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# Has Subchapter V Solved the Problems of Small Business Bankruptcies? Views and Reflections of Subchapter V Trustees on the First Two Years of the New Law

***Eastern - 1st, 2nd, 3rd & 4th Circuits*** *by Paula S. Beran, Eastern and Western Districts of Virginia; Francis J. Brennan, Northern and Western Districts of New York, District of Vermont; Sam Della Fera, District of New Jersey, and Chuck Persing, Eastern and Southern; Districts of New York; Nancy J. Isaacson, District of New Jersey; David Klauder, District of Delaware; J. Kershaw Spong, District of South Carolina; Steven Weiss, Districts of Maine, Massachusetts, New Hampshire, and Rhode Island.* ***Central - 6th, 7th, 8th & 11th Circuits*** *by Kelly M. Hagan, Western District of Michigan; Bob Handler, Neema T. Varghese, Matthew Brash, and Ken Novak, Northern District; of Illinois; Leon Jones, Northern District of Georgia; Iana Vladimirova, Subchapter V Trustee, Northern District of Illinois; Eastern and; Western Districts of Wisconsin and Leanne O'Donnell, Husch Blackwell.* ***Western - 5th, 9th & 10th Circuits*** *by Kent Adams, District of Kansas; Robert Byrd, Northern and Southern Districts of Mississippi; Katherine Battaia Clark, Northern District of Texas, and David Warfield, Thompson; Coburn LLP; Brian M. Rothschild, District of Utah; Steve Sather, Western District of Texas.*

Congress passed the Small Business Reorganization Act of 2019 (SBRA) in an effort to streamline the process by which small businesses might reorganize and rehabilitate their financial affairs. The act became, codified as Subchapter V of Chapter 11 of the Bankruptcy Code, became effective on February 19, 2020. [1]

The House Report on the bill posited that small businesses, including family-owned companies and startups, form the backbone of the American economy. The duration of many of these businesses is limited, though, by their nature. Congress considered that, while small businesses comprise the majority of chapter 11 filers, they were the least likely to reorganize successfully under chapter 11. [2] The sponsor of the bill in the House described the legislation as allowing these debtors to file bankruptcy "in a timely, cost-effective manner," and hopefully to remain in business, for the benefit both of their owners, and the "employees, suppliers, customers, and others who rely on that business." [3]

The debtor remains in possession of its business and estate in Subchapter V and is authorized to continue to operate the business. Only the debtor in possession may propose a plan. A plan, to be confirmed, must provide for the payment to creditors of the debtor's disposable income over a three-to-five-year period.

A Subchapter V Trustee is appointed in every Subchapter V case. The duties of the Subchapter V Trustee include facilitating the development of a consensual plan of reorganization, ensuring that payments commence under the plan, operating the business if the debtor is removed from possession, and many if the duties of a chapter 7 trustee. The bankruptcy court, for cause, can expand these duties.

  

The editors of the *Norton Journal of Bankruptcy Law and Practice* asked several Subchapter V Trustees in different parts of the U.S. to give the *Journal*'s readers their thoughts regarding the new Subchapter V, in the following suggested areas or any other issues that they thought significant:

1. The strengths and utility of Subchapter V (including in comparison to Chapter 11 and other Chapters).
2. The goals of debtors in these cases, and the extent to which those goals are being achieved.
3. The involvement of creditors and other parties in interest in these cases.
4. The shortcomings of Subchapter V that might be improved on by further legislation, rules, and/or case law.
5. How Subchapter V cases are conducted in the district.
6. Any creative or unexpected use to which Subchapter V has been put.

Our aim was to give the *Journal*'s a broad, nationwide view of how Subchapter V is working in practice. The article which follows is a compilation of the responses that we received.

The Editors appreciate the contributions of these Subchapter V Trustees.

The Editors.

## A. EASTERN - 1 ST , 2 ND , 3 RD & 4 TH CIRCUITS

### I. Subchapter V in Virginia - The Recap

*By Paula S. Beran,* [4] *Subchapter V Trustee, Western District of Virginia and Eastern District of Virginia, Richmond and Norfolk Divisions*

Desiring a mechanism that would reduce the cost of Chapter 11 for small businesses and/or businesspersons to foster a better likelihood of successful reorganization, Congress enacted the Small Business Act Reorganization Act of 2019 on August 23, 2019 with an effective date of February 19, 2020. Bankruptcy constituencies across Virginia immediately embraced Subchapter V. In fact, the first confirmed Subchapter V plan addressed the debts of an individual represented by a seasoned Chapter 13 and 7 practitioner who had never filed a Chapter 11 case. In re Chamberland, No. 20-60300 (Bankr. W.D. Va. Feb. 21, 2020) (Connelly, J.). Key provisions to help facilitate a quicker, lest costly reorganization include:

1. Shorter deadlines, including date by which a plan must be submitted (90 days from entry of order for relief, *see* 11 U.S.C.A. § 1189(b)).
2. Debtor's exclusive right to file plan; and no disclosure statement required.
3. No creditors' committees (unless ordered otherwise).
4. No absolute priority rule
5. Ability to modify mortgage on principal residence when value recovered in said transaction was used in connection with business.
6. No quarterly fees to the Office of the United States Trustee; but a Subchapter V trustee is appointed and receives compensation from the estate.
7. Professionals remain disinterested with up to $10,000 owed pre-petition.

Given these provisions, as well as the stated desire from the Bankruptcy Judges in Virginia that it be a flexible, viable mechanism for deserving small businesses and businesspersons to successfully reorganize and the positive oversight from the Office of the United States Trustee, Subchapter V was positioned for success. And from the perspective of a Subchapter V Trustee serving in the Western District of Virginia ("**WDVA**") and the Eastern District of Virginia ("**EDVA**") Richmond and Norfolk Divisions, as well as debtor's counsel, Subchapter V has overwhelmingly accomplished its objectives in Virginia.

Individuals and businesses in Virginia have utilized Subchapter V. For example, the calendar year 2021 filings were:

  

| | INDIVIDUAL | BUSINESS | TOTAL |
|---|---|---|---|
| Alexandria | 3 | 4 | 7 |
| Norfolk | 3 | 1 | 4 |
| Richmond | 1 | 6 | 7 |
| Roanoke | 3 | 6 | 9 |
| **Total Virginia** | **10** | **17** | **27** |

Serving as Subchapter V trustee in ten bankruptcy cases, five involved individuals and five were business filings. Nine of the ten cases resulted in consensually confirmed plans pursuant to 11 U.S.C.A. § 1191(a). One case was proceeding to consensual confirmation when the individual unfortunately lost her employment for COVID related issues and, thus, the bankruptcy case was converted from Subchapter V to Chapter 7.

The Subchapter V election, if in a voluntary case, normally occurs within the petition, and if related to an involuntary case, must be made within fourteen days from the order for relief. Courts in Virginia have also allowed a debtor proceeding under traditional or small business Chapter 11 cases to amend a petition and make the Subchapter V election even when certain Subchapter V deadlines may have passed. In re Corbett, No. 19-36309 (Bankr. E.D. Va. Dec. 3, 2019) (Huennekens, J.); In re Hash No. 19-70820 (Bankr. W.D. Va. June 13, 2019) (Black, C.J.). Similarly, the Courts in Virginia have (1) allowed conversion from Chapters 13 and 7 to Subchapter V and (2) thereafter modified related deadlines. In re Speas, No. 19-72279 (Bankr. E.D. Va. June 14, 2019) (St. John, J.); In re Turner Long Constr., Inc., No. 19-71589 (Bankr. W.D. Va. Dec. 6, 2019) (Black, C.J.); In re Leroy William Bauserman, Sr., No. 20-30853 (Bankr. E.D. Va. Feb. 19, 2020). (Huennekens, J.).

Immediately upon filing of a Subchapter V case in Virginia, an individual from the Subchapter V trustee pool is contacted by a representative of the Office of the United States Trustee and requested to perform a conflicts' check to determine whether the individual is able to serve as the Subchapter V trustee. There are two pools in Virginia: one pool serves WDVA and Richmond, Norfolk and Newport News divisions of the EDVA; the other pool covers Alexandria division of EDVA (as well as the District of Columbia and Maryland). The Office of the United States Trustee requests the individual to complete a verified statement and return the document if no conflicts exist. Once appointed, the Subchapter V trustee almost immediately takes action and participates in the initial debtor's interview, assisting a representative of the Office of the United States Trustee in obtaining information about the debtor and anticipated reorganization pathways. Similarly, the Subchapter V trustee participates at the § 341 meeting with the same conducted by a representative of the Office of the United States Trustee. The Courts in Virginia expect the Subchapter V trustee to be an active participant and regularly seek the trustee's input on estate matters.

In Subchapter V cases, only debtors may file and present plans for confirmation. The time period by which they may file them, however, is much shorter, and absent an extension, the plans must be filed within ninety days from the order for relief. The standard for extension is the need is “attributable to circumstances to which the debtor should not be held accountable.” 11 U.S.C.A. § 1189. Practitioners initially feared that this standard would be too stringent and foreclose reorganizational opportunities. However, in Virginia this has not been an issue especially when the Court has been fully informed of the specific obstacles inhibiting the filing of the plan and parties either explicitly or implicitly (via opting not to object) support the requested extension. In re Corbett, No. 19-36309 (Bankr. E.D. Va. Dec. 3, 2019) (Huennekens, J.); In re Hash, No. 19-70820 (Bankr. W.D. Va. June 13, 2019) (Black, C.J.).

During the last two years, eligibility issues surfaced nationwide on the meaning of “engaged in business.” However, the same never really materialized in Virginia as a barrier to a successful reorganization. In fact, Courts in both the EDVA and the WDVA have allowed individual cases to proceed where financial issues were derived from a failed, closed business. In re Powell, No.

21-60890 (Bankr. W.D. Va. Aug. 12, 2021) (Black, C.J.); In re Speas, No. 19-72279 (Bankr. E.D. Va. June 14, 2019) (St. John, J.); In re Boone, No. 20-61106 (Bankr. W.D. Va. July 31, 2020) (Black, C.J.).

Many benefits of Subchapter V exist only if the plan is confirmed consensually pursuant to 11 U.S.C. § 1191(a). Accordingly, it is important to have creditors vote in favor of the plan. Consistent with human nature, the focus in Subchapter V cases has often been on the proverbial "squeaky wheels" and trying to work through obstacles. This can be problematic if all attention is provided to the "squeaky wheels" and no votes are ultimately obtained from other classes of creditor. While certain Courts have allowed the "deemed accepted" approach absent an objection given "deemed acceptance" authority within the circuit, s*ee* In re Robinson, 632 B.R. 208 (Bankr. D. Kan. 2021) (10th Circuit is "deemed acceptance" jurisdiction), the same is not the case in the 4th Circuit. Thus, reliance on "deemed acceptance" in Virginia is not advisable. Virginia Courts, however, have allowed limited workarounds in specific instances such as when it can be demonstrated that ultimately a class will not be impaired or similarly situated creditors in another class have voted in favor and the separate classification was for lien modification purposes only. In re Gemini Realty LLC, No. 20-31408 (Bankr. E.D. Va. Mar. 12, 2020) (Phillips, J.); In re Boone, No. 20-61106 (Bankr. W.D. Va. July 31, 2020) (Black, C.J.).

Similar to the nationwide practice, Subchapter V trustees in Virginia are primarily tasked with: (a) facilitating the confirmation of a consensual plan of reorganization and making sure the debtor commences payments under confirmed plan; (b) assessing the viability of a debtor's business and chances of reorganization; and (c) if the debtor is removed from possession, stepping in to operate business. The Subchapter V trustee has no official investigatory authority absent: (a) request and ordered for cause as provided in § 1183 or (b) court ordered as a term of a consensual plan. In Virginia, Courts have been willing to provide a Subchapter V Trustee with investigatory authority as part of the consensual plan. In re Turner Long Constr., Inc., No. 19-71589 (Bankr. W.D. Va. Dec. 6, 2019) (Black, C.J.).

Over the last nine months, Subchapter V case filings in Virginia have decreased. In fact, this Subchapter V trustee has received no appointments since August of 2021. And, although the decrease began before the sun set on the temporary debt limit increase to $7,500,000, the author is aware of numerous businesses who may need to seek Chapter 11 relief but are not currently eligible under the $3,024,725 cap. The success of Subchapter V in Virginia supports the proposition that the House of Representatives should consider and pass the Bankruptcy Threshold Adjustment and Technical Corrections Act, as amended, that was unanimously approved by the Senate on April 7, 2022.

The overwhelming success of Subchapter V in Virginia is certainly attributed to the design of the relief, practitioners embracing and utilizing the same for benefit of their clients, the positive oversight of the Office of the United States Trustee, and thoughtful and insightful application of the law by our Bankruptcy Judges. And the author would be remiss not to provide credit and a sincere thank you to the Honorable Paul W. Bonapfel, the U.S. Bankruptcy Judge for the Northern District of Georgia, for his continued sage guidance in the Subchapter V world with his incredible work "A Guide to the Small Business Reorganization Act of 2019."

## II. Subchapter V Trustee Experience/Thoughts

*By Francis J. Brennan,* [5] *Subchapter V Trustee, Northern and Western Districts of New York; District of Vermont*

The enactment of the Small Business Reorganization Act of 2019 ("SBRA") offered qualifying "small business" debtors an alternative to the more cumbersome process for a business reorganization under "traditional" Chapter 11 and addressed some of the deficiencies and unfinished business from the Bankruptcy Reform Act of 1994 (the "1994 Act"), which introduced the term "small business debtor" and relatively nominal modifications for such businesses attempting to reorganize under Chapter 11.

While the 1994 Act attempted to make the Chapter 11 process for small businesses more malleable, in reality its provisions did little to address the real hurdles small businesses faced in attempting to reorganize and continue as going concerns. Thus, permitting the court to dispense with filing and approving a disclosure statement with incorporation of the information from that statement in the debtor's plan alleviated the time and expense associated with the disclosure statement process. But the plan confirmation requirements of satisfying the Absolute Priority Rule or complying with the New Value Exception to it for the retention of ownership of the business, and of acceptance by at least one impaired class of creditors to satisfy the requirements of 11 U.S.C.A. § 1129(a)(10), often proved too high an impediment for a small business debtor to successfully reorganize.

  

Other factors further undermined the prospects for small businesses to reorganize. In my experience, upon a request under 11 U.S.C.A. § 1125(f)(1), courts in the Northern District of New York would generally determine that a disclosure statement was not required for a small business debtor, but the need to request that the debtor be excused from preparing and filing one instead of that being the default rule required the debtor to spend time and money for that determination. Payment of quarterly fees to the Office of the United States Trustee often proved to be an additional expense that debtors could not afford. Even the continuing availability of the New Value Exception to permit pre-petition equity to receive an interest in the reorganized entity was often unattainable because the debtor's principals had already invested their life savings in the debtor, perhaps including leveraging the family home in the process. Thus, the prospect of having to contribute money that the principal didn't have did little to facilitate a smoother path to confirmation for a small business debtor. The requirement to file a small business plan within 300 days of the petition date [6] and confirm the plan within 45 days of its filing [7] could also constrain a debtor that needed more time to propose and confirm a plan or whose case involved litigation. Absent extensions of those time periods by the court for cause shown as required by the statute, debtors who failed to meet one or the other deadline faced dismissal of their cases.

**The SBRA**

Enough time has passed since the effective date of the SBRA on February 19, 2020, for there to be useful analyses of the efficacy of the statute for small business debtors. Suffice to say, the results are positive. Subchapter V debtors are confirming plans at a rate greater than the rate for confirmation of non-Subchapter V Chapter 11 plans. [8] Every plan in a case in which I have been appointed as a Subchapter V Trustee in the Northern District of New York has been confirmed consensually or is on track to be confirmed consensually. While the sample size is admittedly small (I've been appointed trustee in seven cases since the effective date of the SBRA), those cases are representative of the types of cases generally filed in the Northern District of New York - businesses which are closely held, often with one or only a handful of members or shareholders; businesses operating in the service or hospitality industries; and businesses which generally are viable as long as they were not burdened with the costs of a non-Subchapter V Chapter 11 case.

**1. Strengths and Utility of Subchapter V/Comparison with Non-Subchapter V Chapter 11 and Chapter 7, 12 and 13 Cases**

As noted above, the most significant impediments to small business debtors successfully reorganizing in chapter 11, pre-Subchapter V, were costs and the procedural hurdles to obtain confirmation of a plan. The elimination of U.S Trustee fees is a significant cost savings for small business debtors. Similarly, the relatively short ninety-day period of time immediately following the filing date of the petition within which to file the plan compels the debtor and its counsel to proceed with alacrity to develop a plan with the likely cost savings in attorney's fees, but without the time constraint under 11 U.S.C.A. § 1129(e) to confirm that plan. The default that there will be no committee of unsecured creditors may be less of a cost savings as I rarely, if ever, saw such committees in small business cases, but it nevertheless eliminates another potential cost for the debtor.

Debtors intending to reorganize cannot avail themselves of Chapter 7. But some small business debtors, as discussed below, are eligible to elect to restructure under either Subchapter V, or under Chapters 12 or 13.

A “family farmer” eligible for Chapter 12 is not prohibited from instead electing Subchapter V treatment under Chapter 11. The $1,460 difference in the filing fee between Chapter 11 and Chapter 12 may be significant enough for a family farmer to file for relief under Chapter 12, but that decision is more likely to be based on the more generous and flexible adequate protection provisions under 11 U.S.C.A. § 1205 and the (arguably) lower standard for confirmation (in compliance with the provisions of Chapter 12 and not by any means forbidden by law) under 11 U.S.C.A. § 1225(a)(3) compared even to the “fair and equitable” standard in 11 U.S.C.A. § 1191(b). To the extent a family farmer prefers to avoid the vote solicitation process under 11 U.S.C.A. § 1129, a Chapter 12 filing seems more likely. The prompt entry of the discharge in a consensually confirmed plan under § 1191(a) may be preferable than the discharge under § 1228(a) following completion of payments under the plan.

In deciding between Subchapter V and Chapter 13, while the difference in the filing fees are a consideration, the debt threshold for Chapter 13, particularly with respect to unsecured claims, may be the deciding factor. The entry of a discharge immediately upon confirmation of a consensually confirmed plan under Subchapter V is preferable to the delayed discharge in a Chapter 13 upon completion of payments under the plan.

  

**2. Goals of Subchapter V, Chapter 11 Debtors**

Of the seven cases in which I have been appointed trustee, debtors in five of those seven cases proposed, or proposed and confirmed, reorganization plans, while the other two debtors filed their cases with the intention of liquidating their assets. One such liquidating debtor filed for liquidation after being unable to get the consent of a junior, ostensibly secured (but unsecured based on value) creditor to close on a short sale of commercial real estate outside of bankruptcy; effectively compelling the uncooperative creditor to accept treatment of its claim in bankruptcy that it was unwilling to agree to outside of bankruptcy. The second debtor filed specifically to obtain an order selling the debtor's assets free and clear of liens and encumbrances.

Thus, to the extent that the debtors sought to confirm reorganization plans and continue to operate, those plans were confirmed or are likely to be confirmed. Whether those businesses ultimately succeed in the long-term is unknown at this point as their plans were confirmed relatively recently, but those debtors continue to operate as of this writing.

The reorganization plans were consistent with plans in non-Subchapter V cases - undersecured creditors saw their claims bifurcated with secured claims reduced to the value of their collateral; tax claims were accorded treatment as provided under 11 U.S.C.A. § 1129(a)(9)(C) and (D); general unsecured claims were paid a reduced or (in one case) no dividend based on the debtor's projected cash flow and disposable income. Importantly, with the inapplicability of the Absolute Priority Rule, all of the plans provided for pre-petition equity to receive equity in the post-confirmation debtor and none provided for payment of New Value in exchange for that equity.

**3. The Involvement of Creditors and Other Parties in Interest in the Case**

With the exceptions of an undersecured creditor in one case, a mechanic's lienholder in another case that had been involved in protracted litigation with the debtor pre-petition, and a national supplier of construction materials with a claim against the debtor's principal individually under the trust fund provisions of New York's Lien Law in a third case, creditor involvement in the cases in which I have been appointed trustee is virtually non-existent except for voting. And voting by creditors is inconsistent and sporadic at best. I suspect this is because creditors in Subchapter V cases recognize the “fair and equitable” standard for confirmation under § 1191(b) will be fairly easily met by virtually all debtors.

