SUBCHAPTER V CRAMDOWN PLAN PAYMENTS:

True-Up to Actual Disposable Income or Stay True to Projected Disposable Income?

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SUBCHAPTER V OF CHAPTER 11 HAS BEEN VERY POPULAR AMONG SMALL BUSINESS OWNERS THAT NEED TO REORGANIZE OR LIQUIDATE THEIR BUSINESS THROUGH BANKRUPTCY. SUBCHAPTER V BECAME EFFECTIVE IN FEBRUARY 2020 WITH THE CLEAR PURPOSE OF MAKING CHAPTER 11 A MORE VIABLE OPTION FOR SMALL BUSINESS OWNERS. SUBCHAPTER V IS MORE STREAMLINED AND LESS EXPENSIVE THAN THE TRADITIONAL CHAPTER 11 PROCESS, YET GIVES DEBTORS VIRTUALLY ALL OF THE SAME BENEFITS OF A TRADITIONAL CHAPTER 11 CASE—AND THEN SOME.

KEY POINTS

- **Cramdown Advantage:** Allows plan confirmation without all creditors' consent if it's "fair and equitable."
- **Income Use**: Requires using all projected disposable income for plan payments, allowing owners to retain equity.
- **True-Up Provision**: Courts are split on requiring income adjustment if actual income exceeds projections.
- **Creditor Vigilance**: Creditors must vet income projections to avoid minimal distributions and potential losses.

One of the most significant advantages of Subchapter V is found in its "cramdown" provision. Cramdown is the process by which a debtor confirms a Chapter 11 plan when the debtor does not have the consent of all impaired classes of creditors that are eligible to vote on the plan. In both traditional Chapter 11 and Subchapter V cases, cramdown requires that the plan does not "discriminate unfairly" and is "fair and equitable" with respect to each non-consenting, impaired class of claims. However, unlike traditional Chapter 11, Subchapter V further specifies that a plan is "fair and equitable" if the debtor is providing all of its "projected disposable income" (or its value) to fund plan payments over the three-to-five-year life of the plan. Regardless of whether such payments pay unsecured creditors in full, the debtor's owner can retain the equity in the company without providing any contribution to the plan. This is a significant deviation from the "absolute priority rule" in traditional Chapter 11 cases, which generally requires the full payment of all claims before owners can retain equity interests, and makes reorganizing in bankruptcy a much more viable option for small business owners.

So, then, what happens if the debtor's actual income over the life of the plan ultimately exceeds the amount projected at the time of confirmation? Can the debtor be compelled to include a "true-up" provision in the plan that calls for the upward adjustment of plan payments accordingly? The case law on this issue is sparse, with courts having reached conflicting holdings. In January 2023, the United States District Court for the Middle District of Florida held, in *In re Staples*, that the court may require a Subchapter V plan to include a true-up provision under which creditors would be entitled to any upside in the event that the debtor's actual disposable income exceeds its projected disposable income. However, in its decision in *In re Packet Construction, LLC* in April 2024, the United States Bankruptcy Court for the Western District of Texas declined to follow *Staples*, and instead held that Subchapter V does not require the inclusion of a true-up provision in the plan.

Trade creditors should roll up their sleeves and not sit back and rely on a Subchapter V trustee to vet the debtor's projections since, ultimately, the debtor's unsecured creditors will be adversely impacted by projections that provide for relatively minimal distributions. If the debtor's projected disposable income isn't properly vetted during the debtor's plan confirmation process, trade creditors may be stuck with receiving distributions on account of their claims that are far less than what the debtor may ultimately be able to provide—essentially putting the cost of the debtor's reorganization on creditors. As shown by the *Packet Construction* ruling, trade creditors may never get a second bite at the "projected disposable income" apple.

Read on for a deeper dive!

CRAMDOWN IS THE PROCESS BY WHICH **A DEBTOR CONFIRMS A CHAPTER 11 PLAN WHEN THE DEBTOR DOES NOT HAVE THE CONSENT OF ALL IMPAIRED CLASSES OF CREDITORS** THAT ARE ELIGIBLE TO VOTE ON THE PLAN.

RELEVANT BACKGROUND ON THE SUBCHAPTER V "CRAMDOWN" REQUIREMENTS

The issue of whether a court can require a plan to include a true-up provision arises only in Subchapter V cases where the debtor is confirming a plan via "cramdown"—i.e., where the proposed plan is non-consensual because at least one voting class of creditors has not accepted the plan. One of the requirements for cramming down a non-consensual Subchapter V plan is that the plan must be "fair and equitable" with respect to each class of claims that is impaired and has not accepted the plan. Subchapter V specifically states that to be fair and equitable:

- The plan must provide that all of the debtor's projected disposable income over the three-to-five-year life of the plan will be used to make payments to creditors under the plan, or, alternatively, the value of the property to be distributed under the plan over such three-to-five-year period must not be less than the debtor's projected disposable income;
- The debtor must be able to make all plan payments; and
- The plan must provide appropriate remedies to protect claimants and interest holders in the event that plan payments are not made.

With respect to the projected disposable income requirement, the term "disposable income" means income that "is not reasonably necessary to be expended" for: (a) "the maintenance or support of the debtor or a dependent of the debtor", (b) a domestic support obligation that arose after the bankruptcy filing, or (c) "the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor."

