

SMALL BUSINESS REORGANIZATION ACT OF 2019

11 U.S.C. § 1181 – 95

SUBCHAPTER V

Geoffrey B. Treece and Mary-Tipton Thalheimer

Congressional Intent Behind Subchapter V

Congress intended to streamline the reorganization process for small business debtors because small businesses have often struggled to reorganize under chapter 11:

Small businesses--typically family-owned businesses, startups, and other entrepreneurial ventures— “form the backbone of the American economy.” By their very nature, however, the longevity of these businesses is limited. According to the Small Business Administration Office of Advocacy, approximately 20 percent of small businesses survive the first year, but by the five-year mark only 50 percent are still in business and by the ten-year mark only one-third survive. Notwithstanding the 2005 Amendments, small business chapter 11 cases continue to encounter difficulty in successfully reorganizing...the legislation allows these debtors “to file bankruptcy in a timely, cost-effective manner, and hopefully allows them to remain in business” which “not only benefits the owners, but employees, suppliers, customers, and others who rely on that business.”¹

To that end, Subchapter V imposes shorter deadlines for completing the bankruptcy process, allows for greater flexibility in negotiating restructuring plans with creditors, and provides for a trustee who will work with the small business debtor and its creditors to facilitate the development of a consensual plan of reorganization.

Subchapter V Election

A small business debtor must elect for Subchapter V to apply to its case. The majority of bankruptcy courts have held a debtor that filed prior to the February 19, 2020 effective date of the SBRA may amend its petition to elect to be a small business debtor under Subchapter V and may proceed under Subchapter V unless and until a party in interest files an objection, at which time the matter should be set for hearing. *See In re Body Transit, Inc.*, 2020 WL 1486784 (Bankr. E.D. Penn. 2020). The standard for determining whether an amended petition to make the Subchapter V election is whether the amendment is made in bad faith or would unduly prejudice a party.

¹ 11. H.R. REP. NO. 116-171, at 1-2 (2019).

Subchapter V Code Sections

§ 101(51D) – “Small Business Debtor”

(A) A person engaged in commercial or business activities (including an affiliate that is also a debtor but excluding a person whose primary activity is the business of owning single asset real estate) that has total noncontingent liquidated secured and unsecured debts on the petition date of no more than \$2,725,625.²

- At least 50% of the total debts must have arisen from the debtor’s commercial or business activities.
- The total debt amount excludes debts owed to affiliates or insiders.
- The test for determining whether a debt should be classified as a business debt is whether it was incurred with an eye toward profit. *In re Deirdre Ventura*, 2020 WL 1867898 (Bankr. E.D.N.Y. 2020) (court found that loan secured by mortgage encumbering property purchased as debtor’s primary residence that also serves as a bed and breakfast was business debt).
- Definition does not require a person to be presently engaged in commercial or business activities when he/she files the petition. *In re Wright*, 2020 WL 2193240 (D.S.C. 2020) (citing *Colliers* – person may take care of residual business debt).

(B) Small Business Debtor does not include:

- (i) Any member of a group of affiliated debtors with total noncontingent liquidated debts of more than \$2,725,625 (excluding debts owed to affiliates or insiders); OR
- (ii) Any debtor that is a corporation subject to the reporting requirements section 13 and 15(d) of the Securities Exchange Act of 1934; OR
 - Sections concern the filing of periodic documents, reports, and information to the Securities Exchange Commission by a securities issuer necessary for a security registered pursuant to the Securities Exchange Act of 1934.
- (iii) Any debtor that is an affiliate of an issuer as defined by 15 U.S.C. § 78 c.
 - Section defines issuer as any person who issues or proposes to issue any security.

² The CARES Act, passed March 25, 2020, increased the debt threshold to \$7.5 million for one year.

