Recent Issues in Subchapter V Cases
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Pre-Confirmation Escrow of Funds for Trustee Compensation

Payment of trustee fees in Subchapter V cases is typically provided for by the confirmed plan. However, the SBRA does not address compensation for a non-standing trustee when confirmation is unsuccessful. Judge Bonapfel has discussed three potential solutions to this issue: (1) predicating dismissal orders on the payment of Trustee compensation; (2) including Trustee compensation in the Debtor's budgeting scheme, such as in a cash collateral order; or (3) requiring payments to be held in an escrow account for payment of professional fees. *See* Jerry C. Oldshue, Jr., "*A Dynamic Duo: Consensual Confirmation and Trustee Compensation*," at 12 (2023) (citing Paul W. Bonapfel, "*A Guide to the Small Business Reorganization Act of 2019*," 93 Am. Bankr. L.J. 571 (2020)).

Many courts within the Eleventh Circuit that have addressed this issue have chosen the third option. For a list of various practices throughout the Eleventh Circuit, please see the attached chart from Judge Oldshue's 2023 Bankruptcy at the Beach materials. *Id.* at 13-14.

Additionally, in a recent case decided by the United State Bankruptcy Court for the District of Oregon, the Subchapter V Trustee succeeded in proactively filing a motion seeking a court order requiring the debtor to post a retainer for fees and expenses. *In re Roe*, No. 23-32077-THP11, 2024 WL 206678 (Bankr. D. Or. Jan. 18, 2024). The court held that "a subchapter V trustee may use the trustee's rights and powers under the Bankruptcy Code to the extent it is necessary for a subchapter V trustee to fulfill the statutory duties given to subchapter V trustees in section 1183." *Id.* at 2. Thus, upon a showing of a valid business justification and good faith, a Subchapter V trustee may use property of the debtor's estate outside the ordinary course of business to perform its statutory duties. The trustee's ability to do so is concurrent with a chapter 11 debtor's ability to do the same to fulfill its duties as a debtor in possession. *Id.* The court concluded, however, that the trustee's right to payment is "pro rata with the other administrative expense claimants." *Id.* at 3. "[The] funds should be placed in a trust account to be used to pay administrative

[1] These materials were prepared with the assistance of Kiernan Panish, Term Law Clerk to the Honorable D. Sims Crawford.

expenses, and not in the form of a retainer in which only the Subchapter V trustee would have a property interest." *Id.*

Key Differences Between Consensual and Nonconsensual Cramdown Plans

Application of § 523(a) Exceptions to Discharge of Cramdown Plans

Several bankruptcy courts have concluded that the § 523(a) exceptions to discharge do not apply to the discharge of a corporate debtor after nonconsensual cramdown confirmation under § 1191(b). The Fourth and Fifth Circuits, however, have concluded that the exceptions are applicable. *In re Cleary Packaging, LLC*, 36 F.4th 509 (4th Cir. 2022); *Matter of GFS Indus., L.L.C.*, No. 23-50237, 2024 WL 1644229 (5th Cir. Apr. 17, 2024). The Eleventh Circuit has accepted a direct appeal on the issue. *In re 2 Monkey Trading, LLC*, No. 6:22-BK-04099-TPG, 2023 WL 3947494 (Bankr. M.D. Fla. June 12, 2023).

- *In re Cleary Packaging, LLC*
    - The Fourth Circuit held that the discharge exceptions in Subchapter V of Chapter 11 apply to both individual and corporate debtors, reversing the bankruptcy court's decision and overruling a decision by another bankruptcy court in its jurisdiction.
    - Creditor filed adversary complaint against corporate debtor proceeding under Subchapter V, seeking declaration that $4.7 million debt arising from its state-court judgment for intentional interference with contracts and tortious interference with business relations was nondischargeable as a debt for "willful and malicious injury." Debtor filed a motion to dismiss, which the United States Bankruptcy Court for the District of Maryland granted, reasoning that the debt was dischargeable as the exceptions to dischargeability under § 523(a) applied only to individual debtors. The Fourth Circuit reversed and remanded.
    - The Fourth Circuit found that § 1192(2)'s reference to debts *of the kind* specified in § 523(a) "indicates that Congress intended to reference only the *list of non-dischargeable debts* found in § 523(a)" and not the type of debtors to which the discharge exceptions apply. *In re Cleary Packaging*, 36 F.4th at 515.
- *Matter of GFS Industries, L.L.C.*
    - The Fifth Circuit held that in Subchapter V proceedings, both corporate and individual debtors are subject to the list of discharge exceptions set forth in § 523(a).
    - "A Subchapter V 'debtor' means 'a person engaged in commercial or business activities' with debts not exceeding $7.5 million. § 1182(1)(A). '[P]erson' is in turn defined to include both individuals and corporations…Next, § 1192 excepts from discharge 'any *debt ... of the kind* specified in section 523(a).' 11 U.S.C. § 1192(2) (emphasis added)…Section 523(a) enumerates 21 categories or 'kinds' of non-dischargeable debts. *See* § 523(a)(1)-(20) (including (14), (14A), and (14B)). So, the most natural reading of § 1192(2) is that it subjects both corporate and individual Subchapter V debtors to the categories of debt discharge exceptions listed in § 523(a)." *Matter of GFS Indus., L.L.C.*, 2024 WL 1644229, at *3.
    - "Other Code provisions explicitly limit discharges to 'individual' debtors. Even traditional Chapter 11 proceedings distinguish discharges for individual and

