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## “You’re Killing Me, Smalls!”<sup>1</sup>

### *The Problem of the Nonparticipating Class in Subchapter V*



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Subchapter V of chapter 11 of the Bankruptcy Code was designed to “streamline the bankruptcy process by which small business debtors reorganize and rehabilitate their financial affairs.”<sup>2</sup> Thus, it varies from other chapter 11 cases in several key aspects, including its approach to consensual confirmation, whereby a subchapter V debtor can obtain a discharge on confirmation and avoid the ongoing expense associated with a three- to five-year delay in obtaining a discharge mandated by a cramdown confirmation.

Two recent opinions out of bankruptcy courts in the Eleventh Circuit highlight a major speed bump to the consensual plan confirmation — the nonparticipating class (often consisting entirely of a governmental creditor or a creditor with a small claim.<sup>3</sup> Although some courts have held that such nonparticipating classes should not be considered for confirmation purposes, other courts have recently held that the failure of an impaired class to vote in favor of the plan renders consensual confirmation impossible. This article explores the problem of the nonparticipating class with respect to an otherwise consensual subchapter V plan before concluding that a statutory fix is necessary and creative solutions should be explored in the interim to minimize the negative economic effects of cramdown confirmation.

### **The Statutory Sandlot: Sections 1191 and 1129(a)(8), and Bankruptcy Rule 3018(c)**

Section 1191(a) of the Bankruptcy Code permits consensual confirmation of a subchapter V plan “only if all of the requirements of section 1129(a) ... are met.”<sup>4</sup> Section 1129(a)(8) provides that a plan may be confirmed only if each class of claims or interests has “(A) such class has accepted the plan; or (B) such class is not impaired under the plan.”<sup>5</sup> Section 1191(b) contains subchapter V’s cramdown provision and permits confirmation if § 1129(a)(8)’s requirements have not been met, provided that the proposed plan is fair and equitable and does not discriminate unfairly with respect to the impaired nonaccepting classes.

Chief among the advantages of consensual confirmation is immediate discharge under § 1141(d)(1), as opposed to confirmation under § 1192, wherein discharge is available after three to five years of payments under the confirmed plan. From a cost perspective, consensual confirmation is much preferred, as discharge of the subchapter V trustee occurs after substantial consummation of a confirmed consensual plan, whereas the subchapter V trustee is charged with making plan distributions under a confirmed cramdown plan.<sup>6</sup>

“Acceptance” is not defined in the Code, and voting is permissive rather than mandatory.<sup>7</sup> Class acceptance is calculated based on the number of holders of allowed claims that have voted to accept the plan.<sup>8</sup> In addition, Rule 3018(c) of the Federal Rules of Bankruptcy Procedure specifies that “an acceptance or rejection shall be in writing, identify the plan or plans accepted or rejected, be signed by the creditor or equity security holder or an authorized agent, and conform to the appropriate Official Form.”<sup>9</sup> Without clear guidance for the treatment of nonvoting classes, courts have been split over whether to count nonvoting classes for the purpose of determining whether § 1129(a)(8) has been met.

### **Who’s on First? Approaches to the Nonparticipating Class Problem**

Two disparate approaches to the question of acceptance under § 1129(a)(8) have emerged within the context of a nonparticipating class: (1) excluding such classes for the purposes of the § 1129(a)(8) analysis, and (2) requiring affirmative acceptance to achieve consensual confirmation. A third approach — deeming a nonvoting class to have implicitly accepted the plan — has been largely discredited among courts analyzing the issue.<sup>10</sup>

### **Close Doesn’t Count in Baseball (and Consensual Confirmation): *M.V.J. Auto* and *Florist Atlanta***

The facts in *M.V.J. Auto World Inc.* and *In re Florist Atlanta Inc.* were remarkably simi-

1 Quote from *The Sandlot* (Island World 1993).

2 Small Business Reorganization Act of 2019, H.R. Rep. No. 116-171, at 1 (2019).

3 See *In re M.V.J. Auto World Inc.*, 661 B.R. 186 (Bankr. S.D. Fla. 2024). See *In re Florist Atlanta Inc.*, No. 24-51980-pwb, 2024 WL 3714512 (Bankr. N.D. Ga. Aug. 7, 2024).