**4. Shortcomings of Subchapter V**

While it would not have affected eligibility for the debtors whose cases I was appointed trustee in, the reversion of the debt limit to $2,725,625 ($3,024,725 as of April 1, 2022 based on the periodic adjustment of dollar amounts under the Code) from the $7,500,000 threshold provided under the CARES Act, as extended by the COVID-19 Bankruptcy Relief Extension Act of 2021, will likely exclude a substantial number of true small businesses from electing to proceed under Subchapter V. While the lower threshold is not insubstantial, it is relatively easy to conceive of debtors (including affiliates) whose total debt exceeds the lower amount when mortgage debt encumbering a debtor's real property or a loan secured by equipment is considered. Returning the debt limit to $7,500,000.00 would be an effective way to ensure that Subchapter V remains available for a substantial number of small businesses in need of relief.

While not a shortcoming of Subchapter V, and perhaps an intended consequence of the legislation to provide greater relief to small businesses than otherwise available in non-Subchapter V cases, there is little incentive for creditors to vote in favor of the plan to permit consensual confirmation. From the debtor's perspective, consensual confirmation results in entry of the discharge upon confirmation of the plan. Conversely, entry of the discharge order in a non-consensually confirmed plan must await completion of payments under the plan. Creditors presumably should prefer delaying entry of the discharge until all plan payments have been made. Notwithstanding that, the cases in which I have been appointed trustee and that have been confirmed were done so consensually. With the elimination in Subchapter V cases of the leverage creditors have in non-Subchapter V cases with respect to affirmative voting as a condition of confirmation under 11 U.S.C.A. § 1129(a)(7) and (8) and the Absolute Priority Rule, creditors have little incentive to actively participate absent an objection to eligibility or a valuation issue, for example.

**5. Conduct of Subchapter V Cases in the Northern District of New York**

In my experience, the bankruptcy courts of the Northern District of New York keep Subchapter V cases on a fairly short leash. Status conferences pursuant to 11 U.S.C.A. § 1188(a) are promptly scheduled after the filing of the petitions. I generally contact

  

debtor's counsel and counsel for any creditor that has been actively involved with the debtor pre-petition shortly after my appointment to determine whether the parties are amenable to negotiating treatment of the creditor's claim to obtain consensual confirmation. Absent a valuation issue for a secured creditor or an assertion that the debtor is not devoting all of its disposable income to payments under the plan, the confirmation standard under 11 U.S.C.A. § 1191(b) is a debtor-friendly standard that limits creditors' ability to impede confirmation.

**6. Creative or Unexpected Uses of Subchapter V**

While my trustee cases have had some interesting events precipitating filing, none have had terribly unique or unusual reasons for a filing. Two cases were filed to deal with protracted state court litigation, while two others were filed to take advantage of 11 U.S.C.A. § 363(f) and/or § 1123(b)(4) to effect sales free and clear of liens and encumbrances. In another case, the debtor is a contractor doing business as an LLC, while the principal is an individual debtor under Chapter 13. The objecting creditor asserted a claim that the LLC debtor violated applicable trust fund provisions of New York's Lien Law, which triggers personal liability for the individual member of the LLC. The creditor's objection was resolved with separate treatment of the Lien Law claim in the Subchapter V plan, with a reservation of rights by the creditor to assert the claim against the individual member in his Chapter 13 case in the event of a default under the Subchapter V plan that is not timely cured.

## III. Perspectives on Subchapter V from an Attorney Trustee and Accountant Trustee

*By Sam Della Fera, Jr.,* [9] *Subchapter V Trustee, District of New Jersey and Chuck Persing,* [10] *Subchapter V Trustee, Eastern and Southern Districts of New York*

The authors, Sam Della Fera, Jr. Esq., and Chuck Persing, CPA/CFF, CVA, CIRA, CFE have worked together on several Chapter 7 and Chapter 11 matters over the years, but not in the same case since they each were selected as a Subchapter V trustee in their respective districts upon the enactment of the new small business bankruptcy statutes.

They discuss below their experiences acting as trustees in Subchapter V cases, and their views on how the still new small business bankruptcy provisions work, or not, in practice, both in their separate districts and from the perspectives of an attorney and an accountant.

***What are the strengths and utility of Subchapter V?***

Chuck: Based on my experience, the Subchapter V addition to Chapter 11 of the Bankruptcy Code allows small business debtors to engage in an expedited filing-to-confirmation process, with reduced costs and fewer barriers to plan confirmation. Although the shortened timetable cuts both ways, debtors who are prepared will achieve confirmation far more often and under far more favorable terms of Subchapter V than in a standard Chapter 11.

Debtors who lack the will or ability to meet the new statutory requirements, and who do not maintain historical business records, need not apply. In my opinion, the prospects for a successful Subchapter V reorganization greatly diminish if the debtor is not making a good faith effort and there are inadequate records.

Sam: Without a creditors committee and quarterly fees payable to the United States Trustee's Office (USTO), Subchapter V debtors have a greater ability (and financial wherewithal) to quickly move the case to confirmation while working with the trustee to abide by the rules and keep all parties involved and informed.

Having a neutral third-party like the Subchapter V trustee as a sounding board, mediator, and objective voice with the creditors greatly facilitates the flow of the case and keeps costs down. The courts also have helped, for example by scheduling additional status hearings after the required initial conference to assist the trustee and debtor's counsel in guiding the case forward, including by the debtor's required plan filing within 90 days of the commencement of the case.

Dispensing with the confirmation requirement of an impaired consenting class of creditors permits a plan to be confirmed with no creditor support, and the Subchapter V absolute priority scheme eliminates the need for a new value contribution from business owners. This is a powerful advantage for debtors. In exchange, creditors are guaranteed to receive all of the debtors' disposable income over a period of three to five years.

  

The cumbersome plan solicitation process of standard Chapter 11 cases is much streamlined, I submit for the benefit of all parties. For example, the disclosure statement, rather than being a lengthy, often confusing, and largely unread document that requires pre-solicitation approval (with the attendant costs) is now just a few paragraphs in the plan document itself.

Chuck: It is important for debtor's counsel to note, however, that even though a new Code subsection was added for small businesses, many other Chapter 11 requirements continue to exist. These include those relating to the use of cash collateral, the assumption and rejection of contracts, and the debtor's preparation and filing of monthly operating reports. Sometimes the debtor or debtor's counsel tries to take too much advantage of Subchapter V, and cannot or will not do what is still required. It has been my experience that debtors and their counsel that involve the trustee or, at least, inform the trustee of their intentions and challenges have a far greater chance of confirming a plan.

***What are the goals of small business debtors in Subchapter V cases, and to what extent are those goals are being achieved?***

Sam: I have found that the goals of debtors in Subchapter V are largely the same as those in a standard Chapter 11 case, i.e., to obtain a respite from lawsuits and other aggressive creditor demands in order to get one's financial house in order, but with a greater emphasis on (a) incurring as few administrative costs as possible and (b) restructuring historic debt and maintaining business operations, rather than filing for the purpose of an asset sale followed by liquidation of the remainder. I believe those goals are being achieved by and large - consensual plans have been confirmed in all but one of my completed Subchapter V cases, with the single exception having ultimately been designated as a standard Chapter 11 case.

Chuck: The best cases in my opinion are those that have prior historical records, such that the business is easily adapted to make money again and the issues they are trying to solve, if solved, increase the likelihood of profitability.

There are a group of what I call issue-based cases, and by that, I mean things like landlord problems, unfavorable lender terms, and unreasonable creditors. These cases seem to work if the debtor is reasonable about the goals. I have seen debtors trying to solve lease issues, unwind or restructure merchant cash loans, unpaid sales and payroll taxes, settle disputes and judgments, drop unprofitable locations or operations, and stop foreclosures and/or aggressive creditors. In all but one of my cases the debtor was able to use good judgment, together with working with me and the creditor, to overcome these issues.

***What has been the involvement of creditors and other parties in interest in these cases?***

Sam: The courts have been by far the greatest factor in determining success of the cases, from ease of scheduling, working with debtor's counsel and the trustee to satisfy the Bankruptcy Code's and the court's procedures, and giving the benefit of the doubt (with support from the trustee) to the debtor and their counsel until it is no longer deserved. Bankruptcy judges are learning the new Subchapter V provisions like everyone else and even now, a little over two years later, they have little precedent to work with. They do their best to fulfill the statutory intent to assist small businesses while also guaranteeing due process and fairness to creditors.

The USTO trial attorneys and analysts are a close second. They have been proactive, and regularly engaged with both the Subchapter V trustee and the debtor over the course of the cases, often with gentle reminders (especially in the first year after Subchapter V was enacted) to keep the cases on track. While this continues, I have noticed the call for quicker action by the USTO attorneys, likely to ensure that debtors and their counsel have more accountability for the pace of the case.

Chuck: I find that individual creditors, often through counsel, generally are more involved in the pre-confirmation Subchapter V period. They seem to file claims more often, and on many occasions have reached out to me as the trustee directly with questions and requests for information. In no case of mine has the lessor, secured lender, or creditor with a long-standing dispute remained on the sidelines.

In standard Chapter 11 cases the interactions are primarily attorney to attorney. In Subchapter V cases, the neutral trustee is intimately involved and, as a non-lawyer trustee, I tend to bring the conversation from the strictly legal remedy to how to best resolve the case. For the most part this has worked well and has brought the interactions among the parties to a positive conclusion.

  

But not always, of course. In one case the creditor's counsel piled on motion after motion and appeared at each hearing, until ultimately the debtor and creditor agreed to a dismissal so that they could go back to state court. Despite my efforts, there was no discussion between the parties about how to solve the conflict, but only a desire for punishment for what transpired pre-bankruptcy. The creditor did have a number of legitimate complaints about the debtor's pre-petition actions, but it appeared to me that they were intent on destroying the debtor and the principals unless they were paid at once and in full, which likely was not financially possible.

Sam: The first point of contact by the creditor typically is with the debtor's attorney, as it should be, unless the creditor feels that they have been ignored. When I have been contacted by the creditor's attorney they appreciate my role and usually want to lay the foundation for their positions and suggested solutions.

Notwithstanding what I also perceive to be greater direct creditor participation in Subchapter V, I have not had a single credit card company, all of whom have internal legal departments, contact me in my cases. There were a few who voted on the plan, but most did nothing.

Chuck: I have had little interaction with taxing authorities, likely because their plan treatment under the Bankruptcy Code remains fixed. In all my cases, the taxing authorities have filed claims, but few have formally appeared. Where the debtor has disputed the claim, in all but one case the taxing authority worked with the debtor and/or its accountant to resolve the issue. There was one tax auditor who appeared to be conducting a full-scale audit, with request after request for information. In the end, the cost of the debtor's accountant responses was more than the additional tax he found due. If the debtor does not dispute the tax claims no interaction generally occurs.

***What are the shortcomings of Subchapter V that might be improved by further legislation, rules, and/or case law?***

Chuck: Fees have been a problem for cases that do not confirm. In addition to the unlikely payment of Chapter 11 administrative expenses in a small business case that is converted to Chapter 7, collection becomes almost impossible upon case dismissal. Debtors generally continue to dodge creditors (now including the trustee). One debtor in a dismissed case told me that his wife was going to file her first Subchapter V case to continue to tie-up the jointly owned real estate lender; the Subchapter V case was his third filing. In the event of nonpayment of the trustee's fees, the ability to reopen the case for the entry of an order directing payment should be made available.

Sam: Subchapter V trustee fees are at substantial risk, and a fee set-aside should be standard in all cases. Trustees are usually the last person standing (and holding the bag), as debtor's counsel gets an upfront retainer and, with appropriate disclosure, can be paid by the debtor's principal(s) with non-debtor funds. In the absence of quarterly fees or interim committee counsel fees payable during the case, debtors should be required to deposit a percentage of their monthly revenue with the Subchapter V trustee. This not only will ensure that trustee fees are payable, but the funds also could be used to fund initial payments due under a confirmed plan and would get the debtor in the habit of making regular, periodic bankruptcy-related payments, which are required in any event in most successful cases.

Also, Subchapter V trustees should be able to propose a plan and/or a sale of the debtor's business when the trustee is in possession. That is a rare circumstance, but it typically arises when the debtor is a bad actor. In that circumstance, why should the debtor retain the exclusive right to file a plan? The trustee should be able to propose, confirm and execute a liquidating plan rather than being forced to convert the case to Chapter 7, with the attendant additional costs and delay.

Chuck: I have also found that the Subchapter V trustee acting as the plan distribution agent is problematic - it is far too costly for the case, the final reports are much more complicated, and the time spent making the plan payments should be a responsibility of the debtor. The trustee should stay involved post-confirmation but should rarely, if ever, be the disbursing agent. When the trustee is not the disbursing agent, the discharge of the trustee from the case should be made automatic upon the filing of the final report.

***How are Subchapter V cases conducted in your district?***

Chuck: I have the privilege of serving in both the Southern Eastern Districts of New York, and the cases are conducted similarly in each:

  

- the debtor files the chapter 11 petition with the election for Subchapter V treatment
- the USTO requests me to act as trustee
- I file my verified statement of disinterestedness after my conflict check and review of the petition, schedules, and other filings
- the Initial Debtor Interview (IDI) and the section 341(a) meeting are scheduled after consultation among the USTO, trustee, and debtor's counsel. I make an effort to speak with the debtor before the IDI and impress upon the debtor the importance of providing all required financial information in advance; when that does not happen the case is more likely to go sideways
- the case status conference is scheduled by the court to be conducted within 60 days after the filing as required by the Bankruptcy Code
- I attend the IDI, section 341 meeting, and status conference, and ask questions and offer observations when requested or appropriate
- I monitor the debtor's business and case activities during the case. These include motions - remember, it is still a chapter 11 case, so professional retentions, cash management, cash collateral, utilities, and other matters will come into play. I also keep an eye on the filed monthly operating reports (still required even though quarterly fees are not due to the USTO), in particular the debtor's cash balance and unpaid post-petition bills. If the case is complicated or the business is operating at a loss, I ask the debtor to maintain a 13-week budget vs. actual and provide other financial reporting to me
- I set up periodic calls with the debtor and counsel regarding case status and operations, and I assess with them obstacles to consensual plan confirmation and might suggest a proactive course of action. I also make myself available for discussion with creditors' counsel
- I assist the debtor and counsel in the development of a plan that, preferably, can be confirmed consensually. This includes ensuring that they do a proper liquidation analysis and disposable income calculation (as an accountant I usually lend a hand). I also review the plan for completeness and try to get buy-in from larger creditors before the debtor files it, which generally must occur within 90 days of the petition date
- Finally, I attend the plan confirmation hearing and await the closing of the case, filing the necessary reports with the USTO. As a result of the problems identified above, I try not to be the plan disbursing agent.

Sam: The conduct of Subchapter V cases in the District of New Jersey is consistent with Chuck's description. The mood of the courts and USTO has been favorable, particularly given the impact of the pandemic, to Subchapter V debtors who are making a good faith effort to meet the Bankruptcy Code requirements. I expect that will continue to be true. Both the USTO and the bankruptcy bench appear to want to see these small business cases succeed, allowing debtors a bit more leeway in Subchapter V than they might otherwise have regarding adjournments, formal financial reporting, and non-mandatory deadlines. I attribute this to a concern about inappropriately ending the effort to confirm the small business case.

I too review the debtor's cash flow, projections, and other monthly financial reporting, but because I am not an accountant I rely primarily on the work of the debtor's financial advisor where one has been retained and enter into a regular dialogue with that estate professional.

Also, I often find myself acting as a de facto bankruptcy mediator, facilitating dialogue as a neutral party between counsel for the debtor and other creditors toward the development and negotiation of a consensual plan. Bankruptcy judges often consider the Subchapter V trustee's views in the case influential, so debtors and creditors both generally want to align their positions with that of the trustee, and a good trustee will attempt to reach an acceptable middle ground when necessary.

***Any creative or unexpected uses to which Subchapter V has been put?***

Chuck: I had a case where the debtor company and its principal (who also owned a non-debtor entity with equity) both filed small business bankruptcy cases. The debtor company filed to facilitate the sale of excess assets and to liquidate; the debtor principal was a guarantor but felt that his disposable income from other sources would be sufficient to pay a reasonable dividend in his case. Unfortunately, the principal was mugged and very badly hurt, and was not able to continue to operate the business. A state court guardian was appointed who was able to file a plan. I worked with the guardian to sell assets to a (disclosed) related party, pay off the secured debt, and use the excess funds to pay a reasonable dividend to creditors in the debtor's case. When

  

determining the plan dividend, debtor's counsel, the guardian, and I conferred on the amount, leaving as much for the individual debtor as we could to maintain him until he recovered from his injuries. To my surprise and delight, no creditors objected and the bankruptcy judge asked if there were enough funds for the principal's care and rehabilitation.

Another case I had was a conference event company, and the primary issue was the large amount of deposits on hand for future events, some of which were cancelled due to Covid, and related preservation of customer relationships in response to the filing. We used the plan to provide creditors a pathway to attend the event or another event and retain the full deposit, or to take the reduced cash distribution. The disposable income was not substantial and the foreign parent funded the plan, allowing the debtor to make a dividend in excess of the liquidation value while providing for the deposit creditors to remain whole and go forward with their event if they wanted to.

Sam: One aspect of Subchapter V practice that I did not anticipate is the number of individual debtors who have taken advantage of the new law. Fully half of my trustee cases have been filed by individuals. Congressional intent for the new law was clearly to assist small businesses who could not afford the costs associated with a standard Chapter 11 case; but it is equally clear that individuals qualify for Subchapter V treatment as long as 50% or more of their non-contingent liquidated debt arose from their "commercial or business activities." Courts have broadly construed those activities to allow many individuals with even attenuated business-related debts to qualify for Subchapter V treatment.

In addition, although there is a limitation on the amount of debt that an individual or corporate entity can carry to qualify as a Subchapter V debtor ($3,024,725 as of this writing, which is expected to increase back up to $7,500,000 under pending legislation), as set forth above only "non-contingent" and "liquidated" obligations are included in the limiting debt calculation. As a result, certain guarantee liabilities and debts that have not yet been reduced to judgment, or are otherwise contingent and unliquidated, even if in the tens of millions of dollars, are not included in the small business debt limit calculation. This could allow for even larger companies to utilize Subchapter V, and makes the timing of a small business filing (i.e., before the debt is liquidated) strategically important.

***Conclusion***

The authors agree that many small business debtors, corporate and individual alike, have benefitted from the provisions of Subchapter V, and will continue to do so. Those provisions have streamlined the Chapter 11 process as to both cost and time, and have allowed a higher percentage of confirmed plans in Chapter 11 cases.

Based upon their experiences, Subchapter V should be amended to offer trustees a better chance of getting paid for their efforts, and to provide an alternative to case dismissal or conversion when a debtor cannot, or will not, propose a confirmable plan.

## IV. Views of a New Jersey Sub V Trustee

*By Nancy Isaacson,* [11] *Subchapter V Trustee, District of New Jersey*

In early 2019 I heard rumors about an amendment to chapter 11 which would streamline the reorganization process, and make it more affordable and efficient for small business debtors. It piqued my interest because New Jersey has a plethora of small family-owned businesses for which a traditional chapter 11 was too expensive. As a chapter 7 trustee for more than 20 years, I've seen my share of family-owned businesses that liquidated because they could not afford the traditional chapter 11. Owners liquidated their retirement plans and borrowed against their homes to save the business only to lose the business in the end.

The Small Business Reorganization Act ("SBRA") 11 U.S.C.A. § 1183 et seq., facially seemed like the proverbial shot in the arm New Jersey business owners needed. The legislative history and commentary corroborated my anticipation. SBRA was intended to afford a debtor, whether an individual or a business entity, a more efficient and economic method to reorganize under Chapter 11. SBRA requires, *inter alia,* the appointment of a "Subchapter V Trustee" to act as a facilitator to resolve disputes/issues between the debtor, its creditors and/or other parties in interest to foster a consensual reorganization plan. The concept of the Subchapter V trustee as a facilitator intrigued me. I have been an approved bankruptcy mediator for the New Jersey Bankruptcy Court since the mediation program was established in the in 1985 by then Chief Judge William H. Ginden. Pursuant to New Jersey local bankruptcy rule (D.N.J. LBR 9019-1), mediation is now mandatory for all adversary proceedings unless otherwise ordered by the court. Parties talking instead of litigating has proven quite successful.

  

In the two years since my appointment, my Subchapter V trustee cases for individuals and businesses, I have dealt with issues of eligibility, disposable income, mismanagement, removal of the debtor in possession and debtor's counsel's lack of chapter 11 experience and frustration with the limitations of SBRA.

