation principles underlying chapters 12, 13, and individual chapter 11 cases, the court suggested that conversion after cramdown confirmation under § 1191(b) negates the binding effect of the plan because discharge does not occur until the completion of the plan payments.[38] Therefore, if the plan is no longer binding on the creditors, and since there has been no discharge, creditors would have both their prepetition rights and rights under the confirmed plans after conversion.[39]

To avoid these potential issues and to ensure that the estate has property at the time of conversion, creditors negotiating a consensual plan should insist on a provision in the plan that will keep assets as property of the estate until the debtor completes payments or meets some other milestone.[40]

IV. SUBCHAPTER V TRUSTEE

a. Payments under a cramdown plan under § 1194(c).

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case of individual, holding that preconfirmation assets vested in debtor but income earned postconfirmation and prior to conversion did not.); *In re L & T Machining, Inc.*, 2013 WL 3368984 (Bankr. D. Kan. July 3, 2013); *In re Sundale, Ltd.*, 471 B.R. 300 (Bankr. S.D. Fla. 2012); *In re Canal Street Limited Partnership*, 260 B.R. 460, 462 (Bankr. D. Minn. 2001); *In re K & M Printing, Inc.*, 210 B.R. 583 (Bankr. D. Ariz 1997); *Carter v. Peoples Bank and Trust Co.* (*In re BNW, Inc.*), 201 B.R. 838, 848-49 (Bankr. S.D. Ala. 1996); *In re T.S. Note Co.*, 140 B.R. 812, 813-14 (Bankr. D. Kan. 1992) (The court granted a motion to convert but noted that property of the chapter 7 estate would consist only of non-administered assets remaining in the preconfirmation estate, such as possible causes of action. "[W]hat is being converted . . . are the cases and the assets, if any, whether tangible or intangible, remaining in the debtor's pre-confirmation estate.); *In re TSP Indus., Inc.*, 117 B.R. 375 (Bankr. N.D. Ill. 1990). 6 NORTON BANKRUPTCY LAW AND PRACTICE § 114:13 (Different approaches to revesting of assets upon conversion after confirmation).

[35] *Smith v. Lee* (*In re Smith*), 201 B.R. 267 (D. Nev. 1996), aff'd 141 F.3d 1179 (9th Cir. 1998); *Carey v. Flintridge Lumber Sales, Incl* (*In re RJW Lumber Co.*), 262 B.R. 91 (Bankr. N.D. Ca. 2001); *In re Midway, Inc.*, 166 B.R. 585, 590 (Bankr. D.N.J. 1994).

[36] 2022 WL 1195631 (Bankr. D. N.M. 2022).

[37] Id. at *5 ("If a typical chapter 11 case is converted after plan confirmation, the resulting chapter 7 estate has no assets because the plan vested all estate property in the reorganized debtor.")

[38] Id. at *6 ("There is no case law deciding whether subchapter V "cramdown" plans would survive dismissal or conversion. Nevertheless, because of the similarities to Disposable Income Plans (primarily the delayed discharge;10 retention of the trustee;11 inability to close the case until all plan payments have been made;12 and the disposable income cramdown13), the Court suspects that dismissal or conversion would negate such plans.").

[39] Id.

[40] Bonapfel, *supra* note 13, at 257.

Generally speaking, under a consensual plan, the debtor makes plan payments. Any funds "received by the trustee shall be retained by the trustee until confirmation or denial of confirmation of a plan."[41] Upon confirmation, "the trustee shall distribute any such payment in accordance with the plan."[42] "-If a plan is confirmed under section 1191(b) of this title, except as otherwise provided in the plan or the order confirming the plan, the trustee shall make payments to creditors under the plan."[43]

Some courts permit the debtor to make plan payments after cramdown confirmation under § 1191(b). In *In re Creason,* the court permitted the debtor to serve as the disbursing agent after cramdown confirmation.[44] The court permitted the debtor to be the disbursing agent because of the non-acceptance of a non-participating creditor with control of the entire class, effectively forced a cramdown on the debtor.[45] However, given that all other creditors had accepted the plan, and the trustee suggested that cause existed to permit the debtor to disburse plan payments, notwithstanding confirmation of the plan under § 1191(b), the court agreed to deviation to mitigate but not eliminate the hardships associated with cramdown.[46]