corporate debtors…By contrast, § 1192 provides dischargeability simply for 'the debtor,' which…[encompasses] both individual and corporate debtors." *Id.* at *4-5.

- *In re 2 Monkey Trading, LLC*
    - The United States Bankruptcy Court for the Middle District of Florida granted the defendant's motion to dismiss, concluding that the plaintiff could not maintain an action for denial of discharge under § 523(a)(6) against the debtor defendants, who were proceeding under Subchapter V, because they are limited liability corporations, not "individuals."

Recent cases within the Eleventh Circuit

- *In re Hall*
    - Creditor filed adversary complaint seeking determination that debts owed by debtor defendants were excepted from discharge. The court granted the defendants' motion to dismiss, holding that the exceptions to discharge set forth in Chapter 5 of the Bankruptcy Code do not apply to corporate Chapter 11 Subchapter V debtors.
    - "The Court reaches this conclusion primarily because the SBRA amended the language of § 523(a) to add a reference to § 1192. If Congress intended for § 523(a) exceptions to apply to corporations receiving a discharge under § 1192, then this addition was unnecessary. The theory advanced by [the debtor] and the Fourth Circuit would render that addition superfluous and violate a canon of statutory construction…Most bankruptcy courts deciding this issue have relied upon this canon when reaching their decisions." *In re Hall*, 651 B.R. 62, 68 (Bankr. M.D. Fla. 2023).
    - In *In re 2 Monkey Trading, LLC* the United States Bankruptcy Court for the Middle District of Florida rejected plaintiff's argument, which relied on the Fourth Circuit's ruling in *In re Cleary Packaging, LLC* and instead followed *In re Hall*. *In re 2 Monkey Trading,* 2023 WL 3947494, at *2.
- *In re Ra Custom Design*
    - The United States Bankruptcy Court for the Northern District of Georgia held that exceptions to discharge under § 523(a) do not apply to corporate debtors proceeding under Subchapter V.
    - "This Court agrees with fellow bankruptcy courts and the Ninth Circuit Bankruptcy Appellate Panel that § 1192 does not make § 523(a) exceptions to discharge applicable to corporate entities. While the Court appreciates the Fourth Circuit's analysis of the plain language of § 1192, the Court agrees with [Judge Paul W. Bonapfel] that the 4th Circuit's conclusion does not necessarily follow from the language of § 1192. Moreover, the Court does not read § 1192(2)'s reference to § 523(a) to eliminate the restriction inherent in § 523(a) that it only applies to individuals." *In Re Ra Custom Design, Inc. v. Ra Custom Design, Inc.*, No. 23-58494-SMS, 2024 WL 607716, at *2 (Bankr. N.D. Ga. Feb. 13, 2024).

Please refer to Judge Wilson's 2023 Bankruptcy at the Beach materials for further analysis of these cases. Jamie Wilson, "Subchapter V: Cramdown Discharges and Nonconsensual Plans," at 3-6 (2023).

Acceptance by all impaired classes under § 1129(a)(8)

A longstanding issue in Subchapter V cases is whether a creditor or class of creditors, by simply failing to act, can force the debtor to use the cramdown provisions of the Bankruptcy Code to obtain confirmation of a plan. This issue was originally addressed by the Tenth Circuit in *In re Ruti-Sweetwater, Inc.*, where the court held that creditors' inaction constituted acceptance of the debtor's plan. *In re Ruti-Sweetwater, Inc.*, 836 F.2d 1263 (10th Cir. 1988) ("To hold otherwise would be to endorse the proposition that a creditor may sit idly by, not participate in any manner in the formulation and adoption of a plan in reorganization and thereafter, subsequent to the adoption of the plan, raise a challenge to the plan for the first time.).

Within the Eleventh Circuit, there is a line of cases holding that a failure to vote on a plan cannot be deemed acceptance. *See In re Townco Realty, Inc.*, 81 B.R. 707, 708-09 (Bankr. S.D. Fla. 1987) (holding that "the failure to vote" does not "constitute[ ] acceptance of the plan."); *In re Higgins Slacks Co.*, 178 B.R. 853, 856 (Bankr. N.D. Ala. 1995) (same). The Northern District of Florida, however, has previously adopted the Tenth Circuit's conclusion in *In re Ruti-*Sweetwater. *See In re Campbell*, 89 B.R. 187, 188 (Bankr. N.D. Fla. 1988) ("A single creditor or class of creditors should not, by their total inaction, be able to force a debtor to have to resort to the cram down process to obtain confirmation of a plan when all of the other confirmation requirements, including the affirmative acceptance of the plan by at least one impaired class, have been met.").