I received notice of my appointment to my first Subchapter V case within one month of SBRA becoming effective on February 19, 2020—an individual with legacy debt from a failed business. The questions that immediately jumped out to me were (1) does an individual debtor with legacy debt qualify as a Subchapter V debtor since the debtor is not "engaged in commercial or a business activities," 11 U.S.C.A. § 1182(1), and (2) how do I determine if the debtor is not entitled to a discharge if I am not permitted to investigate the debtor's financial affairs? See 11 U.S.C.A. § 1183(b)(1) which excludes 11 U.S.C.A. § 704(a)(4) (Chapter 7 trustee duty to investigate the financial affairs of the debtor). I determined that it was not worth litigating these issues because the case had very few creditors and few assets other than W2 income. A consensual plan was confirmed, the debtor received a discharge and the issues identified remained unresolved. How can a Subchapter V trustee object to a debtor's discharge without the ability to review financial records and does a debtor with legacy business debt qualify for Subchapter V? [12]

My next case was a traditional chapter 11 business case that had been converted to a Sub V case at the bankruptcy court's suggestion in reaction to the request of a creditor to convert or dismiss the Chapter 11 because of alleged mismanagement by the managing member. The parties agreed, the case converted to Subchapter V, and I was appointed. Within days of my appointment, the largest creditor sought to remove the debtor from possession of its assets because of the managing member's mismanagement (diversion by and to the managing member of the proceeds from a Small Business Administration PPP loan obtained while in the traditional chapter 11 without court approval). The Court determined to remove the debtor of possession and I became the Trustee in possession of the Subchapter V debtor's assets - the first in NJ! The order removing the Debtor from possession also expanded the Subchapter V Trustee powers pursuant to 11 U.S.C.A. § 1106(a)(3) to investigate the debtor's financial affairs.

While my investigation identified assets to be liquidated for benefit of creditors, I quickly learned that the tools in my toolbox were limited. 11 U.S.C.A. § 1189(a) permits only the Subchapter V debtor to file a plan, so having removed the debtor from possession, how is the case administered? In consultation with the US Trustee, I determined that selling the assets was appropriate. I found a purchaser for the business assets, entered into a management agreement with him until the asset sale could be approved by the Bankruptcy Court. Thereafter, I negotiated a settlement with the creditors which was approved by the Bankruptcy Court and, made disbursements pursuant to the Settlement Agreement. With administrative expenses and creditor claims paid a dividend, and the debtor depleted of assets, the case should have converted to a chapter 7.

However, Debtor's sole member reached out and asked me not to convert the case because he believed Debtor's first bankruptcy counsel may have committed malpractice. After investigating the merits of the alleged malpractice, I agreed with Debtor's principal that the case should be prosecuted for the benefit of creditors. Since I was not permitted under the bankruptcy code to file a plan, I asked Debtor to do so. Over various objections of the largest creditor, Debtor confirmed its nonconsensual plan of reorganization to permit Debtor to pursue the malpractice case, with me remaining as trustee in possession to administer the disbursement of funds realized from the malpractice litigation. Special malpractice counsel was retained.

A cautionary observation. Once a debtor is out of possession, a debtor no longer needs an attorney which renders Debtor's bankruptcy counsel's compensation at risk. For this reason, in a recent case, In re NIR West Coast, Inc., [13] the bankruptcy court denied the out of possession debtor's counsel legal fees. If SBRA permitted the Subchapter V Trustee to file a plan, this harsh consequence would be avoided.

In another matter, I was appointed in a case that was transferred from Nevada to New Jersey because the debtor's business operations were located in New Jersey. Eligibility for Subchapter V immediately became an issue when it was learned that the Debtor had related entities subject to the Securities Exchange Act of 1934 thereby removing the Debtor from eligibility for Subchapter V pursuant to 11 U.S.C.A. § 1982 (1)(B)(ii) or (iii). The motion objecting to eligibility was filed by the US Trustee under Federal Rules of Bankruptcy Procedure ("FRBP") 1020, which requires the objection for "small business debtor's" eligibility to be made within thirty days of the date of filing the petition. It should be noted neither the bankruptcy code nor the FRBP state that Subchapter V debtors are subject to Rule 1020. Indeed, Rule 1020 refers to 11 U.S.C.A. § 1121 (who may file a plan under a traditional chapter 11) not 11 U.S.C.A. § 1188 (who may file a plan under Subchapter V).

  

The time to object to eligibility is very important. It impacts the rights of all constituencies to a bankruptcy proceeding. A debtor can feel safe that it will not be challenged on eligibility and then find itself faced with an eligibility challenge at confirmation. I had an individual Subchapter V debtor with legacy debt from failed real estate venture where his creditors raised eligibility at confirmation alleging that the debt exceeded the $2,750,000 cap. The Bankruptcy Court directed the debtor to amend his petition to accurately set forth his debt and remove the business debt for which he did not have liability. Luckily for this debtor, he was able to confirm a nonconsensual plan and overcome the very late eligibility challenge. Other debtors may not be so lucky.

By not having a specific rule setting a time period in which creditors and other parties in interest must object to a debtor's Subchapter V eligibility, and have a hearing on the objection, it is possible for a Subchapter V bankruptcy to proceed through confirmation and then find itself defending an eligibility challenge. [14]

In the case transferred from Nevada, while the objection filed by the US Trustee's office was filed under Rule 1020, a hearing on the objection has not been held. The case is proceeding as if it is legitimately a Subchapter V case. The consequences are obvious—legal fees are accruing and parties are prevented from seeking their state court remedies and the court may ultimately find that the debtor is not eligible for Subchapter V.

Subchapter V's purpose and intent may be the anodyne for the midmarket businesses facing financial distress. SBRA just needs a few adjustments, i.e., expanding the parties who may file a plan; setting specific time frames for an objection and hearing related to eligibility; and giving Subchapter V trustees investigative powers.

**V. Subchapter V**

*By David Klauder,* [15] *Subchapter V Trustee District of Delaware*

Chapter 11 bankruptcy has long been known to be an expensive and complicated process for businesses attempting to reorganize and rehabilitate their financial situation. Prior to 2020, this was especially true for small businesses whose chapter 11 cases often were doomed to fail because of the difficulty with navigating the chapter 11 process. The administrative expenses alone in chapter 11 bankruptcies made it extremely difficult for small businesses to successfully reorganize. In 2020, legislation went into effect to specifically assist small businesses in the chapter 11 process. Subchapter V, a subset of chapter 11 of the Bankruptcy Code, was created exclusively for small businesses. Generally, Subchapter V is meant to reduce the costs of a chapter 11 bankruptcy process, and make reorganization more achievable for small businesses. This article addresses some of the relevant features of the law and some early impressions of its success.

A debtor must qualify to elect Subchapter V status. To qualify, a debtor must have noncontingent, liquidated secured and unsecured debts of not more than $2,725,625. This debt limit was temporarily raised to $7,500,000 during the COVID-19 pandemic, but the provision reverted to the original debt limit on March 27, 2022. As a result of the higher debt limit, more businesses were able to utilize Subchapter V, and there is a belief that Congress will eventually raise the debt limit back to the $7,500,000 amount. In addition, a Subchapter V debtor must be “engaged in commercial or business activities” (and those activities cannot be simply the business of owning single asset real estate). So far, bankruptcy courts have liberally interpreted the definition of engaging commercial or business activities in favor of debtors.

Several provisions of Subchapter V are unique to it and intended to accomplish the goal of making reorganization achievable for small businesses. At the outset of a case, a trustee is appointed for the duration of the case. This is not a traditional bankruptcy trustee in the sense that the trustee is managing or operating the business or liquidating its assets. Rather, the Subchapter V trustee oversees the bankruptcy case and serves more as a facilitator to assist in a successful reorganization for the debtor. In some instances, the Subchapter V trustee may serve as a quasi-mediator in attempting to bridge differences between a debtor and dissident creditors. The trustee also serves in a pseudo-committee role and can make recommendations about the chapter 11 plan to the court. Another important distinction about Subchapter V is that an unsecured creditors committee is not appointed in a Subchapter V case. This greatly reduces the administrative costs for the debtor.

Debtors in Subchapter V bankruptcy filings enjoy the exclusive right to file a chapter 11 plan. This differs somewhat from a traditional chapter 11 filing. While unique even in traditional chapter 11 cases, creditors can file their own chapter 11 plan after a certain amount of time has passed since the debtor filed bankruptcy. In a Subchapter V case, by contrast, the debtor is the sole and exclusive party that can propose a chapter 11 plan. In addition, in a Subchapter V case, the chapter 11 plan must be

  

submitted to the court within 90 days of filing, although bankruptcy courts have shown over the short period the law has been in effect that an extension will be provided upon a modest showing of cause.

As a relates to a chapter 11 plan, like in a traditional chapter 11 filing, the debtor must demonstrate that the creditor is receiving more in a chapter 11 restructuring than they would in a chapter 7 liquidation. However, important creditor advantages are loosened for plan confirmation in a Subchapter V case in comparison to chapter 11. A Subchapter V debtor is more likely to confirm a plan over creditor objections, because an impaired class of creditors is not needed to vote in favor of a plan to confirm the plan. Also, the absolute priority rule is not applicable to equity, thereby allowing equity holders of a Subchapter V debtor to keep their equity notwithstanding the creditors not being in full on their claims. This is a critical part of the law as most small businesses are closely held and equity is not widely distributed, so the law permits equity to remain while not requiring often debilitating payments to creditors.

Creditors still have some of the protections they normally experience throughout the bankruptcy process. Most importantly, secured creditors still maintain their security interest in the collateral pursuant to their loan agreement. Secured creditors also maintain the right to seek relief from the stay if it is necessary to protect their collateral. Unsecured creditors, however, lose a lot of leverage in a Subchapter V case, because they lose their ability to block a chapter plan from being confirmed through dissenting votes on the plan.

There are other important changes that benefit debtors in Subchapter V. First, debtors do not pay the quarterly United States Trustee fees that are due in traditional chapter 11 cases. Second, debtors can pay administrative fees (including legal and professional fees) over the 3 to 5-year term of the Subchapter V plan as opposed to on the effective date of the plan, which is traditionally shortly after the plan is confirmed. Third, the debtors can present a chapter 11 plan that repays creditors over the course of the 3 to 5-year plan period. In this type of plan, the debtor is tasked with projecting future income and repaying creditors with any disposable income after necessary expenses. Finally, debtors do not have to submit a disclosure statement with their chapter 11 plan, thereby further saving administrative costs that are incurred in developing and filing a disclosure statement.

In the limited time this law has been in place, the Delaware Bankruptcy Court has shown a willingness to shepherd these cases to a successful resolution through confirmed Subchapter V plans. The Delaware Bankruptcy Court has provided debtors with leeway in administering these cases, particularly with the tight timing requirements for filing a plan. Extensions to file plans have been liberally granted. In many respects, and the Delaware Bankruptcy Court has expressed this on several occasions, the presence and engagement of the independent Subchapter V Trustee has provided the Court with comfort in allowing the Subchapter V process, in particular creditor negotiations, to play itself out even in circumstances where the initial 90-day plan deadline must be extended. It has become clear that the judges who oversee these cases on the Delaware Bankruptcy Court are interested in seeing these small businesses successfully reorganize, especially in light of the Covid-19 pandemic that ravaged so many small businesses.

One area of particular interest and worth monitoring as the law progresses is the appointment of a Subchapter V Trustee with expanded powers. While addressed generally in the Bankruptcy Code, [16] it is a safe assumption that the drafters of the statute were not necessarily contemplating Subchapter V Trustees to become like traditional trustees in bankruptcy by either operating a business or liquidating the debtor's assets. Yet, there are some cases in which the courts have expanded the role of the Subchapter V Trustee to include additional duties, either because of a debtor's misconduct or a debtor's inability to confirm a plan coupled with creditor disillusionment. While these still are the most unique cases and debtors perform their standard duties in most Subchapter V cases, it will be interesting to monitor the cases to see if expanded power orders for Subchapter V trustees become more prevalent. If so, it may be a situation that provides a creditor with some negotiating leverage if circumstances warrant.

To summarize, Subchapter V provides small business debtors with the opportunity to restructure without facing many of the administrative barriers that traditionally make it too expensive for small businesses to pursue a chapter 11 reorganization. Especially after the debt limit was raised during the pandemic, small businesses had a lifeline to address some of the disruptions they experienced. It is the hope of this author that Congress eventually increases the Subchapter V debt limit again to allow for broader access to a law that is providing much needed assistance for companies to reorganize and rehabilitate. Certainly in the two years since passage, this legislation has shown to be generally successful in accomplishing the primary goal of having small businesses achieve reorganizations through a chapter 11 process.

**VI. Survey of Subchapter V Cases In South Carolina**

  

*By J. Kershaw Spong,* [17] *Subchapter V Trustee, District of South Carolina*

The Small Business Reorganization Act of 2019 (SBRA), signed into law by the President on August 23, 2019, enacted a new section of Chapter 11 of the Bankruptcy Code: Subchapter V codified as new 11 U.S.C.A. §§ 1181 to 1195. The purpose of the SBRA is to "streamline the process by which small business debtors reorganize and rehabilitate the financial affairs." [18]

After considering numerous applicants, Region IV of the United States Trustees Office (UST) appointed two Trustees to handle cases in the District of South Carolina on a case-by-case basis.

On February 28, 2020, I was appointed Subchapter V Trustee for the first Subchapter V case in South Carolina. Since then, I have been appointed Subchapter V Trustee in seven cases. Of these cases, one was dismissed, five have been confirmed on a consensual basis, and one is pending.

In South Carolina, the Trustee is expected to participate, at a minimum, in four milestones in the case: 1) the Initial Debtor Interview (conducted by the UST); 2) the 341 hearing (conducted by the UST); 3) the Status Conference; and 4) the Confirmation Hearing.

Underlying this participation is the ongoing duty of the Subchapter V Trustee to "facilitate the development of a consensual plan of reorganization." § 1183(b)(7).

Generally, compensation for the Subchapter V Trustee is awarded after a court has reviewed and approved a fee application based on hours spent on the case. Other methods of compensation may be considered, such as a percentage fee, or a blend of hourly fee and percentage of disbursement; but to date, this has not occurred.

Trustee fees have typically been paid in part at confirmation, with the balance paid over a set time in the Plan. As explained below, in two cases, this arrangement resulted in no compensation for the Trustee. Not ideal for the Trustee!

A survey of the cases follows.

Case One. This case was one of the first Subchapter V cases filed and occurred during the peak of the pandemic. The goal of the debtor was to address his individual liability on personal guaranties arising out of his previous business. It was an individual case and the debtor was not seeking to reorganize his failed business. Accordingly, the UST filed a motion to strike debtor designation as a Subchapter V case because debtor did not meet the definition of a "small business" debtor pursuant to 11 U.S.C.A. § 101(51D). The court found the debtor personally eligible because the debtor was "engaged in commercial or business activities" by addressing residual business debt and otherwise meeting the remaining requirement under § 101 (51D). As mentioned, this case was filed during the height of the pandemic, and may have reflected the desire of the court to give a broad reading of Subchapter V eligibility. Unfortunately, the case was ultimately converted to a Chapter 7. Moreover, since there were no available assets and the Plan was not confirmed, the Subchapter V Trustee went uncompensated. Not a good result from the Trustee perspective!

Case Two. This Subchapter V case involved a golf course filing to reorganize and stop the foreclosure initiated by the major secured creditor. The debt was restructured and a consensual Plan was confirmed. The Trustee acted as a facilitator to assist the parties in formulating a consensual Plan. Contributing to confirmation was the fact that the secured creditor was over-secured. The Trustee was paid the majority of his hourly fees upon confirmation, with the balance to be paid over the life of the Plan. Unfortunately, the debtor complained about all the legal and administrative fees in the case, and stubbornly refuses to pay the balance of the Trustee fee. Since the debtor has received his discharge and the Trustee role terminated, it leaves the Trustee in a quandary on how to get paid the balance. The only real option is to sue in State Court, which the Trustee has elected not to pursue.

Case Three. This case involved an individual debtor seeking an orderly liquidation of his various business entities. The debtor was engaged in numerous real estate ventures through partnerships and LLCs which needed unwinding and liquidation. The Plan provided for liquidation over time with payments disbursed to respective creditors. Helpful to a consensual confirmation was a large amount of cash on hand from a recent sale. The Plan provided for specific timetables for liquidation which, if not

  

met, envisioned a party in interest having the Trustee reappointed post-confirmation to take over the liquidation process. So far, the Plan is on track. All Trustee fees were paid out of the initial disbursement shortly after confirmation.

Case Four. This case involved the reorganization of an arcade and food establishment negatively impacted by the pandemic. The goal of the debtor was to stop the lease termination and eviction. At issue were the terms of the lease which went beyond merely accepting or rejecting the lease. With some facilitation from the Trustee, but mostly by the respective parties and attorneys, the lease issues were resolved, and a consensual Plan confirmed. The Trustee fees are being paid in the first few years of the Plan.

Case Five. This case involved the reorganization of an ambulance service based on improved financial projections coming out of the pandemic. The case proceeded in a timely manner and a consensual confirmation was reached. The Trustee has been paid over the life of the Plan.

**CONCLUSIONS**

Overall, Subchapter V appears to have been of some benefit to debtors in South Carolina. The number of filings is less than expected - perhaps due to robust government financial assistance from pandemic programs. The types of debtors have been diverse: an individual addressing liability from past business failure, a golf course, a small trucking company, a real estate developer, an ambulance service, an arcade, and a farmer. Despite the variety of types of debtors, they were, for the most part, able to take advantage of Subchapter V provisions. This suggests Subchapter V can be of assistance on a broader scale than is currently being used. Arguably, providing for a quicker and cheaper reorganization path for debtors. It is still new and its success will further depend on the debtor bankruptcy bar becoming more familiar with it. The debt limit needs to remain at the $7.5 million range for it to have any real impact going forward. Finally, near and dear to the Trustee's heart, the Trustee compensation for case-by-case Trustees constitutes an ongoing challenge to be fair to the Trustee and debtor alike. Trustees need to be cautious in relying on the debtor paying the Trustee over the life of the Plan, but sensitive to debtor's cash flow and costs.

## VII. Thoughts on Subchapter V

*By Steven Weiss, Subchapter V Trustee,* [19] *Districts of Maine, Massachusetts, New Hampshire and Rhode Island*

Since Subchapter V became effective a little over two years ago, I have been appointed as Subchapter V trustee in 12 cases, which has provided me, I think, with a fair ability to assess the benefits of the statute. Additionally, I am a member of the Subchapter V subcommittee for the National Association of Bankruptcy Trustees. [20] I strongly believe that the statute is a resounding success, as it is meeting the stated goals of making Chapter 11 reorganizations more accessible and more successful for small business debtors.

I feel that a couple of preliminary comments are in order. First, to date, of the cases in which I have been appointed, fully 50 percent of them have been resulted in a confirmed Chapter 11 plan (with two recently filed cases still pending). That is a much higher success rate than has typically been true of “traditional” small business Chapter 11 cases. They have also been confirmed in well under a year after the filing date. I believe that my experience is consistent with the results being seen nationally. That alone is cause for celebration.

Second, shortly after the statute went into effect, the cap on the amount debt for determining eligibility for Subchapter V relief was increased from $2,725,625 to $7,500,000 through the CARES Act. However, the increased cap amount had a “sunset” provision, so on March 27, 2022 the cap reverted to $2,725,625. As of the date of this piece no increase has been approved by Congress, even though there appears to be no organized opposition to making the $7,500,000 cap permanent and, indeed, there appears to be some support for increasing the debt limit to $10,000,000. Until this is remedied, the overall effectiveness of Subchapter V will be unduly restricted. While my 12 cases are obviously only a small sample, 5 of them have fallen in between the lower cap and the temporary, higher debt limit. Absent legislative action, the door to Subchapter V relief will be closed for a great many small business debtors.

**The Benefits of Subchapter V**

In my view, the two biggest advantages of Subchapter V are interrelated: first, a plan has to be filed within 90 days after the petition is filed; second, there is no need to file a disclosure statement. Traditionally, for most small to medium size debtors, the longer they stay in Chapter 11, the less likely it is that they will successfully emerge from Bankruptcy Court. Traditional Chapter

  

11 cases have no meaningful deadline for filing a disclosure statement and plan of reorganization, unless specifically ordered by the court. In the absence of a deadline, many small business debtors get comfortable with the protections of the bankruptcy court. Cases languish, the quarterly fees pile up, and the administrative costs—largely professional fees for the debtors' counsel and creditors' committees—continue to accrue. And in a traditional Chapter 11 the latter must be paid in full at confirmation. The requirement for debtors' counsel to file a plan within 90 days helps to alleviate these problems. I recognize that this only means that a plan has to be *filed* within 90 days, and that there is no deadline for *confirmation* of a plan; nonetheless, the deadline compels debtors and their counsel to focus not just on getting into Chapter 11, but on how to *get out* of bankruptcy court expeditiously.