4 11 U.S.C. § 1191(a).

5 11 U.S.C. § 1129(a)(8).

6 See 11 U.S.C. §§ 1183(b), 1194(b).

7 See 11 U.S.C. § 1126(a) (holders of allowed claims or interests “may accept or reject a plan”).

8 See 11 U.S.C. § 1126(c).

9 Fed. R. Bankr. P. 3018(c).

10 See, e.g., *In re Hot’z Power Wash Inc.*, 655 B.R. 107, 116 (Bankr. S.D. Tex. 2023) (observing that “most [courts] agree that a nonvote cannot be construed as an implicit acceptance”). The pre-1978 Bankruptcy Act expressly provided that a failure to vote was deemed a rejection of the plan, but that provision was removed when the Code was passed in 1978. *In re Ruti-Sweetwater Inc.*, 836 F.2d 1263, 1267 (10th Cir. 1988) (citing H.R. Rep. 95-595, at 410 (1977)).

lar.<sup>11</sup> In both cases, the debtors placed the Small Business Administration (SBA) in a separate class and the SBA elected not to vote,<sup>12</sup> the debtors sought consensual confirmation under § 1191(a), and no party filed an objection to plan confirmation. In *Florist Atlanta*, the subchapter V trustee, counsel for the U.S. Trustee and counsel for the SBA all appeared and had no objection to confirmation. In *M.V.J. Auto*, the U.S. Trustee, the subchapter V trustee and one other secured creditor argued at the confirmation hearing that the plan could only be confirmed under the cramdown provision in § 1191(b) because § 1129(a)(8)'s terms had not been met as required by § 1191(a).

Under these circumstances, each court concluded that § 1129(a)(8) requires affirmative acceptance of the plan from all impaired classes. Thus, because the SBA class did not vote, the plans could not be consensually confirmed under § 1191(a). The courts' analyses began and ended with the statutory language. Neither court addressed the requirements of Bankruptcy Rule 3018(c), the legislative history or the implications of effectively inferring rejection from silence for purposes of the § 1191(a) analysis.

### You're Out! Cases Not Counting Nonvoting Classes in Their § 1129(a)(8) Analyses

In two cases preceding *M.V.J. Auto* and *Florist Atlanta*, bankruptcy courts in the Southern District of Texas concluded that nonvoting classes should not be considered in a § 1129(a)(8) analysis, thus consensual confirmation could be achieved without the affirmative vote of all of the impaired classes. In *In re Franco's Paving LLC*,<sup>13</sup> the plan contained six classes. Three classes voted in favor of the plan, and three classes — consisting nearly entirely of governmental claims with the exception of unknown claims added into one class — did not vote. In their closing argument at the confirmation hearing, the U.S. Trustee objected to consensual confirmation, arguing that § 1129(a)(8) had not been satisfied.

The court first considered the language of § 1126(c), explaining that class acceptance depended on two mathematical equations: (1)  $A/B > 50$  percent, where "A" is the number of claims in the class that vote for the plan and "B" is the number voting claims in the class; and (2)  $C/D \geq 66.67$  percent, where "C" is the dollar amount of claims in the class that vote for the plan and "D" is the dollar amount of voting claims in the class. Absent a vote in the class, each equation becomes  $0/0 = E$ , where "E" is the quotient and solving for "E" is  $0 \times E = 0$ , rendering "E" unsolvable because it can be any number. As a result, the calculation under § 1126(c) cannot be performed. When faced with such a scenario, "certainly not contemplated in the statute," the court reasoned that courts "should read the statute to align with congressional intent and 'the statute's design.'" The court further observed that "by implementing a denominator that includes only votes actually cast in § 1126, it logically

follows that Congress presumed that at least one vote [had been] cast."<sup>14</sup>

Turning to subchapter V's underlying policy goal — encouraging consensual plans — the court reasoned that a creditor in agreement with a plan may express such consent either by affirmative vote or opting not to object, and the outcome should be no different because the overarching policy of subchapter V is satisfied. Accordingly, the court concluded that a nonvoting class "should not be counted for purposes of § 1129(a)(8)."<sup>15</sup>

