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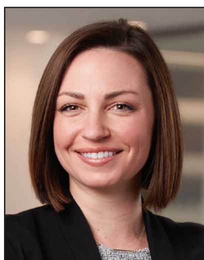
Feature

By Colleen Restel

The ABCs of Subchapter V

Editor's Note: *ABI's Subchapter V Task Force released its Final Report and recommendations to Congress in April, and its findings support maintaining the eligibility limit of $7.5 million in aggregate noncontingent, liquidated debt for small businesses looking to reorganize under subchapter V. For more information, please visit subvtaskforce.abi.org.*



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The Small Business Reorganization Act of 2019 (SBRA) went into effect in February 2020, creating subchapter V of the Bankruptcy Code. Its enactment acknowledged the long-felt barriers to chapter 11 for small business debtors — as chapter 11 is often a prohibitively expensive and lengthy process — which nonetheless would benefit from the Code's fresh start. The SBRA's goal was to reduce costs and increase efficiency to make bankruptcy a feasible option for small business debtors in need of the Code's protections.

Subchapter V's creation has become a popular option for eligible debtors. Recent statistics have shown that subchapter V is a more popular option for small business debtors than the traditional chapter 11 path, and with promising levels of success.[1] The Department of Justice recently reported that "[c]ompared to other (non-subchapter V) chapter 11 small business cases, subchapter V cases have had approximately double the percentage of confirmed plans and half the percentage of dismissals, as well as a shorter time to confirmation."[2] With subchapter V's growing popularity, it is increasingly important to understand the primary differences between a subchapter V case and a traditional chapter 11 case so that potential debtors can consider and choose their paths forward wisely, and creditors can likewise be prepared to participate in either process.

Regardless of whether proceeding in a traditional chapter 11 or subchapter V, a debtor maintains many of the fundamental bankruptcy protections, such as the automatic stay's breathing spell, the ability to maintain control over the business as a debtor-in-possession throughout the bankruptcy process, and the opportunity to reorganize and emerge with a fresh start. However, many aspects throughout the life of the bankruptcy case are markedly different. This article explores several of the key differences in a subchapter V case, beginning with who qualifies as a subchapter V debtor through differences during the pendency of the case, and extending through the divergent confirmation requirements.

Who Is Eligible to Be a Debtor Under Subchapter V?

To qualify as a debtor under subchapter V, 11 U.S.C. § 1182 provides that (1) the debtor must be engaged in commercial or business activities other than owning single-asset real estate; (2) the debtor does not have more than $3,024,725 (the "aggregate debt limit)[3] in noncontingent, liquidated debt, including both secured and unsecured debts, excluding debts owed to affiliates or insiders; and (3) at least 50 percent of its noncontingent, unliquidated debts must have arisen from commercial or business activities.

Shortly after the SBRA went into effect, the COVID-19 pandemic shuttered businesses, amplifying existing liquidity constraints and impacting small businesses on levels that could not have been anticipated prior to the legislation's enactment. As a result, and anticipating the pandemic's strain on the economy, the Coronavirus Aid, Relief and Economic Security (CARES) Act, enacted on March 27, 2020, increased the aggregate debt limit to $7.5 million for a limited time.

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1 "Chapter 11 Subchapter V Statistical Summary Through April 30, 2024," Dep't of Justice, U.S. Trustee Program, *available at* justice.gov/ust/page/file/1499276/dl (last visited May 20, 2024).

2 *Id.*

3 At its enactment, the aggregate debt limit was $2,725,625, which was increased to $3,024,725 effective as of April 1, 2022.

The expiration of the increased aggregate debt limit was subsequently extended, which is now set to sunset — absent approval of further extensions — on June 21, 2024. On April 17, 2024, a temporary extension of the $7.5 million aggregate debt limit was once again introduced in the Senate through the Bankruptcy Threshold Adjustment and Technical Corrections Act (S. 4150). If it passes, the aggregate debt limit will remain at $7.5 million for another two years.

Notably, the aggregate debt limit does not apply to contingent or unliquidated claims, meaning that a subchapter V debtor qualifies even with potentially significant contingent[4] or unliquidated[5] claims. However, if a claim or an amount is merely *disputed* (*e.g.*, the parties disagree as to the amount of the liability), that claim must be included in the calculation. If a debtor intends to proceed with a subchapter V case, this must be indicated on the debtor's petition.

How Will a Subchapter V Case Proceed Differently from a Chapter 11 Case?

