

Subchapter V: Smaller Businesses Can Benefit from a More Streamlined and Cost-Effective Bankruptcy Option

The Small Business Reorganization Act (as amended, the “SBRA”) was enacted in February 2020 to provide businesses with \$7.5 million or less in non-contingent, non-insider debts with a faster, less costly option to reorganizing through a traditional chapter 11.

The SBRA was intended to address a problem faced by many struggling smaller businesses: reorganizing in chapter 11 was often too difficult, time-consuming, and expensive for these companies. As a result, many of these businesses would not get the help they needed and, instead, might end up liquidating in chapter 7 bankruptcy or not filing at all.

To address these concerns, Congress enacted subchapter V of chapter 11 of the Bankruptcy Code. 11 U.S.C. §§ 1181-1195. Subchapter V is an option that eligible debtors can elect to restructure their balance sheet while preserving the existing equity structure, through a process that was designed to be simpler, less expensive, and more efficient.

Key Benefits of Subchapter V

- A plan may be confirmed even without an accepting “impaired class” so long as the debtor’s disposable income is distributed to creditors through the plan, over a period of between three and five years. 11 U.S.C. § 1191(b); *In re Pearl Res. LLC*, 622 B.R. 236, 266 (Bankr. S.D. Tex. 2020). As a result, a subchapter V debtor can “cram down” a plan on its secured and unsecured creditors, while the debtor’s owners retain their equity in the business, potentially without paying creditors in full or making any “new value” contribution.
- Unlike in a traditional chapter 11, in a subchapter V case no creditor’s committee is formed. Instead, a subchapter V trustee is appointed, primarily, to assist the debtor in formulating its plan and negotiating with creditors. 11 U.S.C. § 1183. As a result, there may be potentially significant savings as the debtor would not have to pay the fees and expenses of a creditor’s committee’s professionals.
- Subchapter V features an expedited case schedule, including an early status conference within the first 60 days of the case and a plan submission deadline of 90 days. 11 U.S.C. § 1188; 1189.
- Only the debtor is allowed to file a proposed plan. 11 U.S.C. § 1189(a). And the subchapter V plan follows a more streamlined format. For example, the debtor is not required to file a separate disclosure statement, a further cost savings.
- If the plan is confirmed and the debtor completes the plan payments, it generally receives a discharge of its remaining debts. 11 U.S.C. § 1192.

Eligibility for Subchapter V

In order to take advantage of the significant benefits of subchapter V, a debtor must meet the eligibility requirements, which include the following:

- **Be engaged in commercial or business activities** – The debtor must be a business entity or individual engaged in “commercial or business activities,” other than primarily owning a single asset real estate. 11 U.S.C. § 1182(1)(A). Courts interpreting this requirement generally have held that the debtor is not required to be “actively operating” on the petition date. Instead, some courts require that the debtor be “presently” engaged in commercial or business activities,¹ while other courts have only required that the debtor have been engaged in commercial or business activities at some point.² This requirement may be implicated where, for example, the debtor was forced to cease operations before the bankruptcy due to a lockdown order or for financial or other reasons. In addition, 50 percent or more of such debts must have arisen from the debtor’s commercial or business activities. 11 U.S.C. § 1182(1)(A).
- **Have debts of \$7.5 million or less.**
 - The debtor must also have \$7,500,000 or less in aggregate noncontingent, liquidated secured and unsecured debts as of the petition date. 11 U.S.C. § 1182(1)(A). The current debt limit, which had briefly expired, was reinstated retroactively in June 2022 and remains in effect until June 2024.³
 - Contingent and unliquidated debts are excluded from the subchapter V debt limit. For example, funds distributed pursuant to the Paycheck Protection Program (PPP) and potential future lease obligations may be considered contingent and unliquidated and not count toward the debt limit total. *See In re Parking Management, Inc.*, 620 B.R. 544 (Bankr. D. Md. 2020).
 - The debt limit also excludes debts owed to an affiliate, parent company or other “insiders,” as defined in 11 U.S.C. § 101(31). *In re 305 Petroleum, Inc.*, 622 B.R. 209 (Bankr. N.D. Miss. 2020).
 - Importantly, if more than one company are filing for bankruptcy, the subchapter V debt limit applies to the “group of affiliated debtors.” 11 U.S.C. § 1182(1)(B).

¹ See, e.g., *Nat’l Loan Invs., L.P. v. Rickerson (In re Rickerson)*, 636 B.R. 416, 424-25 (Bankr. W.D. Pa. 2021); *In re Ikalowych*, 629 B.R. 261, 283-84 (Bankr. D. Colo. 2021); *In re Johnson*, No. 19-42063-ELM, 2021 WL 825156, at *6-8 (Bankr. N.D. Tex. Mar. 1, 2021); *In re Thurmon*, 625 B.R. 417, 422-23 (Bankr. W.D. Mo. 2020).

² See, e.g., *In re Blanchard*, No. 19-12440, 2020 WL 4032411, at *2 (Bankr. E.D. La. July 16, 2020); *In re Wright*, No. 20-01035-HB, 2020 WL 2193240, at *3 (Bankr. D.S.C. Apr. 27, 2020).

