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Small-business owners will lose a Covid-era option for bankruptcy filings unless Congress acts

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The revised upper limit in the Subchapter V program expires next month unless Congress agrees to extend it.

Small businesses will be left without a useful Covid-era bankruptcy tool when it expires in the coming weeks – a development occurring just as bankruptcies are on the rise.

The program, called Subchapter V, was created to enable businesses with less than $2.75 million in debt to go through the Chapter 11 bankruptcy reorganization process in a streamlined way. In March 2020, as the pandemic took hold across the country and worldwide, Congress raised that benchmark to $7.5 million, allowing many more businesses to use the Subchapter V option.

The upper limit reverts to $2.75 million after June 21 unless Congress once again extends it. It's been extended twice previously.

“Chapter 11 can be expensive and it can be burdensome and be laden with paper-documentation requirements. And it can be daunting for a smaller business owner,” said Jonathan Carson, co-CEO of Stretto, which offers corporate restructuring and bankruptcy services. “But at the same time, with Chapter 7 bankruptcies, there is no chance to fix the problem.”

The cost, speed and efficiency of the Subchapter V process compared to a traditional Chapter 11 filing also allows smaller businesses to continue to operate during the process – something that is harder through the standard Chapter 11 process.

“It can be overly disruptive and not really tenable for some businesses that have maybe $5 million in debt,” Carson said. “This is a better process for smaller businesses.”'

Bankruptcy filings increase
The deadline looms as the Subchapter V bankruptcy option has seen more takers.

In fiscal 2020, there were 1,118 Subchapter V cases. That number increased to 1,986 in fiscal 2023, and there have been 1,502 in fiscal 2024, according to data from the U.S. Trustee Program at the Department of Justice.

The data also reflects the process being quicker than traditional Chapter 11 procedures. Small businesses that entered into Chapter 11 bankruptcy between fiscal 2020 and fiscal 2023 saw a median of 10.3 months until the confirmation of a reorganization plan, while those under Subchapter V took just 6.5 months.

Additionally, while 52% of Chapter 11 small-business bankruptcies were dismissed, just 30% of Subchapter V were dismissed – and whereas 21% of small businesses in Chapter 11 got a reorganization plan confirmed, 51% of those in Subchapter V did.

Part of the reason Subchapter V is faster and cheaper is because small businesses are not required to pay fees to the U.S. Trustee and the cases do not generally have creditors committees. Businesses also can opt to pay administrative expenses over time.

So what happens if the deadline lapses and more small businesses have to go through the standard Chapter 11 process?

“Either they will struggle through a Chapter 11 process and spend more time and money than they should have, or they will end up liquidating in Chapter 7,” Carson said. “That's a bad result. That means a business went away.”

The prospect of an extension for the Subchapter V debt-limit increase looks unlikely. A bipartisan group of senators have introduced legislation that would extend Subchapter V's expanded debt limit through 2026, but it has not yet passed the Senate. It also would need to pass the House and be signed by President Biden, either as standalone legislation or as part of a larger bill.

Small-business owners take on more debt
Despite a comparatively robust economy with low unemployment and significant growth, many small businesses are straining under the weight of debt taken on during the Covid-19 pandemic. While 28% of small businesses report they have no outstanding debt – roughly the same as the 29% in 2019 – 39% of small-business owners report having more than $100,000 in debt. That's a notable increase from the 31% that reported more than $100,000 in debt in 2019, according to the 2024 Report on Employer Firms: Findings from the 2023 Small Business Credit Survey published by the Federal Reserve in March.

A report by Creditsafe found that 58% of U.S. businesses surveyed have increased their long-term debt in the last 12 months, while 17% said their ability to repay their debt has worsened in the last 12 months.

A report by Janus Henderson Investors found that companies worldwide took on a record $456 billion of new debt in 2022-23, and S&P Global found that corporate debt defaults increased by 80% in 2023 compared to 2022.

Bankruptcy filings of all types peaked at around 1.6 million in 2010, during the height of the Great Recession, and plateaued at around 774,000 annually in the years leading up to the Covid-19 pandemic.

In the subsequent years, with a host of relief programs for individuals, families and businesses taking effect, the number of annual filings slid to about 388,000, according to data from the Administrative Office of the U.S. Courts on behalf of the Federal Judiciary.

That number increased to about 453,000 last year and experts expect it will continue to rise in the months and years to come.