Next, in *In re Hot'z Power Wash Inc.*,<sup>16</sup> the plan contained three impaired classes: Two voted in favor of the plan, and one class — consisting solely of the secured claim of the Internal Revenue Service (IRS) — did not vote. Aware of the IRS's policy to not vote on plans, the debtor attempted to use a notice on the face of the plan deeming nonvoting classes to have implicitly accepted the plan. The U.S. Trustee objected to such notice as being contrary to Bankruptcy Rule 3018(c)'s requirement that "an acceptance or rejection shall be in writing, identify the plan or plans accepted or rejected, be signed by the creditor or equity security holder or an authorized agent, and conform to the appropriate Official Form."<sup>17</sup> The U.S. Trustee also objected to the debtor's alternative argument that a nonvote should be deemed acceptance as being violative of the plan language of § 1129(a)(8). The court agreed with the U.S. Trustee, concluding that "nonvotes do not satisfy the language of § 1126(c)."<sup>18</sup>

Observing the Code's silence as to the proper treatment of nonvoting classes, the court then reasoned that both "acceptances and rejections must satisfy the formality requirements in Bankruptcy Rule 3018(c) to be counted." Further, the court agreed with the mathematical analysis in *Franco's Paving*, concluding that "the calculation mandated by § 1126(c) as applied to a nonvoting class creates a mathematically undefined result that cannot be construed as a rejection of the class."<sup>19</sup> Accordingly, the court concluded that the nonvoting class should not have been deemed to have rejected the plan for purposes of the § 1129(a)(8) analysis.

## Taming the Beast: Resolving the Nonparticipating Class Problem

Resolution of the nonparticipating class problem is difficult in the face of the Bankruptcy Code's silence as to the treatment of such classes. The preferable fix is legislative, but such action is neither easy nor certain. Absent a legislative fix, courts may seek to treat a nonvoting class as neither accepting nor rejecting the plan. In the event the court is inclined to follow the reasoning in *M.V.J. Auto* and *Florist Atlanta*, there are other creative fixes that can be employed to minimize the adverse effects of cramdown confirmation under § 1191(b).

<sup>14</sup> *Id.* at 110.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* (citation omitted). *In re Hot'z Power Wash Inc.*, 655 B.R. 107 (Bankr. S.D. Tex. 2023).

<sup>17</sup> Fed. R. Bankr. P. 3018(c).

<sup>18</sup> *Hot'z Power Wash*, 655 B.R. at 114-15.

<sup>19</sup> *Hot'z Power Wash*, 655 B.R. at 114.

<sup>11</sup> See *supra* n.3.

<sup>12</sup> In *Florist Atlanta*, there were also no votes cast by the class of unsecured creditors. See *Florist Atlanta*, 2024 WL 3714512, at \*1 n.1.

<sup>13</sup> *In re Franco's Paving LLC*, 654 B.R. 107 (Bankr. S.D. Tex. 2023). See *M.V.J. Auto*, 661 B.R. at 187.

## Everybody Gets One Chance to Do Something Great: Statutory Revision

As in most instances where silence in the Bankruptcy Code results in disparate approaches to statutory construction, the ideal fix is legislative. In this case, § 1129(a)(8) could be amended to clarify that a plan may be confirmed if a class of claims either fails to reject the plan or fails to vote. In addition, § 1191(a) could be amended to clarify that the failure of a class to vote shall either be construed as acceptance or result in noninclusion of the class for purposes of the § 1129(a)(8) analysis.

Finally, § 1192(2) could be revised to add language akin to § 1141(d)(5)(A), which specifies that discharge is granted upon completion of payments “[u]nless after notice and a hearing the court orders otherwise for cause.” Such language would give courts discretion to afford an earlier discharge and terminate the subchapter V trustee earlier. Congress also could elect to specify that affirmative acceptance is required under § 1129(a)(8).

In any event, ending the silence is the best way to clarify the path forward. While statutory amendment is preferred, such action is not certain to occur anytime soon.