³ See Bankruptcy Threshold Adjustment and Technical Corrections Act, signed on June 21, 2022 (PL 117-151).

- **Is not a publicly traded company or an affiliate of one** – Subchapter V is not available to an any debtor that is a corporation subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)), or any affiliate of such a corporation. 11 U.S.C. § 1182(1)(B).

A business considering a bankruptcy filing should carefully discuss all eligibility requirements with their chosen counsel.

Subchapter V Plan

As with all proposed chapter 11 plans, a proposed plan in a subchapter V case must define the classes of claims and interests, provide for their treatment, and classify together substantially similar claims and interests. 11 U.S.C. §§ 1122(a); 1123(a). The plan must not “discriminate unfairly” and must be “fair and equitable” with respect to each class of claims or interests that is impaired under, and has not accepted, the plan. 11 U.S.C. § 1129(b).

A subchapter V plan must also include (i) a brief history of the debtor’s business operations, (ii) a liquidation analysis, and (iii) projections regarding the debtor’s ability to make payments under the plan and must provide for all or a portion of the debtor’s future earnings or income to make distributions under the plan, among other things. 11 U.S.C. § 1190.

As in other chapter 11 cases, a subchapter V debtor may seek confirmation of a consensual plan, where all impaired classes have accepted the plan and the plan complies with the applicable requirements of Bankruptcy Code section 1129(a) (other than 1129(a)(15)), or seek confirmation of a cramdown plan, that may be confirmed notwithstanding its rejection by one or more classes. 11 U.S.C. § 1191(a), (b). Subchapter V debtors may be incentivized to confirm a consensual plan, however, because in a cramdown situation, the property of the debtor’s estate includes post-petition acquired property and earnings/income, the subchapter V trustee remains in place post-confirmation to make plan payments, and the debtor does not receive its distribution until it has completed making its plan payments. 11 U.S.C. §§ 1141(d); 1181(c); 1186(a); 1192; 1194.

Selected Subchapter V and Chapter 11 Representations

Archer’s bankruptcy team has significant experience representing chapter 11 debtors-in-possession, including subchapter V debtors, as well as chapter 11 trustees, chapter 7 trustees, creditors’ committees, purchasers, and other parties in all aspects of bankruptcy cases and bankruptcy-related litigation.

Recently, Archer acted as co-counsel for Augustus Intelligence Inc., a start-up developer of artificial intelligence. Augustus filed for chapter 11 and elected to proceed under subchapter V. As the business’s condition deteriorated, the debtor pivoted to a liquidation, sold its remaining tangible assets, and in July 2022 successfully confirmed a subchapter V plan of liquidation. A litigation trustee has now been appointed to pursue potential causes of action and other assets for the benefit of creditors and equity holders.

In addition, Archer attorneys have led a number of other chapter 11 cases, including:⁴

- Wave Systems Corp. (Bankr. D. Del.) – lead counsel to the chapter 11 trustee of data and information security company, including confirming a plan of reorganization and achieving a 50% recovery to general unsecured creditors.
- Woodcrest Country Club (Bankr. D. N.J.) – lead counsel to the chapter 11 trustee of country club and golf course, including confirming a plan of liquidation resulting in a successful sale of the business.
- Midway Games (Bankr. D. Del.) – lead counsel to the chapter 11 debtors, developer and publisher of video games and interactive entertainment software, including conducting a 363 asset sale and confirming a consensual plan.
- Wind City Penna Oil & Gas Bankr. D. Del.) – lead counsel to the chapter 11 debtors, oil and gas explorers and developers, including confirming a chapter 11 plan by which the debtors’ assets were sold and achieving a 41% recovery to general unsecured creditors.
- Street Level LLC (Bankr. S.D.N.Y.) – counsel to the chapter 11 debtor operator of an entertainment venue in negotiating a resolution with an adjoining property owner, a Manhattan real estate developer, and obtaining a prompt resolution of its chapter 11 case.
- In re Paul F. Wallace (Bankr. S.D.N.Y.) – chapter 11 counsel for several affiliated debtors with interests in boutique hotels. Successfully sold hotels and interests in hotels pursuant to section 363 sales, litigated numerous and contentious claims, and confirmed a plan that provided full recovery for unsecured creditors.
- Northeast Brooklyn Partnership (Bankr. E.D.N.Y.) – counsel to chapter 11 debtor, owner and operator of buildings that were sold pursuant to a consensual plan.
- Voras Enterprise Inc. (Bankr. E.D.N.Y.) – counsel to chapter 11 debtor, owner and operator of buildings that were sold pursuant to a consensual plan.
- Hexacon Electric (Bankr. D.N.J.) – counsel chapter 11 debtor, soldering iron company.
- Premier Food Systems (Bankr. D.N.J.) – counsel to chapter 11 debtors, franchise owners of fast food restaurants.
- Hampshire Group, Ltd. (Bankr. D. Del.) –counsel to chapter 11 debtors, clothing manufacturers and distributors, including conducting an expedited 363 sale and confirming a consensual plan of liquidation.

⁴ The following list includes certain matters that Archer attorneys handled while at prior law firms.