

January 21, 2021

SMALL BUSINESS REORGANIZATION ACT OF 2019: SUBCHAPTER V EXPLAINED

Lenders are likely familiar with the procedure and ramifications of Chapter 11 bankruptcy cases, but may not have experience with the new Subchapter V of Chapter 11 (“Subchapter V”). Enacted via the Small Business Reorganization Act of 2019, Subchapter V was designed to make bankruptcy reorganization more accessible to small businesses by condensing the process and limiting the costs attendant to filing Chapter 11. The number of Subchapter V filings since the Small Business Reorganization Act of 2019 became effective in February of 2019 have been modest. However, with small businesses still acutely feeling the financial effects of COVID-19, lenders are wise to become more familiar with Subchapter V before bankruptcy filings are expected to rise in the coming year.

Eligibility for Relief under Subchapter V

Relief under Subchapter V is available to any person engaged in a commercial business activity, other than ownership of single asset real estate, with non-contingent liquidated secured and unsecured debt as of the date of filing not exceeding \$7,500,000, with the majority of that debt arising from the debtor’s commercial or business activities. The debt limit was raised from \$2,725,625 to \$7,500,000 as part of Congress’ COVID-19 relief legislation in March of 2020 and, absent additional congressional action, will return to \$2,725,625 on March 27, 2021.

Notable Differences between Chapter 11 and Subchapter V

In order to fast track Subchapter V cases, the Bankruptcy Code requires the Bankruptcy Court to hold a substantive status conference within 60 days of the filing. This is unsurprising given that, absent an extension, the debtor must file a plan of reorganization no later than 90 days after filing. Unlike a typical Chapter 11 case where a significant amount of time commonly passes between first day motions and confirmation, a Subchapter V case is setup to immediately bring the debtor and its creditors together after filing to begin negotiating a consensual plan of reorganization. To facilitate these discussions, a trustee is appointed in each Subchapter V case. The trustee does not take control of the debtor’s business as they would in a regular Chapter 11 case. Rather, the trustee serves as a conduit to reaching a consensual plan of reorganization by working with the debtor and its creditors throughout that process. The trustee’s role is an important one because, unlike a normal Chapter 11 case, the debtor is the only party entitled to file a plan of reorganization. As such, and given the quick turnaround from filing to the beginning of the confirmation process, creditors are well advised to begin communicating with the debtor and the trustee promptly upon receiving notice of the debtor’s filing.

In addition to those procedural differences, there are important substantive differences, only a few of which are highlighted below. First, similar to a plan of reorganization under Chapter 13, the debtor

must make plan payments in an amount no less than its projected disposable income over the life of the plan, which can range between three and five years. This deviation from Chapter 11's absolute priority rule will, of course, inform negotiating plan terms. Second, administrative expense claims are paid in full on the effective date in typical Chapter 11 cases, but in Subchapter V cases with non-consensual plans, the administrative expense claims may be paid over the duration of the plan. Finally, where the debtor cannot establish conclusively at confirmation that it will be able to make all plan payments, the plan must include remedies to protect parties holding claims in the event the debtor defaults on plan payments. Creditors, therefore, should immediately begin to work with the debtor and trustee in order to obtain the most favorable remedy provisions.

Subchapter V cases, although similar to regular Chapter 11 cases, are unique, and creditors are best served by moving quickly to protect their interests after receiving notice of filing. If you have question about how to best respond to a Subchapter V filing, call or email anyone in our Creditor's Rights Practice.