Two recent cases from the Southern District of Texas have addressed this issue.

- *In re Franco's Paving LLC*
    - The Corpus Christi Division held that a creditor class in which no votes were cast on a proposed plan would not be considered in determining whether the plan could be confirmed as consensual.
    - "The Court finds the policy underlying *Ruti-Sweetwater* compelling. The Court does not, however, believe that it is limited to the binary choice between a 'deemed acceptance' and a 'deemed rejection.' Subchapter V is intended to encourage consensual plans confirmed under § 1191(a)… From a practical perspective, a creditor that agrees to a debtor's plan may express its consent by affirmatively voting for a plan or by simply choosing not to file an objection. The outcome should be no different, as the overarching policy of Subchapter V is satisfied. The Court finds that in making the change to § 1126 when enacting the Bankruptcy Code, Congress presumed the existence of at least one vote in each class. In a situation where no votes are cast, the Court holds that the class should not be counted for purposes of § 1129(a)(8). *In re Franco's Paving LLC*, 654 B.R. 107, 110 (Bankr. S.D. Tex. 2023).
- *In re Hot'z Power Wash*
    - The Houston Division held that non-voting, impaired creditor classes will not be counted for purposes of whether § 1129(a)(8) is satisfied.
    - "Courts have generally followed one of three approaches when presented with a plan in which there is a non-voting impaired creditor class: (a) a nonvoting class is deemed to have accepted the plan for purposes of § 1129(a)(8); (b) a nonvoting

class is deemed to have rejected the plan for purposes § 1129(a)(8); and (c) a nonvoting class is not counted for purposes of § 1129(a)(8). *In re Hot'z Power Wash, Inc.,* 655 B.R. 107, 115 (Bankr. S.D. Tex. 2023).

- "This Court concludes, similar to the court in *In re Franco's Paving LLC*, that…treating a nonvoting class as having implicitly accepted or rejected the plan is prohibited by the Code and applicable rules. Thus…this Court is left with only one option: when an impaired class of creditors fails to cast a ballot, that class will not be counted for purposes of whether § 1129(a)(8) is satisfied. *Id.* at 118.

Please refer to Judge Bonapfel's 2023 Subchapter V update for additional cases on this issue. Paul W. Bonapfel, "Subchapter V Update," at 24-25 (2023).

ELEVENTH CIRCUIT SUBCHAPTER TRUSTEE FEES SURVEY*

Alabama Northern	On BA's Motion will enter an order requiring that $1000 mth be budgeted and held in D's counsel's trust account, until compensation is awarded or denied.
Alabama Middle	The Court enters an order in Sub V cases requiring that within 30 days of the petition date and continuing monthly thereafter, Debtor shall remit to the Trustee interim compensation in the amount of **$1,000.00**. It is subject to adjustment by the Court on the request of any interested party and the Court's approval of the Trustee's fee application under 11 U.S.C. § 330. Also the Debtor shall include the Trustee's interim compensation in any proposed cash collateral budget.
Alabama Southern	The Court is contemplating implementation of a local administrative order providing for escrow of Subchapter V Trustee fees.
Florida Northern	The Court enters an Order in Sub V cases requiring that within thirty (30) days of the petition date and continuing monthly thereafter, Debtor shall remit to the Subchapter V Trustee interim compensation in the amount of **$525.00** to be held in trust until approved by the Court. It is subject to review by the Court pursuant to 11 U.S.C. § 330. Also, the Debtor shall include the Subchapter V Trustee's interim compensation in any proposed cash collateral budget.
Florida Middle	The Court enters an order in Sub V cases requiring that within 30 days of the petition date and continuing monthly thereafter, Debtor shall remit to the Trustee interim compensation in the amount of **$1,000.00**. It is subject to adjustment by the Court on the request of any interested party and the Court's approval of the Trustee's fee application under 11 U.S.C. § 330. Also the Debtor shall include the Trustee's interim compensation in any proposed cash collateral budget.
Florida Southern	Typically does not require an escrow of fees but has ordered it when debtor's counsel acknowledged that it would be helpful for budgeting purposes.

*This information is taken from Judge Oldshue's 2023 Bankruptcy at the Beach materials. Updated as of May 2024 and derived from survey responses of the courts listed.

ELEVENTH CIRCUIT SUBCHAPTER TRUSTEE FEES SURVEY*

Georgia Northern	Does not have a local rule or policy requiring a fixed monthly amount be escrowed to ultimately be applied towards Sub V Trustee fees
Georgia Middle	Has not addressed this issue yet.
Georgia Southern	Has not addressed this issue yet.

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