BEST PRACTICES: CONSIDERATIONS IN FILING UNDER SUBCHAPTER V

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I. OVERVIEW

Subchapter V of the Bankruptcy Code, effective February 19, 2020,[2] provides several advantages to a business, including a person engaged in business, in reorganizing under Chapter 11. These include:

- a relatively speedy, inexpensive process;
- the absolute priority rule does not apply;
- administrative expenses can be paid over the life of a confirmed cramdown plan under 11 U.S.C. § 1191(b);
- no quarterly fees are payable to the Office of the U.S. Trustee;
- in most cases, there is no unsecured creditors' committee;
- a Subchapter V trustee is appointed and can help facilitate a consensual plan of reorganization;
- only the debtor may file a plan; and
- for individuals, a confirmed plan can modify the rights of a creditor secured by a security interest in the debtors' residence, providing certain conditions are satisfied.

II. PRE-FILING CONSIDERATIONS

But there are some important issues that counsel for a potential Chapter 11 debtor must consider before electing to proceed under Subchapter V. Failure to address these issues can lead to redesignation outside of Subchapter V, conversion to Chapter 7, or dismissal, as well as a waste of time and resources.

This article addresses three issues:

1. Qualifications to be a debtor under Subchapter V.
2. The need to file a plan of reorganization within 90 days.
3. The feasibility requirement.

A. The entity must qualify to be a debtor under Subchapter V

A good starting point is to read and understand the definition of "small business debtor" under 11 U.S.C. § 101(51)D) and 11 U.S.C. § 1182.[3] Of course these sections are only one part of the evaluation of whether a company or person engaged in business can seek protection under Subchapter V of the Bankruptcy Code. And Subchapter V is relatively new legislation, so case law is only in the first stages of development.

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[1] The author thanks Virginia A. Burdette for her contributions to this article. Virginia is a Subchapter V, Chapter 12, and Chapter 7 trustee.

[2] Subchapter V was created by enactment of the Small Business Reorganization Act of 2019, or the "SBRA."

[3] The definitions of a Subchapter V "debtor" under 11 U.S.C. § 1182 and "small business debtor" under 11 U.S.C. § 101(51D) are substantially similar.

Three elements of the definition of "small business debtor" are discussed below.

1. Is the debtor engaged in business?

Among other requirements, a small business debtor must be engaged in "commercial or business activity." Two important cases to look at are *In re Wright*, No 20-01035, 2020 WL 2193240 (Bankr. D.S.C. April 27, 2020) and *In re Thurmon*, No-41400 (Bankr. W.D.MO December 8, 2020). The Bankruptcy Court in *Wright* held that the debtor did not have to be "currently" engaged in business to qualify for Subchapter V small business relief. The *Wright* decision has been followed in other courts. In the *Thurmon* case, the Bankruptcy Court sustained an objection to the Debtors' designation as small business debtors because they had ceased operating their business, and in fact had sold all business assets prior to filing and were retired. Will your client qualify? If the debtor is not currently engaged in business activity, you should anticipate an objection by the U.S. Trustee to the Subchapter V election. Consider filing before all business activity has ceased or consider establishing new "business activity."

2. Are the debtor's noncontingent, liquidated, secured, and unsecured debts, including the debts of affiliate debtors (but not inter-affiliate debts), not more than $7,500,000?[4]

Simply claiming a debt is "disputed" does not remove it from the calculation of total aggregate debt for purposes of qualification for Subchapter V. *In re Fountain,* 612 B.R. 743, (Bankr. 9th Cir. BAP 2020). For a debt to qualify as contingent, adequate information regarding its contingency status should be documented prior to filing.

Affiliate debt is aggregated. Generally, if the entity filing bankruptcy is a member of a group of entities under common ownership who are also filing bankruptcy cases, the debt of all the affiliates will be counted toward the monetary cap. 11 U.S.C. § 1182(1)(B)(i) specifically excludes "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)" as a debtor under Subchapter V. And 11 U.S.C. §101(2)(B) specifically provides that an "affiliate" includes a "corporation 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by the debtor, or by an entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor, other than an entity that holds such securities[.]"

3. Did not less than 50 percent of the debts owed arise from the commercial or business activities of the debtor?

11 U.S.C. § 101(51D)(A) requires the debtor to not only be under the Sub V debt limits, but also requires that not less than 50% of those debts must come from the commercial or business activity of the debtor.

B. Filing a plan of reorganization

If the debtor is qualified to be a small business debtor and elects to proceed under Subchapter V, the debtor must file a plan within 90 days of the original petition date.

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[4] The current limit of $7,500,000 will sunset on or about March 26, 2021, absent action by Congress. Congress could also increase or decrease the limit.

11 U.S.C. § 1189 provides that only the Subchapter V debtor may file a plan, and the debtor must do so within 90 days of the order for relief unless the court extends the deadline, which it may only do if the need for extension is attributable to "circumstances for which the debtor may not justly be held accountable." So, the debtor should not expect to be able to obtain an extension, but should be working on the plan immediately and, if possible, even before filing the petition.

C. Feasibility

The Small Business Reorganization Act does not excuse the feasibility requirements of 11 U.S.C. § 1129(a)(11), which requires that the proposed plan must be feasible, that is, the debtor is not likely to default and require liquidation or further financial reorganization. This applies to both consensual plans and "cramdown" plans confirmed under 11 U.S.C. §1191.

III. CONCLUSION

A debtor filing a Chapter 11 bankruptcy petition and electing to proceed under Subchapter V must first qualify as a small business debtor, and must file a feasible plan of reorganization within 90 days of the original order for relief. Counsel's best practice is to be certain a debtor qualifies as a small business debtor, especially if a debtor has affiliates, and have a draft plan, supported by careful financial projections showing feasibility, BEFORE filing a petition for relief and electing to proceed under Subchapter V.