THE STAPLES AND PACKET CONSTRUCTION DECISIONS

The *Staples* and *Packet Construction* holdings addressed the question of whether the court can require increased payments under a Subchapter V plan if the debtor's actual disposable income exceeds the projected disposable income determined when the plan was confirmed. Specifically, in *Staples*, the debtor appealed the bankruptcy court's confirmation order because it included a paragraph stating that the distributions to unsecured creditors "shall fluctuate based upon the Debtor's actual disposable income" based on quarterly post-confirmation reports to be filed before the 21st day of each month, but in no event will distributions be less than the disposable income projected at confirmation. In *Packet Construction*, the Subchapter V trustee objected to confirmation of the debtor's proposed plan because the plan did not provide for any upward adjustment in plan payments if the projected disposable income ultimately proved too pessimistic. The ability to require an upward adjustment to plan payments based on the debtor's actual disposable income was at issue in both cases—but the similarity ends there.

In *Staples*, the Florida district court held that the bankruptcy court can require a true-up and increased distributions based on the actual disposable income the debtor earned over the life of the plan. The court relied on the All Writs Act, which provides "The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law." The court also relied on section 105(a) of the Bankruptcy Code, which grants the court authority to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]."

The *Packet Construction* court held the opposite—that a Subchapter V debtor cannot be required to "true up" its payments to its creditors under a confirmed plan when its actual disposable income exceeds its projected disposable income. The court rejected the *Staples* ruling since the *Staples* court did not set forth any specific authority that would support the imposition of a true-up in Subchapter V.

The *Packet Construction* court analyzed Subchapter V's projected disposable income requirement by comparing and contrasting Subchapter V's provision with similar provisions of Chapter 12 (covering family farmers and fishermen) and Chapter 13 (covering an individual debtor's restructuring). The court noted:

Generally speaking, the term "projected" means "[e]stimated or forecast on the basis of current trends or date." The court concluded this meaning is consistent with the "forward-looking approach" that the United States Supreme Court endorsed when it interpreted "projected disposable income" in the Chapter 13 case of *Hamilton v. Lanning* (2010). Requiring a true-up based on actual disposable income would eliminate the forward-looking element of the term "projected" and effectively read the word "projected" out of the statute.

The decision historically relied on for requiring a true-up in Chapter 12 cases—an opinion issued in 1994 by the United States Court of Appeals for the Eighth Circuit, in *Rowley v. Yarnall*—rests on an "unsteady foundation." In that case, the Eighth Circuit held that while requiring a true-up conflicts with the

TRADE CREDITORS SHOULD ROLL UP THEIR SLEEVES AND NOT SIT BACK AND RELY ON A SUBCHAPTER V TRUSTEE TO VET THE DEBTOR'S PROJECTIONS SINCE, ULTIMATELY, **THE DEBTOR'S UNSECURED CREDITORS WILL BE ADVERSELY IMPACTED BY PROJECTIONS THAT PROVIDE FOR RELATIVELY MINIMAL DISTRIBUTIONS**.

plain language of the statute, doing so is appropriate because, otherwise, debtors could simply propose a plan that projects no disposable income. The *Packet Construction* court rejected this argument, stating that the prospective assessment of projected disposable income provides a meaningful check on the bankruptcy process since a court can deny confirmation of a plan when projected disposable income is not well supported. The *Packet Construction* court also noted, as other courts have, that the *Rowley* decision contradicts the Supreme Court's and other courts' holdings in the Chapter 13 context.

Moreover, the *Packet Construction* court noted that after the *Rowley* decision was issued, Chapter 12 was amended to include the requirement that is also in Subchapter V's cramdown provisions—that projected disposable income *or the value of it* must be provided to fund plan payments. By adding the alternative option of providing "value" based on projected disposable income, rather than just requiring payment of the projected disposable income itself on an ongoing basis, the Bankruptcy Code gives debtors the option of making a lump sum payment of projected disposable income. In such a scenario, the debtor's actual disposable income is entirely irrelevant in determining plan payments.

The *Packet Construction* court also observed that, in Subchapter V, only the debtor may seek to modify the plan post-confirmation. This is a clear deviation from Chapters 12 and 13 where unsecured creditors may seek to modify the confirmed plan for higher or lower plan payments. This suggests that projected disposable income is intended to be the "ceiling" in Subchapter V.

The *Packet Construction* court further noted that the determination of projected disposable income as part of the process of confirming a non-consensual Subchapter V plan via cramdown should be based on objective evidence. In light of this, the court concluded with the following suggestion directed toward creditors in Subchapter V cases:

> "Vigilant creditors can and should evaluate and, if necessary, challenge projections before plans are confirmed. But construed properly, this aspect of subchapter V also provides incentive for debtors to exceed projections, because they get to keep the surplus. Perhaps Congress structured the statute this way precisely to induce small business growth and to provide yet another incentive for parties to bargain on consensual plans."[1] BC

1. The Packet Construction *court noted that it was not ruling out the possibility that a true-up may be an appropriate means of ensuring a plan is "fair and equitable" under certain circumstances. However, the court held there is certainly no general rule that would require a true-up, and did not find sufficient circumstances existed for imposing one in its case.*

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