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The Impaired Insider Paradox and the § 1191(b) Solution

Under § 1129(a)(10), “[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan” must accept the plan.¹ However, a class of insiders cannot serve as the single impaired accepting class.² Hence, if a plan leaves all noninsider creditors’ classes unimpaired, but a class of insiders has agreed to accept less than 100 percent on account of their claims, the accepting insiders’ willingness to make additional estate funds available to other classes results in a paradoxical impediment to the confirmation of a plan that pays all noninsiders in full.

This exact issue precluded confirmation of the plan proposed in *In re Ingleside Associates*, where in the debtor proposed a plan that paid all noninsider classes in full, leaving them unimpaired and not entitled to vote to accept or reject the proposed plan.³ The only impaired classes were comprised of insiders.⁴ The court found that votes cast by insiders could not be considered under 11 U.S.C. § 1129(a)(10), and denied plan confirmation.⁵ The court remarked that “the [d]ebtor’s efforts to confirm a plan [that] impaired only insiders’ claims were an attempt to achieve the impossible.”⁶ Absent an amendment by Congress resolving this arguably unintended glitch in the Bankruptcy Code, few practical solutions emerge to correct the legal impossibility built into § 1129(a)(10).

At a Glance: Solutions to the § 1129(a)(10) Problem Artificial Impairment

The *Ingleside* court noted that a prior plan would have been confirmable because it impaired a

noninsider class.⁷ However, “artificial” impairment is prohibited in some circuits.⁸ Those jurisdictions rejecting the construct of artificial impairment foreclose debtors from securing confirmation through an “exercise of discretion.”⁹

No-Voting Classes

A debtor could also sidestep the problem posed by § 1129(a)(10) by paying the insiders in full. This could be achieved through voluntary modification by settlement or other device. As a downside, this result may leave the insider class with less than acceptable payment rights upon plan confirmation.

Insiders Abstaining from Voting

The U.S. Bankruptcy Court for the Southern District of Texas recently ruled in two separate subchapter V proceedings, *In re Franco’s Paving* and *In re Hot’z Power Wash*, that a creditor class that casts no votes on a proposed plan would not be considered in determining whether the plan could be confirmed as consensual.¹⁰ By disregarding a class that did not cast a vote, the court disagreed with the only circuit that has ruled on the issue.

The Tenth Circuit held in a controversial chapter 11 decision, *In re Ruti-Sweetwater*, that in situations where no votes were cast in a class, the non-voting creditors had consented to the debtor’s plan and that their inaction amounted to acceptance.¹¹ Several other courts have disagreed with the Tenth Circuit, including the Bankruptcy Appellate Panel for the Ninth Circuit.¹²

If disregarding an abstaining class for the purposes of plan confirmation can be extended to non-subchapter V chapter 11 cases, a plan could be confirmed as consensual in a proceeding where insiders are the only impaired class and decline to vote



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1 11 U.S.C. § 1129(a)(10).
2 *Id.* (“If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.”) (emphasis added).
3 *In re Ingleside Assocs.*, 136 B.R. 955, 960 (Bankr. E.D. Pa. 1992); see also 11 U.S.C. § 1126(f) (“Notwithstanding any other provision of this section, a class that is not impaired under a plan, and each holder of a claim or interest of such class, are conclusively presumed to have accepted the plan, and solicitation of acceptances with respect to such class from the holders of claims or interests of such class is not required.”) (emphasis added); see further *In re Union Meeting Partners*, 165 B.R. 553, 569 (Bankr. E.D. Pa. 1994), subsequently *aff’d*, 52 F.3d 317 (3d Cir. 1995) (denying confirmation of plan on multiple grounds, including that “it is questionable whether any of the impaired classes [that] have voted in favor of [the] Debtor’s Plan are eligible to serve as the impaired accepting class required by § 1129(a)(10)” for purposes of cramdown); *In re Three Flint Hill Ltd. P’ship*, 213 B.R. 292 (D. Md. 1997) (confirming creditor’s plan and holding that debtor’s plan was unconfirmable, because it had not been accepted by at least one impaired class).
4 *Ingleside*, 136 B.R. at 960-62.
5 *Id.* at 961-62.
6 *Id.* at 962, n.4.