Similarly, not requiring a separate disclosure statement can significantly shorten a Subchapter V debtor's stay in Chapter 11. In traditional Chapter 11 cases, the process for approval of a disclosure statement and confirmation typically each takes several months. Each iteration of an amended disclosure statement requires updated financial reports and projections. And I tend to be cynical about how informative disclosure statements in small Chapter 11 cases really are. It is not unusual for the period from the filing of the initial disclosure statement to plan confirmation to take six months or more. While a Subchapter V plan still has to contain enough elements of disclosure to enable the court and creditors to make principled decisions on whether the plan ought to be confirmed, having one combined hearing on both disclosure and confirmation significantly expedites the confirmation process.

A third—and significant—advantage to Subchapter V is the elimination of the "absolute priority" rule of Bankruptcy Code § 1129(b)(2)(B) for the owners of the business. Unlike traditional Chapter 11 cases, Subchapter V does not require that owners of small business Chapter 11 debtor (who are often themselves undercapitalized) make a personal capital contribution of "new value" in order to retain their ownership interests. Instead, § 1191(c)(2)(A) provides that a plan can be confirmed if a debtor pledges its projected disposable income to creditors for a three- to five-year period (and so far I've only seen 3 year plans submitted). The absolute priority rule is often an obstacle to confirmation; Subchapter V removes this impediment.

**The Subchapter V Trustee's Role**

The role of a Subchapter V trustee is unique. We're not operating trustees, and absent court order, we do not have the authority to sell a debtor's assets or file a plan. Neither are we exactly in the same position as unsecured creditors' committees, whose agenda is to maximize recovery for creditors, often in ways that may be hostile to debtors' plans. Instead, the trustee's stated role is to "facilitate" the confirmation of a consensual plan of reorganization. And I think that, too, has improved the success rate of Subchapter V cases. In one instance I helped negotiate and document a settlement between the debtor and a secured creditor on a voidable lien, which funded the Chapter 11 plan; in another, I urged the debtor and a very antagonistic creditor to submit their dispute to mediation, which was successful, and enabled a consensual plan to be confirmed. In most cases I've served as a resource and a sounding board for debtors' counsel as they attempt to develop a feasible Chapter 11 plan. Additionally, the judges before whom I practice have also referred to us as "supervising" trustees, i.e., to monitor debtors' progress and to weigh in on the debtors' reorganization efforts. Again, I think these efforts improve debtors' chances of successfully emerging from Chapter 11.

**Suggestion for Improvements**

The biggest uncertainty in Subchapter V cases is establishing some uniformity for Subchapter V trustee compensation. The Code makes no provision for ensuring that debtors set aside reserves for trustee compensation (subject to allowance of fee applications). Some courts have issued standing orders requiring monthly payments by debtors to case trustees, while other courts have issued orders requiring payment of a reserve to trustees in specific cases; however, some courts are reluctant to order any payments to trustees until and unless a case is confirmed. Subchapter V debtors do not have to pay quarterly fees to the United States Trustee as the price for being in Chapter 11, nor will they be saddled with fees for professionals retained by unsecured creditors' committees. But they ought to be required to establish a segregated reserve for payment of the trustees serving in their cases, and there ought to be some uniform procedures established, either through further amendments to Title 11 or through the rule making process.

## B. CENTRAL - 6TH, 7TH, 8TH & 11TH CIRCUITS

### VIII. Subchapter V

*By Kelly M. Hagan,*[21] *Subchapter V Trustee, Western District of Michigan*

  

In January 2020, I became eligible to receive trustee appointments in subchapter V cases in the Western District of Michigan (which covers the western half of the lower peninsula and the entire upper peninsula). Since then, I have been appointed in nine subchapter V cases (one just days ago after a year in which I received no appointments due to a lack of filings). In the first case, subchapter V was incorrectly elected by the debtor (who was ineligible for relief under subchapter V) and my involvement was quickly terminated. Of the remaining cases, one was filed by an individual and two were being jointly administered; in three of the nine cases I was appointed successor trustee (in one case less than two weeks before the plan confirmation hearing). Two plans were confirmed under 11 U.S.C.A. § 1191(b) (on a "non-consensual" basis); in one, I continue to distribute payments pursuant to the plan and in the other, the plan provided that the debtor would make the lump sum payments, which were due shortly after plan confirmation. The other six plans were confirmed under 11 U.S.C.A. § 1191(a). My experience in these cases has led to the conclusions that follow.

Subchapter V has proven to be a success in our district thus far, likely due in part to the absence of quarterly fees and the support of the bench and the U.S. Trustee Program. The stakeholders on the whole appear invested in ensuring the success of these cases. Even despite the lack of funding from quarterly fees, the U.S. Trustee's Office is very involved in these cases, working diligently with the debtor, its counsel, and the subchapter V trustee to help fulfill the legislature's intentions in enacting SBRA.

In contrast, the creditors in a fair share of these cases have been slow to engage, if at all. Some of this may be due to the nature of the debt in some of these cases, namely online loans. In other cases, it is less clear why there has been a lack of creditor involvement. For example, in the case in which I have been making distributions, one creditor has inexplicably failed to negotiate its checks regularly, resulting in multiple discussions with the creditor. Oddly, one of the cases that was confirmed as a non-consensual plan was a 100% plan; ironically, it was being jointly administered with a case which proposed less than a 100% dividend that was confirmed on a consensual basis.

The role of the trustee has varied greatly in my cases. Under the Act, the trustee's primary role is arguably to facilitate the filing of a consensual plan. However, my experience is that I often do not act in that capacity. For example, where DIP counsel is experienced in chapter 11, they have often negotiated directly with the creditors and I have had minimal involvement. In other cases, where counsel is not as well-versed in chapter 11, my role has been primarily as a mentor. Even so, our role as facilitator has prompted me on more than one occasion to wonder where our duties lie when we as trustees have concerns about the plan but it is clear from the votes that creditors support the plan; is it our duty to challenge the plan, even at the risk of undermining creditor confidence in a plan? It is a question which has arisen for me more than once, for which I do not yet have an answer.

As with any new legislation, the implementation of the Act has revealed areas where amendments could prove useful. One such area is trustee compensation. Subchapter V trustees are compensated using the same procedures as chapter 7 and 11 trustees, with one significant difference - in subchapter V case, the trustee may not have any control over funds. In cases where the plan was consensually confirmed, and the trustee is paid upon confirmation, the trustee runs little risk of not being adequately compensated. However, in those cases where the case is dismissed, and the trustee has not collected any funds, the subchapter V trustee runs the risk of not being paid (unlike the debtor's attorney, which has likely received a sizeable retainer before filing). Likewise, in those cases where the debtor proposes a confirmable plan but fails to make the plan payments, the trustee may not be paid in full or at all. *See* U.S.C.A. § 1191(e) (a court may confirm a non-consensual plan that pays administrative expense claims through the plan).

Presumably subsection 1191(e) was drafted to increase a trustee's motivation to successfully facilitate the confirmation of a consensual plan. To the extent the presumption is accurate, it's problematic in at least two respects. First, only the debtor can propose a plan; no matter how qualified a trustee is, she may not be able to convince the creditors to support a plan which may not deserve their support (not all debtors are equally motivated to ensure that the plan is confirmed consensually). Secondly, nothing requires the debtor's professional to be compensated in the same manner as the trustee. For example, in the case in which I continue to make distributions, the debtor's attorney and accountant are being paid upon approval of interim fee applications, but pursuant to the plan, the trustee fees are being paid over the plan period, which is five years. As a result, I run the risk that at some point over those five years the debtor will be unable to make its payments, while the debtor's professionals (which arguably had more control over the plan process), have been paid in full.

To avoid the worst-case scenario, many trustees have started to request that the cash-collateral budget (if there is one) allocates funds for professionals' compensation, which has improved the chances of trustees receiving compensation, and some courts have enacted local rules requiring the debtor escrow funds to pay the trustee. However, that does not address all of the concerns

  

related to trustee compensation. An amendment placing trustee compensation on equal footing with other professional expenses would motivate the debtor's professionals to provide for payment of trustee fees and reduce the chance of the trustee receiving little to no compensation in any given case.

It is possible, however, that the Act already provides an avenue for helping to ensure that a trustee receives compensation for her services; it simply needs to be put into practice. Nothing in Subchapter V appears to preclude the escrow of funds with the trustee until such time as a court awards her fees and reimbursement of expenses; in fact, there are several provisions in the new act which contemplate that the trustee will have funds on hand prior to collecting funds during the course of implementing a non-consensual plan. For example, § 1194 expressly refers to "payments and funds received by the trustee" prior to confirmation or denial of confirmation. 11 U.S.C.A. § 1194(a). That section further contemplates that the trustee will either disburse those funds in accordance with a confirmed plan, or in the case of a plan that was not confirmed, return the payments to the debtor after deducting (1) any for any claim allowed under § 503(b), (2) adequate protection payments, and (3) any fee owing to the trustee. 11 U.S.C.A. § 1194(a). The inclusion of both § 503(b) claims (which includes trustee fees that have been allowed) and "any fee owing to the trustee" suggests that the latter is somehow different from the former. One can reasonably conclude that subsection (a)(3) applies to trustee fees that have not yet been approved by a court. Not only does § 1194(a) contemplate that the trustee will have funds on hand, it contemplates that the trustee has effectively escrowed trustee fees which have not yet been approved. Altogether, this supports the conclusion that while the Act does not specifically provide that a trustee may require the escrow of funds necessary to pay her fees, nothing prohibits it and in fact, it seems to contemplate it. SBRA makes clear that the Subchapter V trustee plays an important role in the success of a Subchapter V bankruptcy case, and the compensation scheme should reflect that.

If I could propose another amendment to the Act, it would be that the standing chapter 13 trustees administer plan payments in non-consensual cases. I also serve as a chapter 7 trustee, and in the asset cases, I typically make just one distribution per case; by contrast, a chapter 13 trustee makes regular monthly payments in countless cases. Although most subchapter V trustees have access to software for the administration of our cases, neither the software nor our offices are structured for the efficient processing of plan payments; nor is it really the best use of our skill set. While the Act does provide that the court may order that payments are made other than by the trustee in a non-consensual plan, *see* 11 U.S.C.A. § 1194(b), given the statutory presumption that the trustee distributes funds in these cases, it is unlikely that courts will be inclined to make it a blanket practice to relieve the trustee of that responsibility in every case. Even if a given court is willing to approve such an arrangement, some debtors will still prefer that the trustee makes the distributions.

Finally, it would be helpful to all parties if either the legislature or the courts provided clarity on what "projected disposable income" means. In a non-consensual plan, the plan must provide that all of the projected disposable income for the plan period will be applied to make payments under the plan. *See* 11 U.S.C.A. § 1191(c)(2)(A). The Code does not define "disposable income" in the context of a subchapter V plan, and it is not otherwise clear whether disposable income is calculated with or without reference to amortization or depreciation expenses. Nor is it clear to what extent a debtor can include in its budget items such as savings for future anticipated expenses. This lack of certainty has continued to raise issues in the case in which I am distributing the plan payments.

In that case, questions surrounding the debtor's projected disposable income led the court to suggest the inclusion of a plan provision whereby this issue would be revisited at regular intervals. As set forth in the plan, I must periodically file a report with the court indicating whether debtor is paying not less than its actual disposable income to its creditors, with the first report due within six months after confirmation of the plan and reports due every six months for three more periods and then annually. Since the issues raised above have not been decided, I simply discuss them in each of the two reports I have filed. It now appears likely that it will result in the debtor filing an amended plan which will provide for a significant increase in the dividend paid to creditors.

### IX. Field Notes: Observations from a Subchapter V Trustee In the Field

*By Leon S. Jones,* [22] *Subchapter V Trustee, Northern District of Georgia*

Field notes, according to the Merriam-Webster Dictionary, are an item in a systematic record of a surveyor or "the observations of a researcher in the field." The following comments are more observational than systematic. Your researcher here has served as subchapter V trustee in approximately twenty-one cases to date. And the author's law firm has served as counsel for the debtor

in a like number of subchapter V cases as well. These field notes are just that. They offer the author's perspective. This is not intended as a field guide. That is offered elsewhere. [23] These notes offer the perspective of a single law practitioner in the field.

**INTRODUCTION**

The Small Business Reorganization Act of 2019 (the "SBRA") was enacted in August of 2019. It became effective in February 2020. [24] Since its enactment, the Covid-19 Pandemic has changed the economy and heavily impacted the practice of bankruptcy law.

Following the enactment of the Bankruptcy Code in 1978 and prior to passage of the SBRA, a gap existed under the Bankruptcy Code for debt relief payment plans for small business debtors. Small business entities and many individuals did not qualify for relief under Chapter 13, and the requirements necessary to confirm a plan under Chapter 11 were often prohibitive. The SBRA created subchapter V of chapter 11. Subchapter V represents an option for relief for small businesses on "Main Street, USA" who were "too big" for Chapter 13 but "too small" for traditional Chapter 11.

The need for this legislative reform to aid Main Street debtors was highlighted by one of the sponsors of the bill in the U.S. House of Representatives:

> Our districts depend on its small businesses, where constituents shop local and support their neighbors. They are convenience stores, restaurants, and pharmacies. Those who endeavor to open and run a small business are proud of their work and their standing in our communities. When they are forced to close, it has a great impact on the communities these businesses call home. [25]

The impact of the SBRA on Main Street businesses also was noted by Samuel Gerdano, Executive Director of the American Bankruptcy Institute:

> The Small Business Reorganization Act is a breakthrough for Main Street businesses to finally have the restructuring tools now available only to large companies.

There are many notable changes to the Chapter 11 process as applied to subchapter V debtors. The deadlines are different and some requirements are less onerous. Drawbacks, however, do exist.

**1. THE STRENGTHS AND UTILITY OF SUBCHAPTER V**

The real, true strength of subchapter V is the greater ability of a small business (or individual) to confirm a plan. Several roadblocks on the confirmation highway are removed. These include the requirements of: (a) obtaining the affirmative, accepting vote of a single impaired class, (b) application of the absolute priority rule in the event that a class of unsecured creditors does not vote to accept the plan, and (c) paying 5 years of disposable income under the plan in the event that a single creditor objects to the plan.

The starting point for confirmation of a subchapter V plan is the same as the one in a traditional chapter 11, and that is Bankruptcy Code § 1129(a) & (b). A subchapter V debtor must satisfy all of the elements of § 1129 except for the ones that are carved out of subchapter V.

The most common break point for a subchapter V debtor in § 1129(a) is the liquidation test of § 1129(a)(7). This is common to both subchapter V debtors and "traditional 11" small debtors. Under this requirement, called the "best interests of creditors" test, the debtor's plan must propose to pay the creditors at least the liquidation value of the debtor's assets.

  

The other big hurdle for a debtor is the disposable income test. This test is triggered differently in a subchapter V and a traditional chapter 11. However, if the debtor is facing an objecting unsecured creditor, then the result may look very much the same in subchapter V and a non-subchapter V case. The debtor is going to have to commit the value of its disposable income to the plan for a term. Subchapter V puts brackets on the term of the plan. It must be at least three years but no more than five years (for dischargeable debts). A traditional chapter 11 does not have these brackets on the plan term. However, in a traditional chapter 11, a single creditor may force a debtor to pay an amount equal to 5 years of disposable income simply by lodging an objection to the plan.

One similarity regarding application of the disposable income test is that both a subchapter V debtor's plan and a traditional plan may commit the value of the projected disposable income rather than the payment stream itself. Bankruptcy Code §§ 1129(a)(15)(B) and 1191(c)(2)(B).

Subchapter V does away with the Absolute Priority Rule for the owners to retain their equity in the debtor, codified at § 1129(b)(2)(B)(ii). This impacts the whole case because it affects the bargaining power of all the parties. It affects the large under-secured creditor (which was common) in small traditional chapter 11 cases. These creditors no longer control the plan process with a blocking vote in the unsecured creditor class that triggers the application of the Absolute Priority Rule that would deprive the small business owners of their company. From the debtor's perspective, the elimination of the Absolute Priority Rule in subchapter V cases does away with what can otherwise be a real problem, and that is the owners' finding a new value contribution necessary to confirm a plan in a traditional chapter 11 under which they could retain ownership.

The creation of subchapter V opened the door to the bankruptcy court much wider for individuals. Prior to the SBRA, individuals were constrained. Chapter 7 was not a great option for debtors with significant non-exempt equity in their residence or other assets. Chapter 13's debt limits [26] made chapter 13 unavailable to individuals with large homes (i.e., mortgages) which placed them over the secured debt cap. Non-contingent guaranty obligations also count against the debt limits.

These debts forced such debtors out of chapter 13 and into a traditional chapter 11 which was ill-fitting given the plan confirmation requirements. Obtaining the accepting vote of at least one impaired class can be a challenge. And even with an accepting class other than general unsecured creditors, where the unsecured class rejected the plan, the absolute priority rule blocked confirmation unless the debtor had access to a new value contribution (either from a non-debtor or from exempt assets). Now, subchapter V eliminates these two problems for individuals in chapter 11 who qualify as small business subchapter V debtors. Therefore, an individual business debtor may qualify for 7, 11, 13, and subchapter V of chapter 11.

## 2. GOALS OF SUBCHAPTER V DEBTORS

The goals of the typical Subchapter V debtor are the same goals as those of the typical small business chapter 11 debtor before the enactment of the SBRA and creation of subchapter V, and that is to confirm an affordable plan and retain ownership and control of the business in order to effectuate the plan. Small business owners do not slumber into bankruptcy court with dreams of 363 sales and “sale processes” in their heads. They are focused on their customers, their employees (most often including themselves), and on keeping the business going for the benefit of these constituencies (if not also their greater community). They want to keep the family business in the family, as it were. The debtor's goals with respect to their creditors vary. There is often an allegiance to a community bank, suppliers, vendors, or other local creditors. The business owner's feelings (and goals) with respect to other creditors may not be the same. It is not uncommon for a small business to have creditors who are not “friendlies.” These may be current or former minority owners, ex-spouses, competitors, or even more traditional third-party creditors who have “had it” with the debtor's non-performance.

Small business debtors are entrepreneurs by definition. Many of these entrepreneurs have never before faced failure of any type, much less a bankruptcy. Many proudly explain that they have “always paid their bills on time.” (Many still have high personal credit scores.) The debtor's initial goal was to avoid bankruptcy. If that has failed, the goal is to succeed in the case.

## 3. INVOLVEMENT OF CREDITORS AND OTHER PARTIES IN INTEREST INCLUDING THE ROLE OF THE SUBCHAPTER V TRUSTEE

The main constituencies in a subchapter V case are those encountered in small cases prior to the SBRA, with the addition of the subchapter V trustee as a new player on the board. In pre-SBRA cases and in current small business debtor cases where

  

a debtor does not elect treatment under subchapter V (or more likely does not qualify), the constituents are usually secured creditors, taxing authorities, the United States Trustee, a represented unsecured creditor with an agenda, and a body of inactive, unrepresented unsecured creditors.

The roles that these actors play has not changed. But their ability to act and control the script has changed. Large under-secured creditors do not have the ability to control the plan process in a sub-chapter V case because they do not have the controlling, "blocking" vote in in the unsecured creditor class which causes the imposition of the absolute priority rule. Though the large under-secured creditor may still cause the rejection of the plan by the unsecured creditor class, the ramifications are much less dire. Rather than imposing the absolute priority rule (and thereby possibly blocking confirmation of any plan at all), such a creditor may cause confirmation by cramdown rather than consensual confirmation of a plan. Thus, the fight is over "disposable income" rather than coming up with new value, a much less difficult fight for the debtor to win.

Treatment of secured and priority debt is similar in subchapter V and traditional chapter 11. Both have similar requirements for confirmation. But there are several advantages for a debtor in a subchapter V case. First, the debtor does not have to worry about obtaining at least one consenting class in a subchapter V case because § 1129(a)(10) does not apply. Second, the subchapter V trustee can often serve as a mediator. In a case where the secured creditor is the primary challenge, there is sometimes a lack of trust between the secured creditor and debtor's management. The trustee may be able to bridge that gap. Third, United States Trustee fees, which are based on revenues in a traditional chapter 11 case, are not payable by a subchapter V debtor. If the debtor is a small business with a high cash flow, this can add up.

**4. SHORTCOMINGS OF SUBCHAPTER V**

Subchapter V has been very largely successful. The provisions of the SBRA which grafted subchapter V into the Code work well, with few exceptions.

One troubling concern is the possibility that a court might find a debtor ineligible for subchapter V because it is affiliated with the "issuer" of a security that is not a publicly traded company. [27]

The other more broad-based issue relates to the subchapter V trustee. The Office of the U.S. Trustee Program chose to appoint persons to a pool of trustees rather than a standing trustee like that which occurs in most districts in chapter 12 and 13 cases. The U.S. Trustee (the "UST") has done an excellent job of managing the subchapter V cases in the author's district. The UST dips into the "pool" of eligible trustees and selects a person with qualifications that match the anticipated needs of each subchapter V case. The decision may be made not just on the initial case filings but may also be based on information that the debtor's attorney provides to the UST. The author recommends that a debtor attorney contact the UST at the instant that the case is filed, if not before, for the purpose of providing the UST information about the case to facilitate the selection from the "trustee pool."

