

# **Best Practices: Following the Bankruptcy Threshold Adjustment and Technical Corrections Act**

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## **Overview**

On June 21, 2022, President Biden signed the Bankruptcy Threshold Adjustment and Technical Corrections Act (“Corrections Act”) into law. The Corrections Act amends various provisions of the bankruptcy code, including, among other things: (1) temporarily increasing the debt limit for Chapter 13 debtors to an aggregate of \$2,750,000; (2) retroactively extending the debt limit increase of \$7,500,000 under the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) for Subchapter V debtors, and (3) correcting an apparent mistake by Congress in the CARES Act creating an overbroad exclusion for affiliates of security issuers. The following provides a brief description of the amendments, the respective effective dates, and when/if the amendment sunsets.

## **Who May be a Debtor Under § 109 (Chapter 13 Eligibility)**

### **a. Amendment**

The Corrections Act introduces a major change in how the debt limits for eligibility under Chapter 13 are calculated. Previously, § 109(e) stated:

Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than \$465,275 [as adjusted effective April 1, 2022] and noncontingent, liquidated, secured debts of less than \$1,395,875 [as adjusted effective April 1, 2022], or an individual with regular income and such individual’s spouse, except a stockbroker or commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than \$465,275 and noncontingent, liquidated, secured debts of less than \$1,395,875 may be a debtor under chapter 13 of this title.

11 U.S.C. § 109(e) (amended 2022).

The Corrections Act removes the distinction between secured and unsecured debt from the eligibility calculation. It also amends § 109 to increase the debt limit overall by providing that an individual is eligible to be a debtor under Chapter 13 if

the debtor owes “noncontingent, liquidated debts that aggregate less than \$2,750,000 . . .”

**b. Effective Date**

This provision shall take effect on the date of enactment (June 21, 2022).

**c. Sunset**

This provision sunsets two years after the date of enactment of the Corrections Act. Upon sunset, the debt limit will decrease as the provision will revert to its form prior to the enactment of the Corrections Act.

**Definition of a Debtor Under § 1182(1)**

**a. Amendment**

The Small Business Reorganization Act of 2019 (“SBRA”) created a new subchapter within Chapter 11: the Subchapter V. Unlike in normal Chapter 11 cases, the absolute priority rule is not applicable to Subchapter V debtors. SBRA also set a debt limit for Subchapter V cases, originally \$2,725,625. The CARES Act increased that debt limit to \$7,500,000. The increased debt ceiling under the CARES Act for § 1182(1) sunset on March 26, 2022. Pursuant to the CARES Act, § 1182(1) stated:

(1) Debtor. The term “debtor”-

(A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than \$7,500,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor; and

(B) does not include-

(i) any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than \$7,500,000 (excluding debt owed to 1 or more affiliates or insiders);

(ii) any debtor that is a corporation subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)); or

(iii) any debtor that is an affiliate of an issuer, as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c).

11 U.S.C. § 1182(1) (amended 2022).

As of March 27, 2022, § 1182(1) stated:

In this subchapter:

(1) Debtor. The term “debtor” means a small business debtor.

(2) Debtor in possession. The term “debtor in possession” means the debtor, unless removed as debtor in possession under section 1185(a) of this title.

11 U.S.C. § 1182 (amended June 21, 2022).

#### **i. Increased Debt Limit**

The Corrections Act amends § 1182 to retroactively extend the increased debt limit under the CARES Act of \$7,500,000.<sup>1</sup>

#### **ii. Narrower Exclusion for Affiliates of Debtor**

Additionally, the current version replaces § 1182(1)(B)(iii) with the language: “The term ‘small business debtor’ . . . does not include . . . any debtor that is an affiliate of a corporation described in clause (ii).” This change is particularly important as the previous version of § 1182(1)(B)(iii) was thought to be much more expansive than Congress’s original intent in including the provision, to exclude affiliates of large corporations. *See* 2 Collier on Bankruptcy P 101.51D (16th ed. 2022); *see also* Mark T. Power et. al., *Not So Technical: A Flaw in the Cares Act's Correction to "Small Business Debtor"*, Am. Bankr. Inst. J. 32 (2022).

The Exchange Act defines an “issuer” as “any person who issues or proposes to issue any security.” 15 U.S.C. § 78c(a)(8). “Security” is defined as “any note, stock, treasury stock, security future, security-based swap, bond, debenture . . . [or] investment contract . . .” *Id.* at § 78c(a)(10). The Bankruptcy Code defines “affiliate” as a “entity that directly or indirectly owns, controls, or

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<sup>1</sup> Official Form 101 has been updated at line 13 and Official Form 201 has been updated to reflect the change in the definition of § 1182.

holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor . . .” 11 U.S.C. § 101(2). Given the expansive definitions of “issuer” and “security” the previous definition excluded Subchapter V debtors that would otherwise qualify. It also required courts to go through a complex analysis if a party-in-interest objected to qualification as a Subchapter V debtor on that basis. *See e.g. In re Serendipity Labs, Inc.*, 620 B.R. 679 (Bankr. N.D. Ga. 2020). Thus, this amendment broadens the definition of who can be a Subchapter V debtor.

### **b. Effective Date**

This provision applies retroactively to cases commenced on or after March 27, 2020, that remain pending on the date of enactment.

### **c. Sunset**

This provision sunsets two years after the date of enactment of the Corrections Act. Upon sunset, the definition of a debtor under § 1182 will revert to the definition of a small business debtor under § 101(51D). Therefore, the debt limit for a Subchapter V debtor will decrease to the current small business debtor limit of \$3,024,725.

## **Definition of a Small Business Debtor**

### **a. Amendment**

Previously, § 101(51D) stated:

The term ‘small business debtor’-

(A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than \$3,024,725 [originally ‘\$2,000,000’, adjusted effective April 1, 2022] (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor; and

(B) does not include-

(i) any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than \$3,024,725 [originally ‘\$2,000,000’, adjusted effective April 1, 2022] (excluding debt owed to 1 or more affiliates or insiders);

(ii) any debtor that is a corporation subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)); or

(iii) any debtor that is an affiliate of an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)).

11 U.S.C. § 101(51D) (amended 2022).

The only change is to §101(51D)(B)(iii). Similar to § 1182(1)(B)(iii), § 101(51D)(B)(iii) was amended to state: “The term ‘small business debtor’ . . . does not include . . . any debtor that is an affiliate of a corporation described in clause (ii).” *See supra* Definition of a Debtor Under § 1182.

#### **b. Effective Date**

This provision applies retroactively to cases commenced on or after March 27, 2020, that remain pending on the date of enactment.

#### **c. Sunset**

There is no sunset for this provision of the Corrections Act.