## Tie Goes to the Debtor? Courts May Omit Nonparticipating Classes

The *M.V.J. Auto* court engaged in a fulsome analysis of the Texas cases, indicating first that the underlying reasoning in *Franco’s Paving* and *Hot’z Power Wash* — that Congress did not contemplate a nonvoting class — was incorrect as evidenced by the permissive rather than mandatory nature of voting under § 1126(a), as well as the fact that the mathematical equation set forth in § 1126(c) does not include nonvoting creditors. However, these provisions only indicate congressional contemplation that *some* creditors within a class would not vote, not that an *entire class* would fail to vote.

The *M.V.J. Auto* court also concluded that treating a nonvoting class as a class that fails to cast a sufficient number of votes in favor of the plan to achieve acceptance is not an absurd result. As such, it is impossible to determine the number of votes necessary to achieve class acceptance when none of the claims have accepted or rejected the plan — an absurd result. Treating classes that fail to vote in this manner effectively likens them to those who have rejected the plan — a conclusion that ignores the requirements of Bankruptcy Rule 3018(c) and contradicts the consensual confirmation goal of subchapter V.

Moreover, exclusion of a nonvoting class is not a novel concept. For example, in *In re DBSD North America Inc.*,<sup>20</sup> the court designated the vote of an entity that had purchased all of the claims in its class under § 1126(e), leaving the class without any countable votes under § 1126(c). Faced with the question of what to do with a class without any members who could vote, the court concluded that the most

appropriate solution was to disregard the class for purposes of the § 1129(a)(8) analysis: “To hold, even though the sole class occupant ... was disqualified from rejecting, that Class 1 *effectively rejected anyway*, because there was nobody left to accept, would make [the] designation ruling meaningless.”<sup>21</sup>

Alternatively, the court concluded that if the class had to be considered, it “should now be regarded as an accepting class.”<sup>22</sup> The court reasoned that because the Bankruptcy Code focuses on those who vote rather than the total membership of classes, and because the former act conditioned confirmation upon votes and not the failure to vote, “the absence of votes in a class doesn’t result in failure to satisfy section 1129(a)(8).”<sup>23</sup>

## I’ve Got This: Drafting Solutions to the Nonparticipating Class Problem

Debtors should include a backup strategy in their plan in case they are before a court that requires affirmative acceptance to meet § 1129(a)(8)’s requirements. The *Florist Atlanta* court explored one such simple, yet effective, solution: specifying in the plan that the debtor would make post-confirmation payments to creditors, and not including any post-confirmation duties to be performed by the subchapter V trustee.

Section 1191(a) provides for termination of the subchapter V trustee’s services on substantial confirmation. Section 1191(b) does not have a termination provision, but nothing in the Bankruptcy Code limits such termination when (1) the debtor, rather than the trustee, will make plan payments; and (2) the subchapter V trustee will not have post-confirmation duties to perform. Observing that no party objected to the debtor making plan payments or requested the performance of post-confirmation duties, the court concluded that it was appropriate to terminate the subchapter V trustee’s services upon substantial confirmation (the commencement of plan payments) and the filing of the subchapter V trustee’s final report.

## Conclusion: Let Them Play

The problem of the nonparticipating class is not one easily solved under the existing statutory scheme. Ideally, revision of the statute is necessary to clarify the effect of such nonparticipation on the analysis under § 1191. In the interim, courts may remove nonvoting classes from the § 1129(a)(8) equation, but debtors should also include plan provisions limiting the post-confirmation duties of the subchapter V trustee to limit costs in the event that cramdown confirmation is required. Such plan provisions as the one approved by the *Florist Atlanta* court can help soften the potentially costly effects of cramdown confirmation under § 1192. **abi**

**Editor’s Note:** ABI’s Subchapter V Task Force released its *Final Report and recommendations to Congress in April 2024*, which is available at [subvtaskforce.abi.org](http://subvtaskforce.abi.org).

<sup>21</sup> *Id.* at 207.

<sup>22</sup> *Id.* at 206.

<sup>23</sup> *Id.*

<sup>20</sup> *In re DBSD N. Am. Inc.*, 419 B.R. 179 (Bankr. S.D.N.Y. 2009).