A Creditors' Committee Is Not Appointed in a Subchapter V Case

Likely the most notable (and controversial) difference between a standard chapter 11 case and a subchapter V case, from a creditor's perspective, is the absence of a creditors' committee. In a standard chapter 11 case, 11 U.S.C. § 1102 provides for the appointment of a committee of unsecured creditors — a group ordinarily comprised of the debtors' largest unsecured creditors who are willing to serve on the committee that is selected by the Office of the U.S. Trustee.

The committee of unsecured creditors is charged with a fiduciary obligation to act on behalf of all unsecured creditors of the debtor, has standing to be heard on any issue in the chapter 11 case, and their professionals' fees are paid by the estate. The creditors' committee generally will analyze the debtor's financials and will investigate potential causes of action; if necessary, it will pursue avoidance, fraudulent-transfer and derivative actions, as well as act as a balance to the debtor's power by challenging the debtor's actions and proposals during the chapter 11 case.

By contrast, in a subchapter V case, no committee of unsecured creditors is appointed unless ordered by the bankruptcy court.[6] While this serves to reduce costs to the estate, it leaves open the question of who, if anyone, can or will fulfill the committee's fiduciary role to protect and seek value for unsecured creditors.

A Subchapter V Trustee Is Appointed in Every Subchapter V Case

In every case, subchapter V provides for the appointment of a subchapter V trustee. This trustee is meant to serve as the replacement for the creditors' committee, but its role and function are slightly different. The subchapter V trustee is responsible for facilitating the debtor's reorganization and monitoring the confirmation and consummation of a plan. In addition, the trustee has certain of the same duties as a chapter 7 trustee, including, *inter alia*, examining and objecting to proofs of claim and opposing the debtor's discharge where appropriate.[7]

> **Practitioners representing debtors and creditors alike would be wise to keep an eye to subchapter V and remain apprised of its differences from traditional chapter 11 cases....**

Subchapter V Contains Different Reporting Requirements and No U.S. Trustee Fees

Subchapter V provides for less stringent reporting requirements and does not require payment of U.S. Trustee fees. Debtors and trustees in chapter 11 cases are required, on a monthly basis, to file reports detailing each debtor's business, including receipts, disbursements, disposition of property and information regarding the estate's administration. Preparing these reports can be time-consuming and costly to compile, depending on the complexity of the case and the debtor's operations. However, a subchapter V debtor is exempt from this requirement.

Similarly, in traditional chapter 11 cases, a fee must be paid to the U.S. Trustee Program each quarter between the date of the bankruptcy filing and the date that the case is closed, dismissed or converted to another chapter. The fee is calculated per debtor and based on company disbursements, and the fee ranges from $250 to $250,000 per quarter. In subchapter V, the debtor *does not* pay any quarterly fees.

Potential Differences in Dischargeability of Debt

Although the Bankruptcy Code provides a discharge for debtors in certain circumstances, a discharge is *not* available for specific debts listed in § 523 of the Bankruptcy Code, including debts relating to financing, property or services obtained under false pretenses, embezzlement, larceny and violation of any federal securities laws. However, § 523 is clear that it only precludes the discharge of an *individual* debtor. Section 1141 of the Bankruptcy Code reaffirms that nondischargeability under § 523 applies *only* to individual debtors in confirmed chapter 11 plans.[8]

Section 1192 of the Bankruptcy Code, part of subchapter V, provides that a discharge of debts through a confirmed plan does not include debts of the kind specified in § 523(a), without specifying whether such exclusion applies only to individual debtors.[9] Although some courts have opined on the issue of whether § 523 exceptions to discharge apply

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4 A contingent claim involves a debt that may be owed in the future, but only if a certain event happens (which may never happen).

5 A claim is considered unliquidated where the exact amount of the debt is not known.

6 *See* 11 U.S.C. §§ 1102(a)(3); 1181(b). An unsecured creditors' committee has been appointed in at least one case pursuant to the bankruptcy court's order. *See* Order Granting in Part and Denying Without Prejudice in Part, Motion of Client Customers for Entry of an Order (I) Appointing an Official Committee of Contingent Litigation Customers Pursuant to 11 U.S.C. § 1102(a)(3); (II) Extending the Deadline to Submit a Proof of Claim Pursuant to Bankruptcy Rule 3003(c)(3); and (III) Granting Related Relief, *In re Lear Capital Inc.*, Case No. 22-10165 [ECF No. 254] (Bankr. D. Del. 2022).

7 *See* 11 U.S.C. §§ 1183(b), 704(a).

