Congress Passes Legislation to Revive Expanded Debt Ceiling for Subchapter V Bankruptcy

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The House has passed a bill that will now go to the President to sign raising the eligible debt ceiling for subchapter V of chapter 11 to $7.5 million. Small businesses with noncontingent, liquidated debts up to this threshold will again be eligible for relief under subchapter V for another two years.

Subchapter V of chapter 11 of the U.S. Bankruptcy Code has played an increasingly prominent role for restructuring distressed small businesses. Enacted under the Small Business Reorganization Act (SBRA) in February 2020, it became a lifeline for many small businesses during the COVID-19 economic crisis when the allowed debt limit was initially increased to $7.5 million under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). On March 28, 2022, the eligibility threshold returned to the original SBRA limit. Thus, eligibility reverted to $2,725,625 on March 28 and increased to $3,024,725 on April 1. However, on June 7, 2022, Congress passed amended S. 3823, the "Bankruptcy Threshold Adjustment and Technical Corrections Act" (BTATCA) to retroactively preserve the higher debt limit and make technical corrections to subchapter V.

The questions of whether subchapter V is being utilized by practitioners and working as intended have been central to the discussion of preservation of the higher debt threshold and potentially its expansion to $10 million. Based on a review of statistics from the American Bankruptcy Institute (ABI), subchapter V case filings have steadily increased over the past two years in proportion to the total number of commercial bankruptcy case filings, reflecting that subchapter V has indeed been adopted as an option for distressed small businesses. When comparing the number of subchapter V bankruptcy filings with total chapter 11 filings annually, the data reveals that the percentage of subchapter V filings increased from approximately 19 percent of all chapter 11 bankruptcy filings in 2020 to more than 38 percent in 2021; and for the period of January 1 through March 2022 is approximately 54 percent.

The second question as to the efficacy of subchapter V bankruptcy is more complicated to answer and should be the focus of study, however, based on many indicators, it appears to be serving its intended purpose. Prior to the enactment of the SBRA, a significant barrier for small businesses to chapter 11 bankruptcy was that the process was too costly. In theory, subchapter V bankruptcies lowered these barriers by doing away with several aspects of standard chapter 11 reorganization that, proponents contended, were cost-prohibitive.

Importantly, BTATCA will make the $7.5 million eligibility threshold available for another two years. But it also amends § 1182(B)(iii) which, as currently drafted, excludes from eligibility any debtor that is an affiliate of an issuer of a security. This issue was addressed on April 28, 2022, in a ruling by Judge Robles of the Central District of California in the *Phenomenon Marketing & Entertaining, LLC* (2:22-10132) where the Court reasoned that an "affiliate" of any entity that issues securities - whether such affiliate is publicly traded or not - is ineligible for subchapter V. BTATCA amends § 1182(B)(iii) to remedy the language that led to this interpretation.

As BTATCA becomes law with the President's signature and the subchapter V bankruptcy debt limit is elevated back to $7.5 million for the next two years, it will be a transformative step and an important avenue for small businesses to successfully restructure and stay in business.