Payment of trustee compensation is one area where there has been a bit of learning curve. Subchapter V trustees are entitled to receive reasonable compensation. Statutorily, this compensation is authorized under Bankruptcy Code Section 330. Such compensation is based upon the hourly billing rate of the trustee. And the persons serving in the trustee pool are expected to post a reasonable hourly rate which is disclosed and published in the verification which the trustee submits to the UST at the time of the initial appointment. As a result, the hourly rate and its financial cost should not come as a surprise to a debtor. And that has not been an issue in cases in the author's district.

The issue is that there is often very little money in the small cases filed as subchapter V cases. And there has been a learning curve in figuring out how to get the trustee paid. The first means of accomplishing this is to ensure that the services rendered by the trustee are proportional to the case. Some cases require extensive trustee effort. Other cases require very little of the trustee other than fulfillment of certain specified required duties.

The rest of the story regarding resolving the trustee compensation issue is largely based upon the facts and circumstances of each particular case. Some cases involve cash collateral, and the parties may seek to include a line item in the budget for monthly trustee compensation. Of course, the trustee may not be paid these monthly amounts until the court actually awards a fee. But the cash collateral order may provide for the debtor to pay the funds over to the trustee who will hold the funds in the trustee's escrow account where the funds may be held until further order of the court. If there is no cash collateral issue incumbent in

  

the case, then the parties may still file a motion requiring the debtor to pay a monthly escrow payment to trustee to serve as a fund from which the trustee may be paid.

Of course, as stated above, the problem is that there is often little money in these cases. And that often means that the debtor has a cash flow problem in the early months of the case. And this translates into an inability to fund a monthly trustee payment at the outside of the case.

Another fact of compensation in subchapter V cases is that the statute allows that administrative expense claims may not be paid on the effective date of the plan. If a plan is confirmed on a consensual basis under Section 1191(a), then the trustee fee must be paid on the effective date unless the trustee agrees otherwise. But if the plan is confirmed on a non-consensual basis (by "cram-down") under Section 1191(b), then the debtor has the right to pay the trustee fee (along with other professionals) over term under the plan, and the subchapter V trustee (and other professionals) may never be paid.

One minor critique of subchapter V is the use of the term "trustee" to describe the role and function of the subchapter V trustee. Upon information and belief, the SBRA drafters and proponents considered other terminology. Perhaps they rightly found no better term.

But law school trust and estates classes teach in the second year of law school that the trustee is the fiduciary for the trust, and the property of the trust is the "res." In this regard, the subchapter V trustee is a trustee with no corpus. Absent action by the court, the subchapter V trustee is not vested with any property. This is a distinction without any legal result with respect to the use of the term to describe the role. But use of the term "trustee" to describe the subchapter V trustee may confuse laypersons and non-bankruptcy practitioners into thinking that the subchapter V trustee has powers or responsibilities [28] with which they are not actually vested.

The Court may enter an order expanding the powers of the subchapter V Trustee to authorize her to take control, custody, and possession of property to ensure that certain funds or assets are not improperly dissipated during the pendency of this bankruptcy case. This may be done without removing the debtor from its role as debtor-in-possession. [29] The statutory construct for doing this is not explicit. Rather it involves application of different code sections. Bankruptcy Code Section 1184 states that:

> *Subject to such limitations or conditions as the court may prescribe*, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all functions and duties, except the duties specified in paragraphs (2), (3), and (4) of section 1106(a) of this title, of a trustee serving in a case under this chapter, including operating the business of the debtor. [30]

At the same time, Bankruptcy Code § 1194 further provides that the Subchapter V Trustee may take possession of money. Specifically, § 1194(a) provides as follows: "Payments and funds received by the trustee shall be retained by the trustee until confirmation or denial of confirmation of a plan". Accordingly, the Court may limit Debtor's rights (as debtor-in-possession) to control certain specified assets and presumptively enlarge the trustee's power to control the same.

**5. SUBCHAPTER V CASES IN THE NORTHERN DISTRICT OF GEORGIA**

Enactment of the SBRA has not changed the types of entities and individuals that need financial relief in Georgia. The Covid-19 Pandemic and its related effect on the economy have had an impact. The number of bankruptcies filed is down. And the number of chapter 11 cases is down. But the types of cases actually filed is much the same as before. Many chapter 11 cases filed in the Northern District of Georgia qualify for subchapter V because most of the cases are "smaller" cases.

The types of businesses that are filing subchapter V cases in our District are exactly those types of Main Street businesses that the sponsors of the SBRA envisioned. They are "family businesses" or individuals (who by definition are engaged in business). The author's law firm represented the debtors in two of the first subchapter V cases filed in our District. One was for a liquor store. The other was for a church. We had Main Street represented from one end to the other. And cases since filed by businesses and individuals in our District have filled in the commercial spaces and homes in between the two ends of the street.

  

The law firms filing subchapter V cases are the same law firms that filed traditional chapter 11 cases before the creation of subchapter V. Large law firms have filed some subchapter V cases. However, most such cases have been filed by smaller boutiques and sole practitioners that concentrate their practice is the area of business bankruptcy. These cases have been largely successful. Pro se debtors and attorneys that do not practice primarily in the area of bankruptcy have filed a small number of subchapter V cases. These cases have been largely, if not uniformly, unsuccessful.

Attorneys that practice primarily in the consumer area of bankruptcy have not been filing subchapter V cases. This might be seen as a result of the dearth of cases in general. But the author attributes this to the mature nature of the bankruptcy practice in the district. The consumer debtor bar is highly developed. The number of consumer bankruptcy cases filed in our District perennially is in the top two or three districts in the country. And this annual production of chapter 7 and 13 case filings is concentrated in the hands of a few "high volume" law firms. These firms know their business model and stick with it. And business cases do not fit their model.

**6. UNEXPECTED USES OF SUBCHAPTER V**

There have not been many unexpected uses of subchapter V. The uses have been those intended by the legislation's proponents and Congress according to the legislative history cited above. Enactment was timely as the pandemic has affected many small businesses, although many have simply shut down rather than seek reorganization.

There already has been much litigation regarding debtor eligibility. This was not unexpected, as many projected this to be an area of dispute. In many of the published cases, the UST was the party objecting to the debtor's eligibility. [31] This may not have been foreseen. And it will take some considerable time for appellate level authority to provide more guidance. As with many bankruptcy issues, appellate level authority eventually may provide binding authority, but many of the cases will still be fact intensive. This will be the case with subchapter V eligibility.

The eligibility rules, as written, are pretty straightforward. They are an amalgamation of terms we've historically seen under the Code but have been repackaged/repurposed in a new way. We believed that eligibility likely was going to be a litigation issue in subchapter V cases going into the post-SBRA world. And it's turned out to be true. It's not going to go away.

First, it's a gate-keeping issue. A debtor generally has more leverage and a better ability to confirm a plan in subchapter V. And remember, it was the debtor's election. The debtor chooses the chapter, and then elects subchapter V. So, an adversarial creditor may see a need to block the debtor at the gate (bar the door) to subchapter V. But as stated, the United States Trustee - and not an actual creditor - actually has been the objecting party in many of these cases (both published and unpublished). [32]

The primary eligibility litigation issue is whether the debtor is engaged in commercial business activity. The trend in the approach of the majority of courts is toward an expansive view of what is encompassed by "commercial or business activity." [33] However, the continued litigation of the eligibility issue will not subside because: (a) it's largely fact intensive, and (b) there will be limited opportunities to obtain circuit-level authority for guidance because most small debtors may seek options other than expensive appellate litigation.

The purpose of subchapter V is to streamline the process and make a payment plan more attainable and less costly. Embroiling small business debtors with costly eligibility proceedings is counter-productive. But it does happen and will continue to happen in the current environment.

**CONCLUSION**

A future systematic comparison of confirmation results in subchapter V cases and traditional chapter 11 cases over time may provide empirical data. But as these field notes suggest, the observed results are positive. Subchapter V provides a much-needed vehicle for restructuring the debts of small business debtors.


Image 1 within document in PDF format.

**X. Thoughts of the Subchapter V Trustees**

*By Bob Handler, Commercial Recovery Associates, LLC, Neema T. Varghese, NV Consulting Services, Matthew Brash, Newpoint Advisors Corporation, Ken Novak, Ken Novak & Associates, Inc., Subchapter V Trustees of the Northern District of Illinois* [34]

The Small Business Reorganization Act of 2019 (SBRA) was designed with streamlined procedures and rules so that "Mom and Pop" businesses could obtain the benefits of a Chapter 11 bankruptcy with reduced administrative burdens and costs. After a little more than two years with these cases under this new regime, the Subchapter V Trustees in this district have several observations, comments, and suggestions for managing companies operating under Subchapter V.

**1. The Strengths and Utility of Subchapter V**

Having worked through Chapter 11 cases both prior to the inception of Subchapter V and now as a Subchapter V trustee, the expedited process provides great benefits to debtors and creditors alike. Some of the key differences from a standard Chapter 11 is that there are no quarterly U.S. Trustee payments. In addition, there is no creditors committee appointed, however the Bankruptcy Code does allow for one to be formed if there is cause. These two benefits provide for lower administrative costs for the debtor's estate. A few other differences are that a disclosure statement is not required to be filed with a Subchapter V plan and that the absolute priority rule and plan voting requirements are modified so that the owners of a Subchapter V debtor can retain their equity over impaired-class objections. Debtors are expected to have a plan on file within 90 days of filing.

The Subchapter V Trustee serves in a more limited capacity than typical Chapter 11 Trustees in that they are more an impartial third party available to both debtors and creditors in the case to help facilitate a consensual plan. Having a Trustee to help a Subchapter V debtor is an incredible asset to those debtors that may not have access to financial advisors or in which they are using counsel that may not have extensive bankruptcy experience.

**2. Debtors' Goals in Subchapter V**

Debtors in Subchapter V cases typically have the same goal as those debtors filing traditional Chapter 11 cases - to successfully put forth a plan of reorganization. In most cases debtors can confirm a plan, either consensually or non-consensually. However, like most cases, Subchapter V cases can also be converted to Chapter 7 or dismissed altogether. This usually happens when a debtor does not have the proper resources in place to confirm a feasible plan. The lack of resources may consist of the inability to develop clear and accurate financial information or insufficient financial resources such as liquid assets or disposable income available to fund a plan. A key benefit of a Subchapter V filing is that the debtor has the exclusive right to file a plan.

A Subchapter V trustee can make recommendations to a debtor to help them through the administrative challenges of a Chapter 11 filing such as facilitating the development of a consensual plan. Trustees also evaluate the viability of the debtor's business by reviewing their financials and monthly reporting. The Subchapter V Trustee takes part in the initial debtor interview, Section 341 meeting and status conferences and hearings to provide the court and the US Trustee's office updates on the debtor's progress toward achieving a consensual plan. Subchapter V Trustees add value, reduce conflict between the debtor the key creditors, and lead to more consensual plans benefitting debtors and creditors alike. Indeed, research conducted across various districts report that Subchapter V cases are six times more likely to result in confirmed plans of reorganization than conventional Chapter 11 cases, and that only 15% of cases are converted or dismissed. [35]

**3. Creditors and Other Parties Participation in Subchapter V Cases**

Creditor and other stakeholders are always parties in interest in Subchapter V cases, and they have a significant interest in the management and outcome of the case. Creditors are encouraged to attend and participate in Section 341 meetings. At these meetings, the debtor is sworn in under oath. In addition to questions to the debtor from the U.S Trial Attorney and from the Subchapter V Trustee, creditors are encouraged to ask questions that they may have.

One of the Subchapter V Trustee's key duties is to work with the parties (creditors and debtors) to assist in coming up with a consensual reorganization plan, if possible. Because of this charge, during the case proceedings, the Subchapter V Trustee may from time-to-time contact creditors to discuss their claims against the debtor and their positions on these claims. The Subchapter V Trustee will also have discussions with the debtor's counsel (with the debtor included) to discuss their positions on creditors' claims.

  

In this district the US Trustee's office requires balloting for all plans. Like typical Chapter 11 cases, creditors will be asked to vote on the debtor's plan after the court gives its preliminary approval. In a few situations, debtors will file their plans and, before votes are cast, they will receive comments from creditors that may persuade the debtor to file an amended (sometimes multiple amended) reorganization plan. Since it is the Subchapter V trustee's goal to promote the confirmation of a consensual reorganization plan, it is critical that the trustee work with the both the debtor and all parties that object to the plan to seek consensus on an acceptable and feasible plan.

**4. The Shortcomings of Subchapter V: Gaps Observed and Workarounds Suggested**

First Day Motions: Like regular Chapter 11 cases, a Subchapter V debtor cannot use cash collateral without a court order, with or without the secured creditor's agreement. Unlike regular Chapter 11 cases, most small businesses do not have the accounting or financial resources to properly respond to a motion to lift stay or to restrict the use of cash collateral. For example, can the debtor dependably show that it can make adequate protection payments and/or make such payments and maintain its business as a going concern? In many of these situations the Subchapter V Trustees in this district have provided the financial analysis, overview, and assessment of the debtor's financial wherewithal, and further reported to the parties and the court, respecting the feasibility of the debtor making such payments.

Assumption/Rejection of Leases and Other Motions: All of the Subchapter V Trustees in this district are restructuring professionals who advise or manage struggling companies in and out of bankruptcy. None of them practice law, so their focus is on the debtor's financial and operational capabilities and the extent to which the debtor needs to restructure its operations under Chapter 11. However, as mentioned above, many small businesses do not have the resources to make the necessary assessment. In addition, many of these mom and pops filed their bankruptcy petitions with only the short-term goal of staying a foreclosure or eviction, then working out a deal with one creditor; no long-term restructuring plan (other than business as usual) was ever contemplated. For example, we have been appointed in cases where the debtors have multiple locations, or overlapping operations, or are servicing debt in a property developed by the debtor as a vanity project. In these situations, debtors have not taken to heart the financial burdens of these operations or are tethered to the notion of “we've always done it this way.” This disconnect between the Subchapter V Trustee's charge to promote the adoption of a consensual plan and the debtor's short-term goal has sometimes resulted in a dialog of the deaf, with the parties finding little common ground upon which to discuss the drafting of a plan. As a result, this some of us have made it a practice at the outset of the case to inform the debtor and its counsel that (i) the Trustee's goal is to work with the debtor and develop a feasible plan and (ii) that the Trustee will agree with a plan - and so advise the court - only if the plan is feasible in the Trustee's opinion. This approach has proven to be successful in establishing an ongoing dialog with the debtor and a free flow of information to the Trustee.

Administrative Delays and Costs: Notwithstanding SBRA's goals to make Chapter 11 more accessible to small businesses, many of the traditional bankruptcy practices, rules and procedures make Subchapter V cases look very similar to other Chapter 11 cases. Of note, the fees and costs of debtor's Subchapter V counsel are rarely less than costs of counsel for a regular Chapter 11 case. While the Subchapter V Trustees understand that debtor's counsel should take the same care and consideration for all cases they undertake, it boggles the mind why there is little or no proportionality of the fees given the smaller size of the company and its financial stakes in play. In addition, many of the SBRA cases have dragged on due to litigation and discovery delays, all of which extend confirmation of the debtor's plan well beyond the 90-day filing date and the 120-day confirmation hearing date. In some cases, however, the Subchapter V Trustees have been successful in getting all parties to agree on an operating/cash collateral budget which includes all professional fees, including the fees of debtor's counsel. As for responding to potential delays, the Trustees work with the US Trustee's office in presenting a unified response to the court when certain motions or discovery practices raise the specter of unwelcome delays towards confirmation of a plan.

**5. How Subchapter V cases are conducted in our district**

SBRA was enacted in August 2019, and took effect on February 19, 2020, which coincided with the spread of COVID-19 pandemic. Due to this, all Initial Debtor Interviews, 341 Meeting of Creditors and court calls in this District are being heard electronically. In March 2022, the court revised its General Order No. 20-05 governing trials and evidentiary hearings during the pandemic where the assigned judge may either (1) conduct a video trial or hearing using the Zoom for Government platforms; (2) conduct an in-person trial or hearing in the courthouse with basic COVID protocols observed; or (3) conduct an in-person trial or hearing in the courthouse with basic COVID protocols observed plus additional protocols that the judge requires to protect and preserve health and safety.

  

The Trustees of the Subchapter V pool in the Northern District of Illinois, Eastern Division, makes a concerted effort to visit each debtor at their place of business as well as visit all locations where assets/collateral are located.

**6. Any creative or unexpected use to which Subchapter V has been implemented**

The road to a confirmed plan (whether consensual or nonconsensual) always requires some sort of creativity, especially in contentious cases where parties were at odds pre-petition. The name of the game is let's make a deal, and the deal is made with facts and findings relating to the viability of a business in a reorganization in contrast to the potential recovery in a liquidation. Seasoned bankruptcy professionals expect the unexpected, and question and anticipate any circumstance. From a creative and perhaps unexpected perspective, companies that don't fit under the SBRA debt ceiling are looking at ways to lobby for the debt ceiling to be raised again, either back up to the $7.5 million temporary COVID-19 ceiling, to a higher, $10 million ceiling. Others are getting creative in finding ways to dip below the debt ceiling threshold through creative accounting or shuffling of debt (of course this could be considered fraudulent).

A problem in Subchapter V, that has hopefully since corrected itself, was the perception that because Subchapter V is smaller and faster, any attorney can file, or any financial advisor can consult a debtor - all without any previous experience necessary. There have been bankruptcy filings in which debtor's counsel or financial advisor, with minimal to zero bankruptcy experience, has filed Subchapter V cases. Even in Subchapter V, there is a Bankruptcy Code and federal and local rules. The debtor in such a case can find itself in a disadvantageous position which could lead to dismissal or conversion, effectively closing the business, employees losing their job and creditors' possible recovery impacted.

**7. Plans live or die by the accuracy of the financials and the projections**

Only the debtor can file a plan in Subchapter V. But if a debtor requests assistance - perhaps a lot of assistance - in putting the plan together, how far should the Trustee go? Notwithstanding the Trustee's charge to promote the confirmation of a consensual plan, what is the Trustee's role when the debtor's historical numbers or projections do not seem reliable? To what extent does the Trustee go to verify the numbers, and get them corrected? Should the Sub V Trustee interface with the debtor's accountant or leave that to the debtor?

These questions frequently arise throughout the course of Subchapter V cases: cash collateral hearings, status hearings, the debtor's Monthly Operating Reports, the debtor's operating budget and its projections for its plan (including the liquidation analysis). In all these situations, the Trustee is called upon by the parties and the court to opine on the feasibility and viability of the debtor going forward as an operating entity. For example, the debtor's Monthly Operating Reports (“MORs”) and other financial information may indicate that the net cash flow is going up minimally, but the A/R and post-petition A/P are rising quite a bit. The financial data that debtor and/or its counsel are providing do not seem to make “accounting” sense. What should the Trustee do, if anything? At what point in the case, before or after a hearing on a critical matter, should the Trustee raise these questions?

Section 1190(1)(c) requires the plan to contain projections “with respect to the ability of the debtor to make payments under the proposed plan of reorganization.” These projections will provide, as of the time of confirmation, the debtor's “projected disposable income.” Bankruptcy Code Section 1191(c)(2) requires that all the debtor's “projected disposable income” will be applied to make payments under the plan (or alternatively the value of the property to be distributed will not be less than that amount). But the Code does not define “projected disposable income”, only “disposable income.” Regardless of the dearth of reliable data, the Trustee must use the debtor's available resources to determine the extent to which the debtor's loss carryforwards and depreciation factor into calculation of disposable income, whether actual or projected. So, does that mean the debtor must pay at least the projected disposable income, regardless of the debtor's actual cash resources to do so? Without reliable financial data, Trustees may find they are not able to effectively advise the debtor (and debtor's counsel) as to how they might respond to unanticipated financial issues after confirmation.