8 *See* 11 U.S.C. § 1141(d)(2) ("A discharge under this chapter does not discharge a debtor *who is an individual* from any debt excepted from discharge under section 523 of this title.") (emphasis added).

9 11 U.S.C. § 1192.

to corporate debtors in subchapter V cases, the question remains largely unresolved in most jurisdictions. Even across the jurisdictions that have taken up the issue, courts have not come out uniformly.[10]

As more courts take up the interpretation of § 523's applicability in subchapter V cases, this case law could have an impact on a debtor's choice to pursue relief under subchapter V. Similarly, until there is a uniform application across jurisdictions, a debtor will undoubtedly consider this as a factor when deciding whether to file a traditional chapter 11 case or a subchapter V case, and in what jurisdiction.

Only the Debtor Can Propose a Subchapter V Plan, but on a Specified Timeline

When it comes time to prepare for the conclusion of the case, only the debtor may file a subchapter V plan. The debtor is also given a short timeline — within 90 days of the petition date[11] — to propose a plan, thus limiting the length of subchapter V cases from filing through confirmation. In chapter 11, by contrast, the debtor only has the exclusive right to file a plan for the first 120 days of the case. After that time, unless extended (which is routinely granted), any party can file a chapter 11 plan for the bankruptcy court to consider, and a chapter 11 plan might not be proposed for several months (or longer) into the case. This provision furthers subchapter V's goal of creating a less expensive, more streamlined process for small business debtors.

What Are the Differences in the Confirmation Requirements?

With respect to confirmation under subchapter V, the plan is subject to different confirmation requirements than in a standard chapter 11, many of which can have a massive impact on the debtor and its going-forward business. Consideration of these differences alone might incentivize a qualifying debtor to opt for subchapter V over the traditional chapter 11 process — even setting aside the provisions that provide for a more streamlined and less expensive process.

Most significantly, subchapter V plans have starkly different requirements for creditor approval and payment to creditors. For example, while plan confirmation in a traditional chapter 11 case requires at least one class of impaired creditors to vote to accept the plan, subchapter V has no such requirement. In fact, a subchapter V plan can be confirmed over the objection of *every* creditor.[12]

Further, the absolute-priority rule in chapter 11 cases requires that junior classes of creditors cannot receive any recovery or retain their interests unless creditors of higher priority are paid *in full*. For example, this means that equityholders cannot maintain their ownership of a bankrupt debtor unless all creditors in the case are paid in full, which is often impossible to achieve in a traditional chapter 11 case. Subchapter V flips the absolute-priority rule on its head, allowing junior creditors to receive distributions despite senior creditors being paid only in part and, significantly, permitting ownership to remain in control post-confirmation despite the debtor not paying more senior creditors in full. In the same vein, subchapter V gives debtors the additional flexibility to pay post-petition administrative expenses over time through the plan, rather than payment in full on the plan's effective date.

Although subchapter V permits some flexibility into the order of priority and amount of payment to creditors in order to confirm a plan, § 1191 requires that a subchapter V debtor contribute, *at a minimum*, all of its projected disposable income for at least three years (and up to five years as determined by the bankruptcy court) to repay creditors under the plan.[13] Thus, the flexibility in payments and consent is counterbalanced by a requirement that the debtor contribute a reasonable sum to compensate creditors to the best of its ability.

Conclusion

Given its growing popularity and success, which might be attributable to the perceived advantages over a traditional chapter 11 case, the use of subchapter V as a bankruptcy tool (and its unique features) must not be overlooked. Practitioners representing debtors and creditors alike would be wise to keep an eye to subchapter V and remain apprised of its differences from traditional chapter 11 cases before, during and at the conclusion of a case. abi

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10 *See, e.g., compare Cantwell-Cleary Co. v. Cleary Packaging LLC (In re Cleary Packaging LLC)*, 36 F.4th 509 (4th Cir. 2022) (concluding that § 523 applied in subchapter V to both individual and corporate debtors); *with Lafferty v. Off-Spec Sols. LLC (In re Off-Spec Sols. LLC)*, 651 B.R. 862 (B.A.P. 9th Cir. 2023) (holding that § 523(a) was only applicable to individual debtors in subchapter V).

11 11 U.S.C. § 1189(b).

12 11 U.S.C. § 1191(b).

13 *See* 11 U.S.C. § 1191(c). "Disposable income" means "the income that is received by the debtor and is not reasonably necessary to be expended (1) for (A) maintenance or support of the debtor or a dependent of the debtor; or (B) a domestic-support obligation that first becomes payable after the date of filing of the petition; or (2) for the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor." 11 U.S.C. § 1191(d).