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Legislation Expanding Subchapter V Bankruptcy Eligibility Awaits Congressional Vote

Subchapter V bankruptcy was initially added to the Bankruptcy Code in February 2020 through the Small Business Reorganization Act of 2019, as an innovative restructuring platform for small businesses with noncontingent liquidated debt of $2,725,625 or less. That debt ceiling was short-lived and quickly increased in March 2020 to $7.5 million as a COVID-19 relief measure implemented through the CARES Act, and subsequently extended through March 27, 2022. The increase of the debt ceiling to $7.5 million increased the number of eligible candidates for subchapter V. After the debt limit was tripled with the passage of the CARES Act in March 2020, subchapter V bankruptcy became widely accepted as a cost-effective and streamlined process for small business debtors to restructure.

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However, the CARES Act provisions expired on March 27, 2022 which caused the debt ceiling to revert from $7.5 million back to the original limit of $2,725,625 (which was adjusted for inflation to $3,024,725 on April 1, 2022). The lowered debt limit has raised concerns throughout the bankruptcy community and prompted calls for Congress to act quickly to restore or even increase the $7.5 million debt ceiling.

On March 14, 2022, the Bankruptcy Threshold Adjustment and Technical Corrections Act (BTATCA) (S. 3823) was introduced to the Senate Committee on the Judiciary. It provides that the $7.5 million debt eligibility for small business debtors, temporarily put in place two years ago with the enactment of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), will continue for two more years. Within the bankruptcy legal community, many consider BTATCA to be a welcome and urgent legislative priority.

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Commonly known as the "Grassley Bill," BTATCA was introduced by Sen. Charles Grassley (R-Iowa), on the heels of the expiration of the CARES Act provisions allowing the $7.5 million debt limit. Swiftly approved by the U.S. Senate, the bill received broad bipartisan support. It was co-sponsored by Senate Judiciary Chair Richard Durbin (D-Ill.) and Sens. Sheldon Whitehouse (D-R.I.) and John Cornyn (R-Texas).

In addition to extending the debt limit to $7.5 million for two more years, BTATCA proposes to cover subchapter V cases pending at the time of expiration of the CARES Act provisions. Its other provisions propose to elevate the Chapter 13 debt limit to $2.75 million and make technical amendments to the SBRA and Bankruptcy Administration Improvement Act.

It also corrects §1182(B)(iii), which as currently drafted excludes debtors that are affiliates of an issuer of a security. A recent tentative ruling in *Phenomenon Marketing & Entertaining* (2:22-10132) by Judge Robles in the Central District of California provides a case example. The court deemed that an "affiliate" of any entity that issues securities—whether privately held or publicly traded—should not be eligible to file subchapter V bankruptcy. BTATCA amends §1182(B)(iii) to address the *Phenomenon Marketing* interpretation so that affiliates of issuers of securities, such as closely held corporations and limited liability companies, are not automatically ineligible.

The Utility of Subchapter V Bankruptcy

In general, subchapter V bankruptcy has been well-received by the bankruptcy legal community. Further analysis of its value revolves around two fundamental questions: (1) Are professionals and debtors using it? and (2) Is it working as intended?

The answer to the first question can be seen in the available data for the number of bankruptcy cases filed under subchapter V. In looking at the annual number of Chapter 11 bankruptcy filings, between 2015-2019, there was an average of 5,400 cases per year, according to data from American Bankruptcy Institute (ABI) and AACER. In 2020, the number of Chapter 11 filings surged upwards to more than 7,100 due to the COVID-19 pandemic and economic crisis. The level of filings dropped off in 2021 to 3,725 cases. When looking at the average number of cases between 2020-2021, the data shows that the annual number of cases was relatively stable considering that the total number of companies filing over that period did not change but was front-loaded in 2020.

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When overlaying the number of subchapter V filings in 2020-2021 with Chapter 11 filings annually, there were fewer cases filed over time, yet the number of subchapter V cases increased. During that time, the percentage of subchapter V filings increased from more than 19% of all Chapter 11 bankruptcy filings in 2020 to more than 38 percent in 2021.

Moving into 2022, with the limited data that is available for the period preceding the expiration of the higher debt limit, it appears that the number of subchapter V cases was holding steady if not increasing. In light of this data, it is apparent that the answer to the first question is, yes, professionals and debtors are using subchapter V bankruptcy—and increasingly so over time, as professionals have developed a deeper understanding of the law and its possibilities for distressed small businesses and business owners.

A more complicated and subjective analysis is required to answer the question of whether subchapter V bankruptcy is working. One of the primary indicators of whether it is working as intended revolves around the idea that a standard Chapter 11 bankruptcy is too costly for a small business debtor. The consensus among proponents of subchapter V bankruptcy is that it has removed some of the more cost-intensive aspects of bankruptcy from the process.

The revisions made to the confirmation requirements within the bankruptcy process are considered to be among the most advantageous to small business debtors. With these, the court is able to confirm a Chapter 11 plan even if dissenting creditors are not paid in full before junior classes receive value and even if there is no impaired accepting class. This permits the debtor to continue their role of ownership and operation of the business.

Additionally, under subchapter V, only debtors are allowed to file proposed plans, albeit within a narrower 90-day window than permitted within a traditional Chapter 11 case. Furthermore, debtors are not required to file disclosure statements for their plans unless the court deems it is necessary.

Subchapter V cases also do not require the formation of a committee of unsecured creditors without good cause. In addition, in some instances, administrative claims are not required to be paid in full but instead can paid over time with distributions from the three- to five-year debtor's plans. These innovations have resulted not only in cost-savings for small-business bankruptcy estates, but also in a higher rate of confirmation of subchapter V plans, as compared to traditional Chapter 11 plans.

Although subchapter V has been a vital lifeline for small-business debtors, it can be somewhat of a trip-line for creditors and their counsel who are not attuned to the variations from a traditional Chapter 11 case. Creditors retain significant rights and leverage in subchapter V cases, but they must be prepared to exercise those rights in different ways and on a different timeline in order to ensure that their interests are protected. Over the past two years, we have seen creditor-side practitioners demonstrate increasing comfort and creativity in subchapter V. If subchapter V is extended and kept relevant, we expect that practitioners representing the spectrum of estate constituencies will continue to explore its nuances and find ways to unlock its benefits for their clients.

The Future of Small Business Bankruptcy

If BTATCA is passed and the subchapter V bankruptcy debt limit is restored to $7.5 million, it will be considered by many as a transformative step for the future of small business bankruptcies across the country. Based on its adoption and utility over the past two years, it appears to be a successful reorganization tool.

However, without a higher debt limit, some believe the role and benefits of subchapter V bankruptcy are unlikely to be fully realized and as a result, a widely available cost-effective small business Chapter 11 bankruptcy may become a remnant of the COVID era. That would be an unfortunate result given that subchapter V has been utilized so quickly and successfully over the past two years. At a time when inflation, recession fears, supply-chain challenges and interest rate increases are threatening small businesses, BTATCA offers another two years of a higher debt limit, which will be a critical tool during a period of economic uncertainty.