V. POSTCONFIRMATION CASE MANAGEMENT

a. Postconfirmation Management issues under § 1129(a)(5)

The confirmation requirement in § 1129(a)(5) requires the plan to disclose the identities of directors and officers and that their appointment to, or continuance in, the office is "consistent with the interests of creditors and equity security holders and with public policy."[47] Issues about adequate disclosure have arisen in the Subchapter V context. In *In re Channel Clarity Holdings, LLC*, the court noted its concern about the lack of a "defined management structure" for the debtor that involved someone other than the principal, the majority shareholder.[48] The debtor's management structure lacked someone "who [could] hold him accountable" given the principal's conduct in securing preferred member majority status, his conflicts of interest as the principal of affiliates doing business with the debtor, several high-level vacancies, and the fact that the debtor might not have anyone in charge of accounting functions.[49]

The court concluded that the debtor continuing its operation with only the principal in charge was inconsistent with the interests of creditors, equity security holders, and public

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[41] § 1194(a).
[42] § 1194(a).
[43] § 1194(b).
[44] *In re Creason,* 2023 WL 2190623 (Bankr. W.D. Mich. Feb. 23, 2023)
[45] *Id*. at *1 (Debtor placed the creditor in its own class and the creditor did not return its ballot, so the class did not formally accept the plan).
[46] *Id*. at fn3.
[47] § 1129(a)(5).
[48] 2022 WL 3710602, at * 11-12 (Bankr. N.D. Ill. 2022)
[49] *Id*. at *12 (The court noted that the trustee had made proposals for management that involved appointment of a plan administrator with authority ranging from full control over all debtor bank accounts and sole signing authority to no signing authority but responsibility for making disbursements.)

policy.[50] However, the court espoused that to satisfy section 1129(a)(5), any amended plan must specifically address a debtor's management structure, including but not limited to a principal's potentially conflicting roles and the provision of accounting services and financial controls.

b. Material Defaults of a confirmed plan postconfirmation

In *In re Ace Holding, LLC*, the debtor's plan provided for payments to be made electronically and received by a date specific date to a specific creditor.[51] The debtor missed the first plan payment, and the creditor declared a default, which the debtor attempted to cure with a check.[52] The trustee and the debtor filed a motion requesting the court to compel the creditor to accept the payment.[53] The creditor stated it would agree to accept the payment if it received prompt payment of its attorney's fees.[54] The debtor argued that attorney's fees were improper because the default was not material.[55]

The court determined that the default was material and awarded attorney's fees.[56] The court reasoned that the debtor's prior defaulted payment agreements, ongoing state court litigation, and multiple bankruptcy filings should have made the debtor "ready, willing, and able" to commence both plan payments and maintain the ongoing monthly fees to this Creditor.[57] Also, the terms of this particular payment resulted from extensive negotiations between the debtor and the creditor.[58] Thus, any default based upon a late payment or a payment not appropriately made was material.[59]

c. Postconfirmation Status Conferences[60]

In the Eleventh Circuit, post-confirmation status conferences are regular. The purpose is to check in with the debtor as frequently as the situation suggests. Courts look for early signs of plan default and other issues about the case, such as claims objections. Furthermore, in cramdown cases, courts use this opportunity to convene with the trustee to discuss possible remedies. As noted already, post-confirmation status conferences are held on an as-needed basis. In some instances, after the first post-confirmation status conference, the next check-in might not be warranted for another year.

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[50] *Id*. (The Court encouraged the debtor to explore all possible proposals with the objecting parties and the trustee in hopes of identifying an acceptable solution to allay concerns.)
[51] 2023 WL 4412184 (Bankr. N.D.N.Y. July 7, 2023).
[52] *Id*. at *2.
[53] *Id*.
[54] *Id*. at *3 ("However, the HOA indicates it would be willing to enter into a conditional order provided it includes prompt payment of $9,243.759 in attorney's fees plus $188.00 in expense reimbursement as consideration for the agreed order.")
[55] *Id*.
[56] *Id*. at *5.
[57] *Id*.
[58] *Id*.
[59] *Id*.
[60] Email from Judge Burgess (I found no specific case).