**8. Subchapter V Trustee with Expanded Powers**

In a small handful of cases in this district, parties in interest or the US Trustee have successfully made motions seeking removal of the debtor-in-possession and replacing that person or entity with the Subchapter V Trustee, and further empowering the Subchapter V Trustee with additional powers and authority to manage the debtor. While these orders greatly modify the Subchapter V Trustee's duties, they nevertheless present unanticipated challenges to the overall management of the case. In particular, the Subchapter V Trustee in this situation has overall responsibility for management of the debtor's affairs, including

handling of its cash, supervision and managements of its operations, and reporting to the court. The Subchapter V Trustee will also have many of the powers typically delegated to a Chapter 7 Trustee, including the power to seek a sale of the debtor's assets. However, since the debtor is the sole party with the power to propose a plan, the Subchapter V Trustee has effectively no ability to make a distribution of the sale proceeds. This requires coordination between the debtor and Trustee from the moment of the Trustee's appointment. From the Subchapter V Trustee's standpoint this should not be a challenge since the Trustee had always operated with the goal of the debtor in possession making distributions under a consensual plan. However, without coordination between these two, the estate will be faced with the unwelcome administrative costs of seeking court approval for what would have been routine decisions by the sole original party in charge, the debtor in possession.

## XI. The 1111(b) Election: The Undersecured Creditor's Sharpest Tool in Subchapter V Cases

*By Iana Vladimirova,* [36] *Subchapter V Trustee, Northern District of Illinois, Eastern and Western Districts of Wisconsin and Leanne O'Donnell,* [37] *Husch Blackwell*

Undersecured creditors in bankruptcy often face the prospect of recovering less than the full value of their claims against the debtor. This is because undersecured claims are bifurcated into two separate claims: a secured claim for the value of the collateral, and an unsecured claim for the remainder of the creditor's claim. [38] In most cases, little or nothing is paid to creditors on their unsecured claims.

Subject to two exceptions, section 1111(b) allows a secured creditor who is undersecured to elect, instead of having its claim bifurcated, to relinquish its unsecured claim, and have its entire claim treated as secured and paid over an extended period of time. [39] This election has not been very popular in regular chapter 11 cases, because, often times, it is more advantageous for a secured creditor to keep its bifurcated unsecured claim, thus maintaining its status as an impaired creditor and its ability to block an unfavorable plan confirmation under Section 1129(a)(10). [40] But in subchapter V cases, this blocking advantage of an unsecured claim is blunted because a debtor may confirm a plan even if no class of creditors accepts the plan. [41] As a result, some undersecured creditors are opting to dust off section 1111(b) in their codebooks and elect the fully secured status afforded by that section. These creditors are using section 1111(b) to negotiate for a better plan treatment - especially when only a nominal distribution to unsecured creditors is likely. [42] Indeed, the case law that has developed to date demonstrates the popularity of the § 1111(b) election among undersecured creditors in subchapter V cases. [43] This comes in large part due to the reduced benefit of unsecured deficiency claims of undersecured creditors through the low likelihood of receiving significant plan payments, the absence of the absolute priority rule, and the removal of the requirement that impaired classes accept the plan.

Not everyone agrees that Congress intended for the § 1111(b) election to apply to subchapter V cases. In the American Bankruptcy Institute Journal article, *The Applicability of the § 1111(b) Election in a Small Business Case*, Thomas C. Scherer and Whitney L. Mosby argue that "the § 1111(b) election is at odds with the SBRA's purpose and structure." [44] The authors point to the fact that the unique features of the SBRA are meant to lower costs and uncertainty in plan confirmation, and that the § 1111(b) election simply reintroduces those costs and uncertainty. [45] In addition, the authors argue that the ABI Commission to Study the Reform of Chapter 11 recommended that that the § 1111(b) election be disallowed in small to medium- businesses reorganization, and that Chapter 12 of the Bankruptcy Code, after which the SBRA is modeled, includes no such provision. [46]

Scherer and Mosby also point to the policy arguments made by the court in *In re Body Transit, Inc.* [47] In *Body Transit*, the debtor ran fitness clubs and proposed a subchapter V plan under which unsecured claims would receive no payments. [48] The secured creditor held a significantly undersecured claim and made an election under section § 1111(b). [49] The debtor objected to the election, arguing that the creditor's interest in the encumbered property was of "inconsequential value," an exception which disallows the 1111(b) election. [50] The *Body Transit* court valued the bank's security interest in the debtor's assets at $90,000, while the overall debt owed to the bank exceeded $900,000. [51]

The court found that the bank's secured claim of 8.2% of the total claim amount was "inconsequential" by comparing the value of its secured claim to the amount of its total claim. [52] Based on precedent, the court was hesitant to conclude that the collateral which was 8.2% of the claim amount was in itself inconsequential. [53] Instead, it made the "inconsequential value" determination

in light of policy considerations. [54] Specifically, the court reasoned that the bank was not being cashed out during a temporary decline in the value of its collateral, which it believed was the fact pattern that Congress envisioned when it enacted section § 1111(b). [55] The court also noted that the circumstances of the case (including effects of the pandemic) called for "a more elastic application of the term 'inconsequential value.'" [56] Finally, the court reasoned that the purpose of subchapter V is to permit small businesses to reorganize and to satisfy unsecured portions of claims by paying their projected disposable income for three to five years, and that this favored a lenient interpretation of section § 1111(b). [57]

Other courts have disagreed with the reasoning of the *Body Transit* court. *In re VP Williams Trans., LLC*, the court allowed the § 1111(b) election and rejected the policy considerations cited by the *Body Transit* court. [58] There, the debtor owned a single taxi medallion in which its only creditor held a security interest. The amount of the claim was $576,927, while the value of the collateral was in the $90,000-to-$200,000 range. [59] The court noted that while courts have taken different approaches to determining whether property is of "inconsequential" value, under all approaches, it was impossible to conclude that the medallion's value was inconsequential. [60]

The court first assessed whether the value of the medallion was "inconsequential" within the plain meaning of the word. [61] The court determined that as the most valuable asset in the case, the medallion value could not be "inconsequential" or "of no significance." [62] It then used a second approach, comparing the value of the asserted secured interest to the value of the collateral. [63] Here, the value of the collateral was 100% of the lien value, and thus, again was not inconsequential. [64] The court then turned to the approach used by the *Body Transit* court whereby the court compared the value of the secured claim amount to the total amount of the claim. [65] After noting that this approach was nonsensical, the court observed that if an 8.2% secured-claim-to-total-claim valuation was not inconsequential in *Body Transit*, then the 15.6% value in the present case could not be inconsequential either. [66]

The court in *VP Williams Trans*., took the opportunity to examine the intended purpose of the § 1111(b)(2) election and reasoned:

> Section 1111(b) is not conditioned on a temporary decline in collateral value; it is available to secured creditors who are not happy with a value that a debtor has proposed, and who are not happy with the prospect of having to live with a judge's decision as to what the value of the collateral is. [67]

The court further explained that the desire of Congress to foster small business reorganization had no bearing on the interpretation of § 1111(b):

> Section 1111(b) applies in all chapter 11 cases, including subchapter V. If Section 1111(b) was supposed to give way in a subchapter V case, or to have a different application in such a case, that was for Congress to say, and Congress did not do so. [68]

The court in *Caribbean Motel Corp*. agreed with the *VP Williams Trans.* court and adopted its reasoning when faced with a similar argument. [69] In that case, the debtor operated a 40-room motel and listed the value of its sole real estate asset, the motel, at $550,000. [70] The mortgagee elected that its $3.1 million claim be treated as fully secured under section 1111(b). The debtor objected, arguing that the secured creditor's interest in the motel property was inconsequential. [71] The court disagreed, noting that "collateral valued at $550,000 is not inconsequential" and "that said collateral is the only real estate asset of the estate and is essential to the debtor's reorganization under the proposed plan in all its proposed scenarios." [72] The court declined to consider other factors cited by the debtor, such as the physical state of property, the effect of the pandemic on the debtor's income, and the fact that the election makes it far more difficult for the debtor to reorganize under subchapter V because the property's value cannot sustain the level of secured debt. [73] Instead, it cited *VP Williams Trans.* and noted that Congress could have eliminated the § 1111(b) election in subchapter V cases but it chose not to do so.

  

**Conclusion**

The option to elect to be treated as a fully secured creditor under section § 1111(b) is emerging as a powerful creditors' tool in subchapter V cases. Although Congress may not have intended for it to be a part of the SBRA, the election neutralizes the debtor-friendly features of subchapter V cases and enhances a creditor's ability to negotiate for a better plan treatment. Courts can expect to continue to hear creative arguments by debtors hoping to circumvent the requirements of § 1111(b).

## C. WESTERN - 5TH, 9TH & 10TH CIRCUITS

### XII. Subchapter V Strengths and Weaknesses

*By Kent Adams,* [74] *Subchapter V Trustee, District of Kansas*

Serving as a Subchapter V trustee in the District of Kansas has been a great experience. My background both as a CPA and a CFO have been instrumental in my ability to perform my duties as a Subchapter V trustee successfully. The overall goal is to achieve a fair and equitable consensual plan of reorganization. However, the role of the Subchapter V trustee is more extensive than just reaching a consensual plan; this includes reviewing debtors' financial condition and business operations, facilitating a consensual plan of reorganization, examining claims against the debtor, and bringing any misconduct to the courts' attention.

The process of Subchapter V has allowed for more small business debtors to reach consensual plans. Some cases start out with issues that appear to be roadblocks to reaching consensual plans. As the cases progress though the Subchapter V process, most cases achieve a consensual plan. This is one of the biggest achievements of Subchapter V and is a benefit to debtors and creditors.

As a new option in bankruptcy, the number of Subchapter V cases was low at the start. The level of activity has increased significantly as those in the bankruptcy practice realize that Subchapter V provides a less expensive and more streamlined process than traditional Chapter 11 cases.

The fact that the Subchapter V trustee is independent has worked well to facilitate favorable outcomes for all parties involved. Overall, both debtor and creditor counsels have been willing to work toward achieving a consensual plan.

I have experienced excellent support and a good working relationship with the United States Trustee's office in Wichita, Kansas. The United States Trustee's office has been supportive of the independence of my role as a Subchapter V trustee. I believe the United States Trustee's office has found the role of the Subchapter V trustee is a benefit to not only resolving conflicts but, also to having another set of independent eyes on bankruptcy cases.

There is strong support for the independent role of the Subchapter V trustees by the Judges in the bankruptcy courts in the District of Kansas. The attorneys in the cases I have been involved with to this point have been more than willing to work with me to explore ways to reach agreements to move cases forward.

I have had a few attorneys question independence from the United States Trustee's office, but that has occurred when I have taken what they consider to be an adverse position. I do think in some instances there is a misconception of the roles of the United States Trustee's office and the Subchapter V trustee. Of course, Subchapter V Trustees work closely with the United States Trustee's office to discuss the status of cases, issues that are occurring with active cases, and monthly/annual reporting.

My background as a CPA is a benefit for the Subchapter V bankruptcy process by providing a strong understanding of the financial issues facing small businesses in bankruptcy. I have been surprised by the fact that those in the bankruptcy process reach out for questions concerning not only the Subchapter V process but also are asking for input on thoughts to achieve a consensual plan.

To this point, I have had an active role in most cases with all parties to the Subchapter V cases I have worked. The best outcomes are the cases where all parties have embraced the role of the Subchapter V trustee to help achieve a consensual plan. My experience has been that cases where the debtor and/or major creditors and their legal counsel are not actively engaged with the Subchapter V Trustee, typically take longer and do not reach as favorable outcomes.

  

The timeframe for resolution of cases under Subchapter V is faster than Chapter 11 and other Chapters of the Bankruptcy Code. The speed with which Subchapter V cases are resolved could be improved. One frustration I have experienced has been the that the process often could move faster, but there is a reluctance of both debtors and creditors to reach agreement on issues until late in the process and significant issues are often continued to a later date. Frequently, debtors are unrealistic about the situation early in the process. This issue frequently requires strong coordination between debtors' counsel and the Subchapter V trustee to ensure that the message concerning the best path forward is consistent. This is one area that could help achieve greater efficiencies in Subchapter V cases.

Other useful changes in Subchapter V would be to allow more access to Subchapter V by allowing single asset cases and retaining the $7.5 million threshold for Subchapter V cases that was temporarily increased from $2,725,625 by the Coronavirus Aid, Relief, and Economic Security Act of 2020. One of the concerns that has been expressed with Subchapter V is that creditors have less protection under Subchapter V than in a regular Chapter 11 bankruptcy which could result in a plan that is not fair and equitable to creditors. In the Subchapter V cases where I have served as trustee, I have not seen issues where I felt that the plan was not in the best interests of the debtor and its creditors.

## XIII. Dispatches from Biloxi [75]

*By Robert Byrd, Subchapter V Trustee, Northern and Southern Districts of Mississippi*

My friend, Bruce Grohsgal asked for a report from the trenches in the hinterlands. At his request, I am happy to oblige.

As most know, the Small Business Reorganization Act became effective February, 2020. I am one of three (3) Subchapter V Trustees covering the State of Mississippi. We receive our appointments from the Office of the United States Trustee for Region V, which includes Mississippi and Louisiana. As with most directives from the Office of the United States Trustee, I usually receive appointments in the Northern District of Mississippi (Oxford and Aberdeen), though I practice on the Mississippi Gulf Coast, in Biloxi - while my two Jackson counter-parts receive the Mississippi Gulf Coast (Gulfport) cases. This model of efficiency is somewhat mitigated by the fact that the two Judges in the Northern District (Woodard and Maddox) still conduct the majority of their matters telephonically or by video.

Since February, 2020, I have been involved in or handled twelve (12) Subchapter V cases. I have one open and pending where the Debtor is represented by Craig Geno, also a Subchapter V Trustee. Of the previous eleven (11) cases, excluding my current case, six (6) were confirmed as consensual plans. The seventh was basically a family dispute among four 70-year-old siblings who had been litigating in state court for thirteen years prior to the filing of the Subchapter V petition. Ultimately a compromise was reached, and the Court approved a sale of the family property to one of the siblings which generated proceeds sufficient to satisfy all parties - including all of the insider claims. One case involved a trucking company whose owner was less than forthcoming with his disclosures, financial and otherwise. Grounds existed for removal of the Debtor pursuant to Section 1185. The Debtor took the easy way out and converted to Chapter 7. There were no unencumbered assets and administrative claims were not paid.

Pursuant to Section 1185 the Debtor can be removed for typical reasons, including fraud, dishonesty or gross mismanagement. This is problematic because pursuant to Section 1189, only the Debtor may file a plan. Unless the Subchapter V Trustee can convince the Debtor to sign on to a plan prepared by the Subchapter V Trustee, the only alternatives are for the Trustee to seek conversion to a traditional Chapter 11, conversion to a Chapter 7, or dismissal. The economics of the situation will determine which course is preferable.

I had four (4) cases that were administratively consolidated where four (4) entities owned four (4) different convenience stores and gas stations. One had an attached liquor store. Each Debtor had common ownership and all four had one primary creditor. Section 1182 provides the definition for a Subchapter V “Debtor” and, at the time, capped liabilities at $7,500,000.00. The debt ceiling is presently $2,750,000.00. There seems to be common consensus that the proposed legislation reinstating the $7,500,000.00 cap will pass once it works its way up the legislative queue. The four Sub V Debtors had a non-debtor affiliate. When considering all outstanding debt, including the affiliate, the Court held the four entities did not qualify as debtors pursuant to 1182(1)(A)(B). They converted to conventional 11's.

Finally, in my Sub V Debtor case, I represented a forty (40) year old manufacturing company that makes pressurized vessels. It was hurt by two factors, the early stages of the pandemic which drastically cut orders and the escalating price of steel. The

  

Debtor had approximately $3,000,000.00 in secured debt and $2,000,000.00 in unsecured debt, along with priority claims for unpaid state sales taxes. It is easier for a distressed debtor to "borrow" from the taxing authorities than a conventional lender but as they say pay back is heck. By negotiating for the Debtor to commit disposable income to payments over a 60-month plan period, I was able to obtain a consensual plan. This would have been utterly impossible in a conventional Chapter 11. Because Subchapter V does not contain the absolute priority rule, the owner was able to retain his equity and thirty-five (35) employees retained their jobs. The business has rebounded, and the Debtor has performed successfully in the twelve (12) months since confirmation.

Subchapter V Trustees have a different function than a Trustee under any other Chapter. While we have certain stated duties, our primary directive is to facilitate the development of a consensual plan of reorganization. Section 1183(b)(7). While sometimes I may become directly involved in negotiating plan terms with creditors, when the Debtor has extremely competent representation, sometimes my best course of action is to stay out of the way.

One of the issues we encounter involves the payment of dividends to creditors. No Sub V Trustee in this district wants to serve as disbursing agent. I encourage Debtor's counsel to draft the plan so that the Debtor will make plan payments. Section 1194(b) provides that the Trustee shall make payments to creditors under the plan "except as otherwise provided in the plan or in the order confirming the plan …" Sub V Trustees who are not otherwise Chapter 7 or 13 panel trustees are not set up to handle the accounting and banking necessary to make disbursements. My argument to recalcitrant creditor counsel, as to why the Debtor should make disbursements, is to remind them that even at my reduced hourly rates, I will spend at least four hours per month on the case making disbursements, which, over the life of the plan, results in $36,000.00 to $60,000.00, that would otherwise be disbursed to creditors. There are many benefits to Subchapter V of Chapter 11. First, the absolute priority rule does not apply, allowing equity to retain its interest even without paying creditors in full. Second, there are no quarterly fees to the United States Trustee's Office. Third, absent extraordinary circumstances and court order, there is no unsecured creditors committee with its attendant costs. Fourth, plan confirmation does not require at least one impaired accepting class. Fifth, there is no requirement for a disclosure statement and court approval of it, but the plan should contain a brief description of the business and its history. Sixth, in certain circumstances, the plan may modify loans secured by a lien on the debtor's primary residence.

The trade-off for these benefits is the expedited track that a Subchapter V case takes. There is a status conference to be held no later than sixty (60) days after the case is filed. Section 1183. Debtor's counsel has to submit a report at least fourteen (14) days prior to the status conference. The plan must be filed within ninety (90) days. Section 1189.

In speaking with my fellow trustees, the principal problem is assisting in cases where consumer counsel, primarily Chapter 13 practitioners, have filed a Subchapter V case. In my experience, most are not conversant with the compressed time frames, or the contents of the plan required by Section 1190, such as pro formas of projected disposable income, feasibility or a liquidation analysis. In assisting debtor's counsel with these items, I feel I have provided the most benefit in fulfilling my duties. Another issue is when my duties cease. In a non-consensual plan confirmed under 1191(b), I remain in place until the plan is concluded after thirty-six (36) — sixty (60) months. In a consensual plan confirmed under Section 1191(a), my service as trustee terminates when the plan has been substantially consummated. 1183(c). It is incumbent upon counsel for the Debtor to file the notice of substantial consummation. Similar to a conventional Chapter 11, substantial consummation generally occurs when the Debtor makes transfers called for by the plan or commences distributions to creditors pursuant to the confirmed plan. Also, in a consensual plan confirmed under Section 1191(a), the plan may only be modified after confirmation if the modification is filed before substantial confirmation of the plan. Non-consensual plans confirmed under 1191(b) may be modified at any time within thirty-six (36) to sixty (60) months after confirmation.

Near and dear to the heart of most trustees, and debtor's attorneys, concerns the payment of fees. All three (3) Sub V Trustees in Mississippi have agreed to serve at reduced hourly rates compared to our normal and customary hourly rates. We have typically waited to submit fee applications until the conclusion of the case, that is at confirmation. Recently, the Office of the United States Trustee has suggested that we submit fee applications every one-hundred-twenty (120) days. I have generally been successful in getting paid in the majority of my cases. Subchapter V Debtors can propose to pay administrative expenses over a reasonable period of time, unlike in a conventional 11 where administrative claims have to be paid in cash, in full at confirmation absent a contrary agreement. I have one fee write off. What has been discussed is that if the debtor files a motion for authority to use cash collateral to respond and request a separate line item for the monthly escrow of trustee fees.

All in all, it's a rewarding experience.

  

## XIV. Subchapter V

*By Katharine Battaia Clark, Subchapter V Trustee, Northern District of Texas and David Warfield, Thompson Coburn LLP*

### 1. Introduction.

This paper provides a high-level summary of the Small Business Reorganization Act of 2019, and considers some of the benefits and burdens it provides in practice. Practitioners on both the debtor and creditor side should carefully weigh those benefits and burdens before filing or taking action in a subchapter V bankruptcy case.

### 2. Subchapter V Basics.

The Small Business Reorganization Act of 2019 (SBRA) [76] was signed into law in the summer of 2019 and has been in effect since February 19, 2020. The SBRA enacts a new section of chapter 11 of the Bankruptcy Code: subchapter V [77] and is an attempt to streamline the process for small business reorganizations. A debtor must opt in (elect) to proceed under subchapter V by checking a box on its voluntary petition.