7 *Id.* at 962.
8 Compare *In re Windsor on the River Assocs. Ltd.*, 7 F.3d 127, 132 (8th Cir. 1993) (“[W]e hold that, for purposes of 11 U.S.C. § 1129(a)(10), a claim is not impaired if the alteration of rights in question arises solely from the debtor’s exercise of discretion.”), with *In re Vill. at Camp Bowie I LP*, 710 F.3d 239, 245 (5th Cir. 2013) (“[W]e expressly reject *Windsor* and join the Ninth Circuit in holding that § 1129(a)(10) does not distinguish between discretionary and economically driven impairment.”).
9 *Windsor*, 7 F.3d at 132.
10 *In re Franco’s Paving LLC*, 654 B.R. 107 (Bankr. S.D. Tex. 2023); *In re Hot’z Power Wash Inc.*, 655 B.R. 107 (Bankr. S.D. Tex. 2023).
11 *In re Ruti-Sweetwater Inc.*, 836 F.2d 1263, 1267-68 (10th Cir. 1988). This approach seems to adopt the principle of *qui tacet consentire videtur* (“whoever remains silent is deemed to agree”).
12 See, e.g., *In re M. Long Arabians*, 103 B.R. 211 (B.A.P. 9th Cir. 1989); *In re Higgins Slacks Co.*, 178 B.R. 853, 857 (Bankr. N.D. Ala. 1995); *In re Townco Realty Inc.*, 81 B.R. 707, 708 (Bankr. S.D. Fla. 1987).

on the plan. However, this strategy would be more safely deployed in subchapter V cases.

The § 1191(b) Solution

In a subset of chapter 11 cases, a creative bankruptcy professional may turn to subchapter V of chapter 11.¹³ Subchapter V solutions typically are not on the radar of bankruptcy professionals involved in “complex” or “mega” cases (typically those cases where liabilities exceed seven figures), and for good reason: The most significant limitation of subchapter V is its availability solely to a “small business debtor,” defined as a debtor with, at most, a few millions of dollars in liabilities.¹⁴

Of particular interest to bankruptcy professionals specializing in complex bankruptcies should be the fact that the subchapter V debt limit excludes debts owed to affiliates or insiders.¹⁵ This renders subchapter V solutions uniquely suitable for portfolio companies of private investment funds and parent-financed operating affiliates in corporate groups where most funded debt comes from insiders. Because contingent and unliquidated liabilities are excluded, otherwise-financially stable operating companies that have little debt but are threatened with an existential risk of a lawsuit might also benefit from subchapter V proceedings, which are cheaper yet provide the protections of chapter 11.

Subchapter V provides to qualifying debtors valuable solutions allowing them to sidestep the paradox of § 1129(a)(10) with respect to impaired insiders’ votes. Significantly, the cramdown provisions of § 1129(b) are not applicable in subchapter V cases. Instead, § 1191(b) provides requirements for cramdown confirmation that are more favorable to subchapter V debtors, which includes the elimination of the requirement that at least one impaired class of creditors — excluding insiders — accept the plan.

Notably, the absolute-priority rule under § 1129(b)(2)(B) with respect to classes of unsecured creditors and interests that have not accepted the plan is not applicable under § 1191(b),¹⁶ “allow[ing] existing owners to retain their full ownership without giving any new value, but only if the plan provides for the debtor to distribute all of its projected disposable income over at least three years from the date the first payment is due under the plan (or property having a value of at least that amount).”¹⁷

To be clear, the § 1191(b) cramdown does not come without other limitations and costs that need to be carefully considered. A subchapter V debtor may confirm a plan despite not meeting the requirements of § 1129(a) in paragraphs (8) (providing that all classes vote to accept the plan or not be impaired by the plan) and (10) (requiring at least

one impaired class to accept the plan). Instead, a confirmable subchapter V “plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.”¹⁸

