The first year of the new bankruptcy law for small businesses: Subchapter V of the Bankruptcy Code, The Small Business Reorganization Act

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Reorganization under Chapter 11 of the Bankruptcy Code has been available to small businesses for many years, but only in theory. The burdensome costs of a reorganization (including the fees of attorneys and other professionals), the substantial delays encountered in a Chapter 11 case, and the difficulty for business owners to confirm reorganization plans while retaining their equity, have made Chapter 11 reorganization practically inaccessible to smaller businesses.

The Small Business Reorganization Act

Fortunately, Congress recognized the problems faced by small business Chapter 11 debtors and, in August 2019, passed legislation intended to help small businesses to reorganize more quickly, and with fewer obstacles, in Chapter 11. The Small Business Reorganization Act (SBRA) became effective in February 2020. The legislative history of the SBRA suggests that Congress understood that the inability of small businesses to reorganize effectively under Chapter 11 means that those businesses commonly liquidate or simply dissolve, harming not only the business owners but their creditors (which often receive nothing), employees (who lose their jobs), vendors and suppliers (who lose revenue) and state and local governments (which lose tax revenue, pay unemployment and other benefits, and so on). In a Congress known for stubborn partisan gridlock, the SBRA was a rare piece of successful bipartisan legislation.

Significant components of the SBRA

The SBRA created a new Subchapter of Chapter 11 of the Bankruptcy Code, known as "Subchapter V." It is a relatively concise piece of federal legislation, contained in a few new sections (sections 1181 through 1195) of the Code. The Act's key features include:

- **Eligibility.** The SBRA provides that reorganization under Subchapter V is available to small businesses with debts of $2,725,625 or less, not including debts owed to affiliates and insiders. To combat the COVID-19 pandemic, Congress raised that limit substantially, to $7,500,000, for a year (which expired March 2021). Notably, an individual can file under Subchapter V if 50% or more of his or her debts were incurred in the operation of a business.

- **Subchapter V Trustee.** Trustees are rarely appointed in Chapter 11 cases, and usually only due to the gross incompetence or dishonesty of the debtor. As in other Chapter 11 cases, the debtor in a Subchapter V case is a "debtor in possession," with the authority to operate its business, unless removed for incompetence or dishonesty. But in Subchapter V cases, a new kind of trustee - a Subchapter V Trustee - will automatically be appointed. The Subchapter V Trustee doesn't operate the debtor's business, but instead performs a limited set of duties, including objecting to filed claims where appropriate; assisting the debtor in formulating a plan of reorganization; facilitating the development of a consensual plan (i.e., one that creditors will support); and monitoring payments to creditors under a confirmed plan.

- **Prompt deadline to file a plan.** In Chapter 11 cases, there is a 120-day "exclusive period," during which only the debtor may propose a plan of reorganization. Once that period expires, other parties in the case may file a competing plan. In Subchapter V cases, only the debtor may file a plan, and the debtor must do so within 90 days of the filing of the bankruptcy case.

- **No Unsecured Creditors' Committee.** If enough unsecured creditors agree to serve, an Unsecured Creditors' Committee is appointed in every Chapter 11 case. The fees of the committee's professionals (lawyers and accountants, primarily) must be paid by the bankruptcy estate, compounding the cost of the debtor's reorganization. A committee can have outsize leverage in the case, and often frustrates the debtor's ability to confirm a plan. The SBRA provides that in Subchapter V cases, it is presumed that an Unsecured Creditors' Committee will not be appointed.

- **Payments to unsecured creditors.** The owners of the debtor in a traditional Chapter 11 case cannot retain their ownership interests unless all unsecured creditors are paid in full under the reorganization plan. In Subchapter V, the debtor can confirm a plan which allows the owners to retain their interests, so long as the debtor directs all of its "projected disposable income" to payments to creditors for a period of three years from the confirmation of the plan. (The court may extend the three-year period to not longer than five years.)

First year's results under the SBRA

The first Subchapter V case was filed on February 19, 2020. In the year that followed, a total of 1,643 Subchapter V cases were filed across the country. That represents about 23% of the total Chapter 11 cases filed during the same period. For the first year of this new reorganization tool, that is a fairly impressive percentage. What remains to be seen, however, is how much of the first year's Subchapter V utilization was driven by (a) the COVID pandemic and the resulting devastation of small businesses, and (b) the increased eligibility for Subchapter V (for debtors with up to $7,500,000.00) during that year. With the increased eligibility no longer in effect, and the pandemic subsiding (we hope), we will learn over the next several years if Subchapter V will succeed in providing an effective and well-utilized way for small businesses to reopen, reorganize, and survive.

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