To qualify for a subchapter V election, at least 50% of pre-bankruptcy debts must arise from commercial or business activities, and the debtor's aggregate secured and unsecured debts can be no more than $3,024,725. [78] 11 U.S.C.A. § 1182(1). [79]

A Subchapter V Trustee is automatically appointed in every subchapter V case. 11 U.S.C.A. § 1183. The office of the United States Trustee in each district has created a pool of qualified trustee candidates and appoints trustees from the pool on a case-by-case basis. [80] The typical role of a Subchapter V Trustee is to act as facilitator, with its overall goal being to encourage development of a consensual plan of reorganization. Subchapter V Trustees can be lawyers or non-lawyers and generally are not permitted to hire their own professionals.

The Bankruptcy Code sets out certain required tasks of a Subchapter V Trustee applicable in each case. 11 U.S.C.A. § 1183(b)(1) & (b)(3). The Court may further assign additional tasks to a Subchapter V Trustee. When a Subchapter V Trustee is appointed from the pool, it is compensated as an administrative claimant pursuant to Bankruptcy Code section 330 by the debtor's estate.

Since the SBRA went into effect, debtors' subchapter V elections have gained steam in a few districts, such as those in Texas and Florida. It remains to be seen whether use of the subchapter V election will capture the substantial percentage of small business filings.

### 3. Why Potential Debtors Might Choose Subchapter V

While the SBRA provides several nuanced changes to the Bankruptcy Code relevant to the bankruptcy practitioner, a few of the changes are of particular importance to the potential small and medium-sized businesses that might be considering a subchapter V election (and seem to be influencing the decision to make the subchapter V election). First, if a debtor elects to proceed under subchapter V, it retains the sole right to file a plan of reorganization. 11 U.S.C.A. § 1189. In contrast, in a typical chapter 11 bankruptcy, the debtor retains the right to file a plan of reorganization for a set period of time (and that time period can be shortened for cause on challenge). [81]

Second, subchapter V includes several provisions that provide natural time and cost savings in comparison to a traditional chapter 11. For instance, there generally will not be a committee of unsecured creditors. The general rule that there will not be one eliminates the cost of committee counsel and other professional fees, which a regular chapter 11 debtor must pay. And while the actual cost savings are difficult to estimate, they are assumed to be a significant by many practitioners. This is particularly true for relatively large-scale debtors. There are also no fees due to the United States Trustee's Office (the department of the government that acts as a monitor in bankruptcy matters). When added to the overall costs of bankruptcy, these fees debtors are required to pay in a regular chapter 11 can make the expense of a bankruptcy case prohibitive for smaller companies or businesses with thin or erratic cashflow models.

  

Subchapter V includes other provisions designed to further reduce costs by encouraging a faster reorganization. For example, a subchapter V debtor is required to file a proposed plan within 90 days of the bankruptcy filing date. *See, e.g.*, 11 U.S.C.A. §§ 1188 & 1189. A subchapter V debtor also does not have to file a separate disclosure statement that describes the terms of the plan, saving in attorney preparation time and mail costs, and shortening the overall case timeline. And while the debtor is required to absorb the cost of the Subchapter V Trustee, the average cost of doing so is relatively limited. Moreover, a Subchapter V Trustee can add value to a case in several ways, including, but not limited to, informal or formal mediation of differences in matters ranging from cash collateral use to plan provisions.

Perhaps most importantly from the prospective of potential debtors, there is no need for a debtor to meet the "absolute priority rule," which rule essentially requires, absent consent, that creditors must be paid in full before equity holders can receive any money or property under a chapter 11 plan. Thus, filing bankruptcy under the subchapter V election does not carry with it the same risks for loss of ownership as a traditional chapter 11. And while subchapter V is designed to encourage consensual plans, the ability to confirm a plan over the objection of creditors under the revised definition of "fair and equitable" provided in subchapter V [11 U.S.C.A. § 1191(c)] allows small and medium-sized businesses to enter bankruptcy with additional potential leverage to successfully confirm a plan.

More frequent hearings before the bankruptcy court, and required interaction with the subchapter V facilitator (the Subchapter V Trustee), appear to offer support for debtors and creditors to raise and potentially resolve issues. For example, co-author Clark served as the Subchapter V Trustee in a bankruptcy precipitated by the sale of a closely held business to existing employees that had gone awry pre-bankruptcy. The debtor used subchapter V to resolve complex, pre-bankruptcy litigation among multiple parties, as well as COVID-induced financial difficulties, through a consensual chapter 11 bankruptcy plan. [82] In fact, twenty-five out of thirty cases to which co-author Clark has been appointed Subchapter V Trustee since June 2020 [83] have concluded in confirmed plans of reorganizations, the majority of which confirmed as consensual plans, indicating a positive trajectory is well within reach for subchapter V debtors.

**4. Why Subchapter V is Not So Appealing**

For all of its intended benefits, subchapter V is not a panacea. Subchapter V still imposes substantial administrative burdens on small businesses. For instance, small business debtors are required to (i) establish a debtor in possession bank account that complies with Section 345 of the Bankruptcy Code and applicable U.S. Trustee requirements, (ii) include the words "Debtor in Possession") on new checks and business forms, (iii) make the Office of the United States Trustee an additional notice party on all insurance policies, (iv) attend an initial debtor interview with the Office of the United States Trustee, (v) submit to the Court a balance sheet, statement of operations, cash flow statements and federal income tax returns, (vi) attend the first meeting of creditors, (vii) file a Status Report on efforts to confirm a plan, (viii) attend a mandatory status hearing, (ix) file Schedules of Assets and Liabilities, and (x) file a Statement of Financial Affairs. These administrative responsibilities stretch the capacity of even the most capable small business managers at what is generally a stressful and chaotic time in the business.

One notable challenge subchapter V presents is in cases where there is a high degree of animosity toward or distrust of a debtor's principal. Subchapter V's provision for replacing a fraudulent or incompetent debtor is unclear and some find the process cumbersome. While the standard for taking the debtor out of possession is essentially the same for a subchapter V case and a regular chapter 11 case, what happens once a debtor is out of possession is not equivalent. *Compare* 11 U.S.C.A. § 1185 to 11 U.S.C.A. § 1104.

Even bringing a motion to expand the duties of a subchapter V trustee and to take a debtor out of possession can be challenging in a subchapter V case. From a practical perspective, the case moves so quickly that a Court may determine to deal with a challenge to the debtor's management through the plan process (e.g., feasibility and good faith), rather than risk stalling the case in motion practice before the plan process can begin to unfold.

If the Court finds cause exists to remove the debtor-in-possession in a subchapter V case, the Subchapter V trustee's duties are expanded rather than a third party being appointed to operate the debtor. However, knowing the extent to which those duties can or will be expanded requires reading several Bankruptcy Code sections, starting with Section 1183(b)(5), which incorporates by reference portions of two other Code sections, Sections 704(a)(8) and 1106(1), (2), and (6).

  

The statute permits the Subchapter V Trustee to operate the business, but some Subchapter V Trustees have neither the time nor the training to operate a business in chapter 11. Furthermore, Section 1185(b)(5) does not permit a Subchapter V trustee to file a Subchapter V plan. [84] If a debtor-in-possession must be removed, the result could be a worse mess: the Subchapter V Trustee running the business may be singularly ill-equipped to run it, and yet the Subchapter V Trustee is prohibited by law from proposing a plan.

Practitioners are divided regarding best next steps following removal of a debtor from possession in a subchapter V case, with one camp arguing that reorganization without conversion is possible through collaboration with the debtor's principals or remaining employees to confirm a plan and/or facilitate a sale of assets through 11 U.S.C.A. § 365, and the other arguing the only paths forward after removing the debtor from possession are conversion to a regular chapter 11 or to a chapter 7 case.

The subchapter V process adds administrative burdens for small businesses that should be fully considered before a subchapter V election is made. Moreover, in cases involving complex or contentious litigation or business models, parties-in-interests and Courts are struggling with whether and to what extent the subchapter V process can or should be utilized, which may further complicate the evaluation of subchapter V. *See, e.g.*, In re InfoW, LLC, No. 22-60020 (Bankr. S.D. Tex. 2022).

**5. Closing Remarks**

As more and more time passes from SBRA's 2019 enactment (and the United States strives to find equilibrium from the COVID-19 pandemic), practitioners are growing more savvy to the opportunities subchapter V provides and Courts are beginning to establish more specialized local procedures and practices to further support the flow of a subchapter V case. [85] Overall, subchapter V provides a centralized and relatively low-cost forum to address what can be complex problems for small and medium-sized businesses. Subchapter V cases move quickly based on the statutory requirements, and parties appear more incentivized to progress to a plan of reorganization even amidst disagreement. Thus, while parties should remain mindful of the relative newness and challenges inherent to the SBRA, it should not be discounted out-of-hand.

## XV. Subchapter V

*By Brian M. Rothschild,* [86] *Subchapter V Trustee, District of Utah*

More than two years after the quiet rollout of Subchapter V under the Small Business Reorganization Act (Public Law 116-54) (the "**SBRA**"), Subchapter V is evolving into a flexible and popular tool for owner-operated business reorganization and orderly liquidation. Subchapter V is, however, most remarkable for what is not there: the statute is sparsely worded, sometimes vague, and open to interpretation. It will, therefore, require further elaboration by the courts and Congress as time goes on. The following are a few examples of the "gaps" that remain to be filled in.

### A. The Promise and Potential of the "Best Efforts Test"

Perhaps the SBRA's greatest innovation - the "Best Efforts Test" that replaces the Absolute Priority Rule in a cramdown - is also its greatest potential for abuse. In 2005, Judge Richard L. Speer of the Bankruptcy Court for the Northern District of Ohio told me that the only difference between a chapter 11 case for Joe's Garage and General Motors was the number of zeros. He was partially correct in that the same statute - traditional chapter 11 - applied to both at the time, but what he failed to capture was that the different nature of ownership made small businesses nearly impossible to reorganize without the consent of their creditors. In a cramdown under traditional chapter 11 under section 1129(b)(2)(B), each class of unsecured creditors had to accept the plan. Otherwise, equity could take nothing on account of its interests. For a large, publicly-traded company like General Motors, it is easy enough to issue new equity to the new owners. That equity, which trades on public markets, is as marketable as cash. For such large companies, incentivizing management, which is not the owner of all of the equity, to make the reorganized business a success would not be difficult, as pay packages could include generous salaries and future equity earn-ins.

But in a small business, the owners are often the business' key employees and management. If they are not allowed to take anything on account of the plan in a cramdown, they would have no incentive to work to make the reorganized business a success. "Joe" of Joe's Garage would be better off just getting a 9-5 job or opening up a new business, resulting in an unnecessary loss of all of the value of the potential reorganization.

  

Enter the SBRA, which replaces the Absolute Priority Rule with the Best Efforts Test with respect to unsecured creditors. Under section 1191(b) and (c), so long as the plan provides for payment to creditors of the debtor's "projected disposable income" or its equivalent value over the plan period (3-5 years), the debtor can confirm a plan notwithstanding the consent of its creditors. Thus, a business owner can keep its equity so long as it makes "best efforts" to repay its creditors during the plan period. This is a thoughtful innovation designed to recapture the value that for so long has been lost for owner-operated small businesses unable to comply with the absolute priority rule.

The test in section 1191(b) and (c) is likewise Congress's "best effort" at a novel solution. But it is not without problems even though takes its general outline from the well-worn principles of chapter 13. In chapter 13, "projected disposable income" is usually a relatively simple calculation because an individual debtor under chapter 13 usually receives a paycheck as a W-2 employee. Or, at the very least, the debtor has "regular income" as required under section 109(e) to even be an eligible chapter 13 debtor. Further, a chapter 13 debtor has knowable expenses, cabined by IRS guidelines, incorporated by reference by sections 1325(b)(2) and (3).

In contrast, a small business's gross income need not be regular, nor can it be discerned by looking at a W-2. As any respectable tax attorney or accountant can tell you, top-line income is subject to a multitude of manipulations or "choices" in the accounting. So too, the small business's expenses are not cabined by IRS guidelines. They are subject, instead, to the vaguest of standards imaginable:

> For purposes of this section, the term "disposable income" means the income that is received by the debtor and that is not reasonably necessary to be expended … for the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor.

11 U.S.C.A. § 1191(d). [87] Again, any respectable accountant or tax advisor could tell you that expenses are subject to a host of manipulations as well, including depreciation, loss recognition, and timing of expenditures and investment.

So, where are the guardrails? What is to prevent a debtor in Subchapter V from confirming a plan that puts all of its net profits into inventory, insiders' salaries, rainy day funds, or R&D for the future that lies beyond the plan period, all for the benefit of the owners? Even assuming that the bankruptcy court can fashion a standard for the gap that Congress did not fill, who is responsible for bringing the issue to the Court's attention? Without an unsecured creditors' committee, the Subchapter V trustee certainly could be heard on the subject (§ 1183(b)(3)(B)), but it is unclear how the Subchapter V trustee could know without hiring counsel and financial advisors to ferret out such information.

Congress and the courts will eventually have to fill in the gaps.

### B. Liquidation Under Subchapter V

Because of the debtor-friendly provisions in Subchapter V, hostile creditors have made eligibility under section 101(51D) a battleground. In particular, creditors have used the purported requirement that a debtor be "a person engaged [present tense] in business activities" and not a now-shuttered business with debts to elect Subchapter V. [88]

Just like traditional chapter 11 in which Subchapter V is found, orderly liquidation is a proper use for Subchapter V (both are found under the same heading "Chapter 11 - Reorganization"). Why would Congress require a small business to be currently operating on the petition date and yet allow it to cease operating and liquidate? There is no basis for such discrimination aside from the reading of the word "engaged" in section 101(51D) as present tense. So long as this remains a battleground without any articulated policy purpose, debtors, creditors, the U.S. Trustee, parties in interest, and the courts are going to have to spend time adjudicating this issue any time a business that is shutting down elects Subchapter V.

### C. Subchapter V Trustee Compensation

One issue (near and dear to me) is the peril of Subchapter V trustee compensation under the SBRA. While it is clear that Subchapter V trustees are not entitled to the share of the distributions that chapter 7 trustees receive under section 326, it is not clear whether Subchapter V trustees are limited to charging their hourly rate and applying for compensation 3 months in arrears.

This arrangement is not always satisfactory or fair. A significant percentage of cases will fail and be administratively insolvent. And the Subchapter V trustee's work is front-loaded, with a large part of the work necessarily done at the beginning of the case for the section 341(a) meeting, the initial debtor interview, and generally coming up to speed on the case. While a debtor's attorney can weigh the risks and decide whether to undertake the representation, the Subchapter V trustee is not able to exercise such discretion. Can, therefore, the Subchapter V trustee negotiate a different compensation scheme under section 328(a), which, after all, authorizes employment "on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis"? Can the Subchapter V trustee demand a retainer?

Subchapter V itself is silent on the subject (and, in fact, does not even specify that Subchapter V trustees are to be compensated under section 327, even though that has been the de facto section under which compensation has been approved). The present default - compensation in arrears without any retainer - leaves the Subchapter V trustee uncompensated for many cases that convert or are dismissed, resulting in a substantial reduction in average overall compensation for Subchapter V trustees. Again, Congress could remedy this with some specificity.

**D. Solicitation and Voting**

Subchapter V does not explicitly require solicitation and voting on a plan. Can a Subchapter V debtor confirm a plan without soliciting simply because it could confirm a nonconsensual plan under section 1191(b)? Again, the question could be answered with reference to whether Congress intended Subchapter V to be more like Chapter 13, which does not require solicitation), or traditional Chapter 11, which requires disclosure and solicitation in most instances. Because the plan must include information that would normally be found in the disclosure statement, some courts have required solicitation even if class consent is otherwise unnecessary for confirmation.

Relatedly, does the non-vote of a class constitute the consent of a class? In the Tenth Circuit, the courts have deemed the failure to vote as consent in Chapter 13, and this precedent has been applied in Chapter 11 cases in the circuit as well. [89] Can this same concept be applied to Subchapter V in the absence of any statutory guidance in the SBRA?

Finally, Subchapter V gives no rule for what is necessary to cram down on non-consenting equity (aside from the Best Efforts Test). Because section 1191(b) does not give any specific means for cramming down a non-consensual plan on equity (because section 1129(b)(2)(C) does not apply), any plan that wipes out equity (*e.g.*, most liquidating plans), could be confirmable under traditional chapter 11 but might not pass muster in Subchapter V unless the plan also meets the Best Efforts Test. So a plan of liquidation that cancels all equity must, counterintuitively, contain a projection of future disposable income to be confirmed on a class of equity that is deemed to not consent.

These issues and likely others will, again, need to be fleshed out as Subchapter V practice evolves and Congress and the courts fill in the gaps as we work through the first iteration of the SBRA.

**XVI. Subchapter V**

*By Stephen W. Sather, Subchapter V Trustee,* [90] *Western District of Texas*

I have seen the workings of Subchapter V in my capacity as a Subchapter V Trustee and as a debtor's attorney filing Subchapter V cases. I have seen Subchapter V used for operating businesses, such as restaurants and construction companies, individuals and investment vehicles. In a limited number of cases, debtors are able to quickly and efficiently reorganize and emerge from bankruptcy. However, many Subchapter V cases fail for the same reasons as other small business cases, such as inability to meet even the reduced requirements of Subchapter V, inability to earn an operating profit or lack of management skills.

**Goals of Debtors**

  

Subchapter V debtors are generally trying to save a business due to some external threat, such as a landlord who has locked the debtor out of its business, a secured creditor about to foreclose or collection activities from the IRS. In a significant subset of cases, Subchapter V is being used as a tactic to gain an advantage in litigation. Whether debtors achieve their goals depends on the propriety of those goals. The honest but unfortunate debtor who has good cash flow and good financial reporting skills has an above average chance of succeeding. When a case is filed to gain an advantage in litigation or is filed without any realistic endgame, the result is usually bad.

**Creditor Involvement**

Creditor involvement generally depends on the level of conflict with creditors pre-petition. If the debtor was engaged in contentious litigation pre-petition, creditor involvement and antagonism is likely to continue in the Subchapter V case. Where a debtor has been fighting with an ex-spouse or an ex-business partner prior to bankruptcy, those fights simply move to a new forum when a debtor files Subchapter V. On the other hand, where a case was prompted by a tax seizure or a landlord-tenant dispute and the dispute had not boiled over into antagonism, creditors are likely to take more of a wait and see approach. Other cases require greater creditor participating such as a construction case where there are multiple lien claimants seeking to collect from the same funds. Generally, the less creditor anger there is in a case, the more likely it is to succeed.

**Role of the Subchapter V Trustee**

The role of the Subchapter V trustee varies dramatically depending on the case. I frequently go to inspect a debtor's business. Sometimes this is necessary to assure creditors that there really is business being conducted. In one case, I recommended that the disputing parties try mediation and then participated in the mediation. While the mediation resulted in a confirmed plan, the debtor was not able to obtain the financing necessary to consummate the plan. I have seen other cases where the debtor is removed and the Subchapter V Trustee steps in to take the lead in reorganizing the business, though this has not happened to me as trustee.

**Areas for Improvement of Subchapter V**

There are several areas, both legal and practical, which could improve the operation of Subchapter V. The operating reports promulgated by the U.S. Trustee are not user-friendly. They require the debtor to answer dozens of questions and generate multiple attachments. In many cases, the success of a case depends on the debtor's ability to hire a professional to complete the operating reports for it. A form of report that could be completed by an unsophisticated debtor would improve the workings for Subchapter V.

One significant hole in Subchapter V relates to what happens when a debtor in possession is removed. Because only the debtor may propose a plan, a Subchapter V trustee is limited to selling assets or converting the case to Chapter 7 unless the debtor (who has been removed for misconduct or incompetence) is willing to cooperate with the Trustee to propose a plan. While I have seen one case where this worked, usually removing the debtor in possession leads to dismissal or conversion.

The 90-day deadline to file a plan is also a challenge for many debtors. However, once a plan is filed, there is no deadline to confirm the plan. This leads to debtors' attorneys filing placeholder plans or “garbage” plans. A placeholder plan is one which meets many of the requirements for Subchapter V but still has areas that need to be litigated or negotiated. A “garbage” plan, on the other hand, is document that says it is a plan with little thought given to confirmability. A better use of the Subchapter V status conference would be to discuss the requirements of the specific case and develop a workable timeline for both filing and confirming a plan.

Another area where Subchapter V could be improved is to provide more support to debtors and debtor's counsel. Some attorneys filing Subchapter V cases are Chapter 13 practitioners who do not have prior Chapter 11 experience. They may not know that it is necessary to seek permission to use cash collateral or to open debtor-in-possession accounts. Additionally, the form Subchapter V plan that has been promulgated, omits certain required elements such as remedies for default. The program can be improved by encouraging Subchapter V trustees to mentor inexperienced debtor's attorneys through the process. Subchapter V debtors could benefit from financial coaching, including examining their business operations and developing systems for financial reporting. Because many Subchapter V trustees are Chapter 11 practitioners, they are not usually capable of providing this assistance.