The standard of “fair and equitable with respect to each class of claims or interests” is defined in subchapter V: The plan needs to provide for a period of payments after the effective date, ranging from a minimum of three years to a maximum of five years, when all projected disposable income of the debtor is dedicated to payments, before the debtor can obtain a discharge.¹⁹ This standard mimics chapter 13 proceedings available to individuals. A subchapter V debtor may prepay or pay in a lump sum the value of projected disposable income,²⁰ but the debtor is not required to make payments before confirmation. Thus, particularly for portfolio companies and bankrupt affiliates, subchapter V allows for the retention of equity and voting by insiders.²¹

In *In re Pearl Resources*, the bankruptcy court confirmed a nonconsensual subchapter V plan where, out of a total of 14 classes, 11 were impaired, and where three classes of claims and interests held by insiders voted to accept the plan (classes 2, 13 and 14); four classes of noninsider claims (three of which were impaired) voted to accept the plan (classes 3, 6, 8 and 9); three impaired classes of claims held by noninsiders voted against the plan (classes 4, 5, 7); one class (class 10) did not submit a ballot; and three classes had no claims associated with them and therefore did not submit a ballot, either (classes 1, 11 and 12).²² The court found that it was required to confirm the plan when all confirmation standards were met except for those set out in paragraphs (8), (10) and (15) of § 1129(a), and under § 1191(b) cramdown rules the plan did not discriminate unfairly and was fair and equitable with respect to each impaired class that had not accepted it.²³

Furthermore, in confirming the nonconsensual plan, *Pearl Resources* stripped pre-petition statutory liens on all assets valued at \$35 million held by secured creditors whose total claims — if undisputed — totaled \$1.2 million, leaving as collateral one piece of property valued at \$7.4 million based on a finding that although the plan reduced the oversecured creditors’ “29 to 1 value-to-debt equity cushion” to “6 to 1,” the remaining collateral and the plan “provide[d] virtual certainty that Allowed Claims [would] be paid in full.”²⁴

Conclusion

Because under subchapter V a plan can be confirmed in the absence of a consenting impaired class, this type of proceeding can provide a solution to the § 1129(a)(10) problem. Furthermore, the absence of the absolute-priority rule and other streamlined features of subchapter V turn it into a useful tool in the hands of a bankruptcy professional focusing on creative solutions for complex bankruptcy cases. **abi**

13 See Small Business Reorganization Act of 2019 (SBRA), Pub. L. No. 116-54 (Aug. 13, 2019), effective Feb. 19, 2020.

14 *Id.* at § 2(a), 1182(1). The statutory debt limit under subchapter V was initially set at \$2,725,625. On April 1, 2022, SBRA § 104 adjusted the debt limit to \$3,024,725. Later legislation contained in a variety of statutes temporarily increased the debt limit to \$7.5 million until June 20, 2024, and unless that legislation is made permanent or extended, the debt limit will return to its previous level of \$3,024,725 on June 21, 2024. See Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, § 1113(a) (March 27, 2020); COVID-19 Bankruptcy Relief Extension Act of 2021, Pub. L. No. 117-5, § 2(a)(1) (March 27, 2021); Bankruptcy Threshold Adjustment and Technical Corrections Act, Pub. L. No. 117-151, §§ 2(a), (d), (i)(1)(B) (June 21, 2022). Congress is currently considering extending the enhanced debt limit.

15 11 U.S.C. § 1182(a)(1)(A).

16 See generally 8 Collier on Bankruptcy ¶ 1180.01.

17 *In re Pearl Res. LLC*, 622 B.R. 236, 265-66 (Bankr. S.D. Tex. 2020) (citing 11 U.S.C. § 1181(a)).

18 11 U.S.C. § 1191(b).

19 11 U.S.C. § 1191(c).

20 11 U.S.C. § 1191(c)(2)(B).

21 *Pearl Res.*, 622 B.R. at 267 (citing 11 U.S.C. § 1191(c)(2) and (3)).

22 *Id.* at 236, 250-51.

23 *Id.* at 274.

24 *Id.* at 249, 270-72.