

Illinois Bankruptcy Court: Preliminary Distributions Lock Subchapter V Plan

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In an issue of first impression for the jurisdiction, the Bankruptcy Court for the Northern District of Illinois has ruled that a subchapter V debtor “substantially consummated” its plan by paying less than \$1,500 in distributions to creditors and, as a result, could no longer modify the plan. In re National Tractor Parts, Inc., Case No. 20-20833 (DDC) (N.D. Ill. June 6, 2022).

Subchapter V Case Background

The Debtor, a seller of heavy equipment and diesel engine parts, confirmed a consensual plan of reorganization under subchapter v of chapter 11, with five classes of creditors entitled to receive distributions. The Debtor made preliminary plan payments of \$843.00 to Class 1 and \$585.20 to Class 4. The Debtor did not make any payments to other creditors, including the Class 5 unsecured claim of Small Business Administration (“SBA”) slated to receive a 5% distribution under the plan. After confirmation, the Debtor discovered it could be eligible for an increased COVID-19 Economic Injury Disaster Loan from the SBA if it repaid its prepetition SBA loan on its original terms. The Debtor filed a motion to modify the plan by reclassifying SBA’s claim under a new Class 7 in order to qualify for the new SBA loan. Only the U.S. Trustee objected.

Bankruptcy Court Decision

The Court found the Plan had been “substantially consummated” pursuant to section 1101(2) of the Bankruptcy Code and could no longer be modified. Section 1193(b) of the Bankruptcy Code only permits modification of a confirmed consensual plan before “substantial consummation”, which Section 1101(2) defines as “(A) transfer of all or substantially all of the property proposed by the plan to be transferred; (B) assumption by 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 (C) commencement of distribution under the plan.”

The Debtor, relying on *In re Dean Hardwoods, Inc.*, 431 B.R. 387 (Bankr. E.D.N.C. 2010), argued that subsection (C) required commencement of distribution to all or substantially all creditors, and thus was not satisfied. The Illinois Bankruptcy Court disagreed, diverging from *Dean Hardwoods*, and holding that the word “substantial” in the statute modified “consummation,” but not “distribution,” and did not require substantial distribution. Thus, while the text of sections 1101(2)(A) and (B) includes the numerosity language “all or substantially all,” the Court concluded that section 1101(2)(C) did not require distribution to all creditors or classes before the Plan’s terms may become locked in place.

Takeaways

The *National Tractor Parts* holding establishes that substantial consummation (even if distributions are “de minimis”) locks in a consensual plan and prevents post-confirmation plan modification by subchapter V debtors. But this holding does not extend to non-consensual plans (i.e., a “cram-down” plan that is confirmed over the objections of non-consenting creditor classes) and debtors retain flexibility to modify a non-consensual plan at any time during the debtor’s three-to-five-year payment plan, which usually will only occur if the debtor’s projections prove to be overly optimistic.

The challenge for creditors when evaluating a debtor’s plan is that they will not have the benefit of knowing whether the plan is consensual or non-consensual until after ballots have been tabulated. Understanding the risk of whether a plan can be modified is therefore difficult to predict.

As a result, when voting on the plan, creditors should assume that the plan is subject to debtor modification:

- a) at any time during the payment plan period if plan confirmation is non-consensual; and
- b) if the plan is consensual, prior to Section 1102 “substantial consummation,” which, depending on the jurisdiction of the case, could also mean prior to any distributions being made by the debtor.

In a jurisdiction following *National Tractor*, debtors will need to cut their deals with creditors before making even a de minimis distribution under a consensual plan.

Creditors should carefully scrutinize the plan’s projections, request additional information from the debtor regarding its business plan and underlying financials, and assess whether the plan offers a sufficient value proposition. Projections are based on future disposable income filed by the debtor during the bankruptcy case and may not reflect the reality of the debtors’ post-confirmation financial condition. Creditors need to be satisfied that the debtor’s projections and distributions are acceptable. After voting on the plan, debtors have less wiggle room to modify the plan if confirmation is consensual. This may be a perfectly acceptable outcome to most creditors and give comfort that the plan is locked in.

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