**Case Studies of Successful Cases**

  

Here are three case studies of successful Subchapter V cases:

- On the first day that Subchapter V went into effect, a restaurant that sold chicken wings filed its case. The case had approximately $24,000 in secured debts, $60,000 in priority tax debts and $184,000 in unsecured debts. The debtor filed due to tax liabilities and a debt from a landlord on a closed location. The debtor received an extension allowing it to file its plan within six months of the petition date. The debtor confirmed its plan without objection. Debtor's counsel was awarded fees of approximately $30,000 and the **Subchapter** V **trustee's** fees were $1,370.00.
- A moving company filed for Subchapter V. It had borrowed money from multiple merchant cash advance lenders who were consuming a good deal of the company's cash flow. The **claims** consisted of approximately $10,000 owed to the IRS, $15,000 to a secured lender and approximately $100,000 in unsecured debt. The debtor experienced difficulties opening a debtor-in-possession account because its principals had criminal records. The **Subchapter** V **trustee** was able to assist in finding a bank willing to open the account. The debtor filed its plan on the 90th day of the case. The plan was confirmed without objection approximately thirty days later. Debtor's attorney's fees were approximately $18,000 and the **Subchapter** V **trustee's** fees were $1,600.
- An eSports lounge filed for Subchapter V. The case was filed after the business had been shut down due to Covid-19 and the landlord had threatened to terminate the lease. The debtor scheduled $1.5 million in unsecured debts, many of whom were owed to insiders. The debtor filed its plan within ninety days. It also filed a motion to assume lease. After the debtor reached an agreement with the landlord, the case was voluntarily dismissed. The **Subchapter** V **Trustee's** fees were approved for approximately $9,200.00. The case was successful because the debtor was able to re-enter the leased premises and negotiate a **settlement** of the disputes between the parties.

**Creative Use of Subchapter V**

The most creative use of Subchapter V that I have witnessed (although I did not participate in the case) involved three entities related to conspiracy theorist Alex Jones. Mr. Jones put three of his tangentially-related businesses who had been named as defendants in litigation into Subchapter V. Because all of the debt involved unliquidated tort claims, the debtors were able to file even though the final amount of their debts when liquidated might exceed the debt limits for Subchapter V. The plan that has been telegraphed is to remove all of the litigation pending against Mr. Jones and his entities and transfer it to bankruptcy court for claims determination. The plan, at least as suggested by initial filings, is to have the non-debtor entities fund sufficient monies to pay the claims while allowing the primary obligors to avoid bankruptcy. This has resulted in multiple motions to dismiss which remain pending at this time.



## Footnotes

1 11 U.S.C.A. §§ 1183 to 1195.

2 H.R. 116-171 (116th Cong. 1st Sess. 2019), 1–2.

3 Remarks of Rep. Ben Cline (R-VA), H.R. 116-171 (116th Cong. 1st Sess. 2019), 4.

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6 *See,* 11 U.S.C.A. § 1121(e)(2).

7 *See,* 11 U.S.C.A. § 1129(e).

8 One analysis of cases filed from February, 2020 through September 30, 2020 determined that 20% of such cases resulted in confirmed plans, which was six times higher than for small business cases that did not proceed under Subchapter V. *See,* Clifford J. White III, "Small Business Reorganization Act: Implementation and Trends," *ABI Journal*, January 2021.

9 Sam Della Fera, Jr., Esq., is a member of Chiesa Shahinian Giantomasi, PC, and a Co-Chair of the Firm's Bankruptcy & Creditors' Rights Group. Sam has nearly 30 years of experience representing individual and corporate debtors, trustees, creditors' committees, secured creditors, landlords, and other parties in bankruptcy cases and in restructurings and workouts both in and outside of court. Sam was selected to serve as a Subchapter V bankruptcy trustee in the District of New Jersey, and has been appointed as trustee in nearly a dozen small business cases. He is also a New Jersey Bankruptcy Court approved mediator.

10 Chuck Persing is a CPA/CFF, CVA, CIRA, CFE and a partner in Bederson LLP's Insolvency & Litigation group. Since 2000, while an employee of Winstar (and the last man standing there in 2006), Chuck has been exposed to all aspects of bankruptcy and financial restructuring. He has acted as the financial advisor or in other fiduciary capacities to debtors, official committees, and both Chapter 7 and Chapter 11 trustees. Recently, Chuck has been a Receiver and COO to a chapter 11 trustee, and has assisted trustees and others in sales of assets including real estate, annuities, industrial equipment, and entire businesses. Chuck was selected as a Subchapter V trustee in the Eastern and Southern Districts of New York and has served in over 20 cases and counting.

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12 Several cases gave determined that debtors with legacy debt are illegible for Subchapter V (In re McCune, 635 B.R. 409, 420 (Bankr. D. N.M. 2021); In re Vertical Mac Construction, LLC, 2021 WL 3668037, at *2 (Bankr. M.D. Fla. 2021); In re Ikalowych, 629 B.R. 261, 70 Bankr. Ct. Dec. (CRR) 44 (Bankr. D. Colo. 2021); In re Thurmon, 625 B.R. 417, 69 Bankr. Ct. Dec. (CRR) 165 (Bankr. W.D. Mo. 2020)) while others found that debtors with legacy debt are eligible for Subchapter V (In re Wright, 2020 WL 2193240, at *3 (Bankr. D. S.C. 2020); In re Bonert, 619 B.R. 248 (Bankr. C.D. Cal. 2020) and In re Blanchard, 69 Bankr. Ct. Dec. (CRR) 16, 2020 WL 4032411, at *4 (Bankr. E.D. La. 2020)).

13 In re NIR West Coast, Inc., 71 Bankr. Ct. Dec. (CRR) 117, 2022 WL 1050055 (Bankr. E.D. Cal. 2022)

14 *In re Thurmon*, 625 B.R. at 422 (although the U.S. Trustee timely raised the issue of eligibility by objecting to the Subchapter V election, the U.S. Trustee did not request a hearing on it; the ruling on eligibility occurred in connection with the hearing on confirmation of the plan, which all impaired classes of creditors had accepted.).

15 David Klauder, Bielli & Klauder, LLC, 1204 King St., Wilmington DE 19801.

16 11 U.S.C.A. § 1183(b) sets for the duties of the Subchapter V Trustee, and provides for certain expanded duties if the debtor is no longer in possession or upon a request from a party in interest when cause for an expanded role is established.

17 Joseph Kershaw Spong, Robinson Gray Stepp & Laffitte, LLC 1310 Gadsden Street, P.O. Box 11449, Columbia, SC 29211.

18 H.R. Rep. 116-171, at 1 (2019)

19 Steven Weiss, Esquire, Shatz, Schwartz and Fentin, P.C., Springfield, MA.

20 The views in this article are strictly mine, and do not represent any official NABT position.

  

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22 Leon S. Jones, Jones & Walden LLC, 699 Piedmont Avenue, NE, Atlanta, Georgia 30308, (404) 564-9300 Telephone, (404) 564-9301 Facsimile, ljones@joneswalden.com, tmcclendon@joneswalden.com. Leon S. Jones is a co-founder of the law firm Jones & Walden, LLC. The firm is located in midtown, Atlanta, Georgia. Mr. Jones graduated from the University of Georgia (A.B., 1985; J.D., 1988). Since graduating from law school, he has concentrated his legal practice in the areas of bankruptcy, debtor-creditor, and commercial litigation. Within the bankruptcy arena, Mr. Jones represents debtors, creditors, and trustees in both consumer and commercial matters. Specifically, Mr. Jones' practice includes representing parties in cases under Chapter 7, 11, 12, and 13 of the Bankruptcy Code, with a particular emphasis on representing individual and small business debtors in Chapter 11. Mr. Jones also serves as Sub-Chapter V Trustee in Chapter 11 cases.

23 See Hon. Paul W. Bonapfel, Guide to the Small Business Reorganization Act of 2019 (2020) (updated 2022). Judge Bonapfel's treatise has been cited as a secondary source on the subject of subchapter V multiple times. *See e.g.* In re Urgent Care Physicians, Ltd., 2021 WL 6090985, at *9 (Bankr. E.D. Wis. 2021) and In re Satellite Restaurants Inc. Crabcake Factory USA, 626 B.R. 871, 70 Bankr. Ct. Dec. (CRR) 12 (Bankr. D. Md. 2021) (adopting Judge Bonapfel's analysis that the exceptions to discharge in § 523(a) do not apply to a cramdown discharge of an entity in a subchapter V case).

24 The Small Business Reorganization Act of 2019 (H.R. 3311) was signed by the President on August 23, 2019 ("SBRA"). The SBRA added new Subchapter V to Chapter 11 of the Bankruptcy Code

25 Representative Ben Cline, 6th District, Virginia, June 19, 2019 Press Release on the Introduction of H.R. 3311.

26 New proposed legislation would extend the sunset on the increased subchapter V debt limit of $7,500,000 for two more years and increases the debt limit in chapter 13 to $2.5 million (secured and unsecured consolidated) for two years.

27 See the Hon. Paul W. Bonapfel, Guide to the Small Business Reorganization Act of 2019 (2020) (Updated 2022) at pp 45–47. In his treatise, Judge Bonapfel reviews the imperfect statutory language and considers the decision of the court in In re Phenomenon Marketing & Entertainment, LLC, 2022 WL 1262001 (Bankr. C.D. Cal. 2022). The *Phenomenon Marketing* Court "concluded that a limited liability company was not eligible to be a subchapter V debtor because affiliates of the debtor were "issuers." One of the affiliates was the sole member of the debtor, and another affiliate was the sole member of the debtor's member …" Bonapfel at p.46. The court ruled that the affiliates were "issuers" under the Securities Exchange Act even though the securities were not publicly traded. *Id.* According to Judge Bonapfel, "Congress could not have intended such results. The appropriate interpretation … is to limit its application to an affiliate of an issuer that is subject to the reporting requirements" under the Securities Act. Id. p. 47.

28 The subchapter V Trustee should not approach the case in an adversarial manner. See In re 218 Jackson LLC, 631 B.R. 937, 947 (Bankr. M.D. Fla. 2021). The Court in *218 Jackson* noted factors including: (1) the subchapter V trustee's duty to facilitate a consensual plan, and (2) the fact the trustee is not required to investigate the financial affairs of the debtor unless the court orders otherwise. As a result, the Court determined that "[i]t is not a stretch then to conclude that the subchapter V trustee's role was intentionally designed to be less adversarial."

29 *See* Bankruptcy Code Section 1185 which provides that the court shall order that the debtor shall not be a DIP "for cause" including fraud, dishonesty, incompetence, etc. And like the test in in a traditional 11, this "cause" may be based on pre-petition or post-petition actions. So subchapter V does not provide for the appointment of a trustee. It does provide for removal of the DIP. And it does provide for the expansion of the Ssubchapter V trustee's powers. Bankruptcy Code Section 1183(b)(5) states that if the debtor "ceases to be a DIP," the trustee shall perform the duties of Sec 704(a)(8) and 1106(a)(1),(2) &

  

(6). Section 1183(b)(5) also expressly authorizes the trustee to "operate the business of the debtor." These are the "expanded powers" of the subchapter V trustee.

30 11 U.S.C.A. § 1184 (emphasis added).

31 In certain instances, the UTS has espoused that a subchapter V debtor must operate a business. But this position ignores the difference between the statutory language regarding eligibility in chapter 12 and subchapter V. A chapter 12 debtor must be engaged in farming "operations". A subchapter V debtor must be engaged in commercial or business "activity."

32 The UST's request for revocation of the debtor's subchapter V election has been denied in at least 10 published cases. *See, e.g.*, In re Ventura, 615 B.R. 1 (Bankr. E.D. N.Y. 2020); In re Wright, 2020 WL 2193240 (Bankr. D. S.C. 2020); In re Bonert, 619 B.R. 248 (Bankr. C.D. Cal. 2020); In re Ellingsworth Residential Community Association, Inc., 619 B.R. 519 (Bankr. M.D. Fla. 2020); In re Blanchard, 69 Bankr. Ct. Dec. (CRR) 16, 2020 WL 4032411 (Bankr. E.D. La. 2020); In re Ikalowych, 629 B.R. 261, 70 Bankr. Ct. Dec. (CRR) 44 (Bankr. D. Colo. 2021); In re Offer Space, LLC, 629 B.R. 299, 70 Bankr. Ct. Dec. (CRR) 45 (Bankr. D. Utah 2021); In re Blue, 630 B.R. 179, 70 Bankr. Ct. Dec. (CRR) 95 (Bankr. M.D. N.C. 2021); In re Port Arthur Steam Energy, L.P., 629 B.R. 233 (Bankr. S.D. Tex. 2021); In re Vertical Mac Construction, LLC, 2021 WL 3668037 (Bankr. M.D. Fla. 2021). For cases sustaining an objection to debtor's eligibility, *see* In re Johnson, 2021 WL 825156 (Bankr. N.D. Tex. 2021) and In re Thurmon, 625 B.R. 417, 69 Bankr. Ct. Dec. (CRR) 165 (Bankr. W.D. Mo. 2020). This field observer believes that *Johnson* adds an additional eligibility qualification which Congress itself did not see fit to include. *Johnson* appears to improperly import an "ownership and control" requirement into the statute.

33 For an extensive analysis of statutory construction and legislative history that reaches a decision in favor of expansive eligibility, see In re Ikalowych, 629 B.R. 261, 70 Bankr. Ct. Dec. (CRR) 44 (Bankr. D. Colo. 2021) ("There is no reason that 'commercial or business activities' are somehow reserved only for business titans, company owners, or management.")

34 Bob Handler, Commercial Recovery Associates, LLC, 205 West Wacker Drive, Suite 918, Chicago, IL 60606; Neema T. Varghese, NV Consulting Services, 701 Potomac Ave., Naperville, IL 60565; Matthew Brash, Newpoint Advisors Corporation, 1320 Tower Road, Schaumburg, IL 60173; and Ken Novak, Ken Novak & Associates, Inc., 3356 Lake Knoll Drive, Northbrook, IL 60062.

35 Clifford J. White III, Small Business Reorganization Act: Implementation and Trends, 40-JAN Am. Bankr. Inst. J. 54 (Jan. 2021).

36 Iana Vladimirova, Husch Blackwell, 33 East Main Street, Suite 300, Madison, WI 53703.

37 Leanne O'Donnell, Husch Blackwell, 111 Congress Avenue, Suite 1400, Austin, TX 78701.

38 11 U.S.C.A. § 506(a)(1).

39 In re 680 Fifth Ave. Associates, 29 F.3d 95, 97, 25 Bankr. Ct. Dec. (CRR) 1445, 31 Collier Bankr. Cas. 2d (MB) 1085, Bankr. L. Rep. (CCH) P 75987, 142 A.L.R. Fed. 789 (2d Cir. 1994); see also In re B.R. Brookfield Commons No. 1 LLC, 735 F.3d 596, 58 Bankr. Ct. Dec. (CRR) 190, 70 Collier Bankr. Cas. 2d (MB) 1098, Bankr. L. Rep. (CCH) P 82533 (7th Cir. 2013) (second lienholder would be treated as having recourse against the debtor even though collateral value would have allowed for no recovery on the claim outside of bankruptcy); In re Batista-Sanechez, 505 B.R. 222 (Bankr. N.D. Ill. 2014) (following Brookfield Commons).

  

40 Hon. Paul W. Bonapfel, *A Guide to the Small Business Reorganization Act of 2019*, at 142, *available at* https://www.flsb.uscourts.gov/sites/flsb/files/documents/Guide_to_the_Small_Business_Act_of_2019_%28Hon._Paul_Bonapfel_rev._07-2021%29.pdf.

41 Bonapfel, at 142.

42 Bonapfel, at 142.

43 *See e.g.* In re Body Transit, Inc., 619 B.R. 816, 69 Bankr. Ct. Dec. (CRR) 56 (Bankr. E.D. Pa. 2020); In re VP Williams Trans, LLC, 2020 WL 5806507 (Bankr. S.D. N.Y. 2020); In re Caribbean Motel Corporation, 71 Bankr. Ct. Dec. (CRR) 52, 2022 WL 50401 (Bankr. D. P.R. 2022).

44 Thomas C. Scherer & Whitney L. Mosby, *The Applicability of the § 1111(b) Election in a Small Business Case,* 40 Am. Bankr. Inst. J. 12, 13 (2021).

45 Scherer & Mosby, at 13.

46 Scherer & Mosby, at 13.

47 In re Body Transit, Inc., 619 B.R. 816, 69 Bankr. Ct. Dec. (CRR) 56, 2020 WL 4574907, (Bankr. E.D. Pa. 2020).

48 2020 WL 4574907, at *1.

49 2020 WL 4574907, at *2.

50 2020 WL 4574907, at *2.

51 2020 WL 4574907, at *16–17.

52 2020 WL 4574907, at *18.

53 2020 WL 4574907, at *17.

54 2020 WL 4574907, at *17–18.

55 2020 WL 4574907, at *18.

56 2020 WL 4574907, at *18.

57 2020 WL 4574907, at *18.

58 In re VP Williams Trans, LLC, 2020 WL 5806507, at *6 (Bankr. S.D. N.Y. 2020).

59 2020 WL 5806507, at *1.

60 2020 WL 5806507, at *3.

61 2020 WL 5806507, at *3.

62 2020 WL 5806507, at *3.

63 2020 WL 5806507, at *4.

  

64 2020 WL 5806507, at *4.

65 2020 WL 5806507, at *4.

66 2020 WL 5806507, at *5.

67 2020 WL 5806507, at *5.

68 2020 WL 5806507, at *6.

69 In re Caribbean Motel Corp., 2022 WL 50401, at * 6 (Bankr. D.P.R. Jan. 5, 2022)

70 2022 WL 50401, at * 2.

71 2022 WL 50401, at * 6.

72 2022 WL 50401, at 6.

73 2022 WL 50401, at 6.

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75 With Acknowledgment to Richard Grant for his Book, Dispatches from Pluto, Lost and Found in the Mississippi Delta

76 Small Business Reorganization Act ("SBRA") of 2019, Pub. L. No. 116-54, 133 Stat. 1079 (codified in 11 U.S.C.A. §§ 1181 to 1195 and various sections of 11 U.S.C.A. and 28 U.S.C.). The SBRA made conforming amendments to several sections of the Bankruptcy Code and statutes dealing with the appointment and compensation of trustees in title 28.

77 *See* 11 U.S.C.A. §§ 1181 to 1195.

78 The United States Senate recently voted to make permanent a temporary COVID-19 related increase of the debt limit to $7.5 million, but as of May 9, 2022, the House had not passed similar legislation.

79 *See also* Hon. Paul W. Bonapfel, SBRA: A Guide to Subchapter V of the US Bankruptcy Code (ABI 2021).

80 Co-author Katharine Battaia Clark is qualified and serves as a Subchapter V Trustee in cases filed in the Northern and Eastern Districts of Texas.

81 This same perceived "benefit" presents challenges where a debtor is taken out of possession.

82 *See* In re Mechanical Equipment, Inc., Case No. 21-50067-RLJ-11 (Bankr. N.D. Tex. 2021).

83 This statistic does not include cases continuing to progress toward a plan or cases in which the appointment concluded prematurely due to conflicts arising shortly after appointment.

84 Section 1185(b)(5) says that the Subchapter V trustee may perform certain duties specified in three named subsections of Section 1106(a). However, Section 1185(b)(5) does not specifically name the subsection that authorizes a Chapter 11 trustee to file a plan. Section 1189(a) says unambiguously that only the debtor can file a Subchapter V plan.

85 *See, e.g.*, Clerk's Notice 22-01 issued by the Office of the Clerk for the United States Bankruptcy Court for the Northern District of Texas, available at https://www.txnb.uscourts.gov/sites/txnb/files/clerks-notices/22-01%20Clerk%27s%20Notice%20Regarding%20Amendment%20to%20Subchapter%20V%20Scheduling%20Order.pdf (last visited May 9, 2022).

  

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87 While the "necessary for the continuation, preservation, or operation of the business of the debtor" occurs in chapter 13, section 1325(b)(2)(B) as well, it only applies where the debtor's income comes from a business, which is not as often the case.

88 *See* In re Thurmon, 625 B.R. 417, 69 Bankr. Ct. Dec. (CRR) 165 (Bankr. W.D. Mo. 2020); In re Wright, 2020 WL 2193240 (Bankr. D. S.C. 2020).

89 In re Ruti-Sweetwater, Inc., 836 F.2d 1263, 17 Bankr. Ct. Dec. (CRR) 155, 17 Collier Bankr. Cas. 2d (MB) 1459, Bankr. L. Rep. (CCH) P 72156 (10th Cir. 1988).

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