§ 1181 – Inapplicability of Other Sections

(a) The following sections of the Code **do not apply** for Subchapter V Chapter 11s:

- § 105(d) – Court shall hold a status conference as necessary and may issue an order setting deadlines for certain actions
- § 1101(1) – definition of debtor-in-possession
 - Definition of substantial consummation in § 1101(2) does apply.
- § 1104 – appointment of trustee or examiner
- § 1105 – termination of trustee’s appointment
- § 1106 – duties of trustee or examiner
- § 1107 – rights, powers, and duties of debtor-in-possession
- § 1108 – authorization to operate business
- § 1115 – additional property of the estate for debtor is an individual in Chapter 11 (includes property acquired post-petition and earnings for post-petition services). Debtor remains in possession of all property of the estate
- § 1116 – duties of trustee or debtor in possession in small business cases
- § 1121 – who may file a plan
- § 1123(a)(8) – in case of individual, plan must provide for payment to creditors of earnings from personal services performed post-petition in an amount necessary for execution of the plan
- § 1123(c) – in case of individual, plan proposed by non-debtor may not provide for the use, sale, or lease of exempt property without debtor’s consent
- § 1127 – modification of plan
- § 1129(a)(15) – in case of individual and in which unsecured creditor objects to confirmation, property to be distributed under the plan is not less than amount of claim or value of property to be distributed is not less than projected disposable income to be received during 5-year plan period or during the period for which the plan provides payments
- § 1129(b) – cramdown

- § 1129(c) – court may only confirm one plan
- § 1129(e) – confirmation of small business plan within 45 days of filing date
- 1141(d)(5) – discharge for individual debtor

(b) Unless the court, **for cause**, orders otherwise, the following sections do not apply for Subchapter V Chapter 11s:

- § 1102(a)(1) – appointment of unsecured creditors committee as soon as practicable
- § 1102(a)(2) – appointment of additional committees on request of party in interest
- § 1102(a)(4) – change of membership of committee upon request and notice and a hearing
- § 1102(b) – members of committee
- § 1103 – powers and duties of committees
- § 1125 – post-petition disclosure and solicitation

(c) If a plan is confirmed under § 1191(b) (cramdown), § 1141(d) does not apply except as provided in § 1192

§ 1182 – Definitions

- (1) Debtor – small business debtor (*see* § 101(51D))
- (2) Debtor-in-Possession – debtor unless removed under § 1185(a)

§ 1183 – Trustee

- (a) US Trustee will appoint a Chapter 11 trustee for small business cases
 - Arkansas Chapter 11 Subchapter V Trustees: Donald Brady; Beverly Brister; and Randy Rice
- (b) Chapter 11 trustee shall
 - (1) Perform the following duties of a Chapter 7 Trustee (§ 704 (a)):

- (2) – be accountable for property received
 - (5) – examine proofs of claim and object to improper claims
 - (6) – oppose discharge if advisable
 - (7) – furnish information about the estate and administration thereof to parties-in-interest
 - (9) – make a final report and file a final account of the administration of the estate with the Court and US Trustee
- (2) If the court, for cause and on a request of a party in interest, so orders, perform the following duties of a Chapter 11 trustee/examiner (§ 1106(a)):
- (3) – investigate the acts, conduct, assets, liabilities, and financial condition of debtor; the operation of the business and desirability of continuing the business; and any other matter relevant to the case or formulation of the plan
 - (4) – as soon as practicable file a statement of investigation and provide it to any committees and any other entity designated by the court
 - (7) – file such reports as are necessary or ordered by the court after confirmation of a plan
- (3) Attend status conferences (§ 1188) and any hearing that concerns the following:
- (A) Value of property encumbered by a lien
 - (B) Confirmation of a Chapter 11 plan
 - (C) Modification of a plan post-confirmation
 - (D) Sale of property of the estate
- (4) Make sure the debtor makes timely payments required by a confirmed plan
- (5) If the debtor ceases to be a debtor-in-possession, perform the following duties:
- § 704(a)(8) – if the business is authorized to be operated, file operating reports as required by the US Trustee and court
 - § 1106(a)(1) – perform the following duties of a Chapter 7 trustee (§ 704(a)):
 - (2) – be accountable for property received

- (5) – examine proofs of claim and object to improper claims
 - (7) – furnish information about the estate and administration thereof to parties-in-interest
 - (8) – if the business is authorized to be operated, file operating reports as required by the US Trustee and court
 - (9) – make a final report and file a final account of the administration of the estate with the Court and US Trustee
 - (10) – provide applicable notice if there is a claim for a domestic support obligation
 - (11) – if the debtor served as administrator for an employee benefit plan, continue performing the debtor’s obligations
 - (12) – use reasonable and best efforts to transfer patients if debtor is in the health care business.
- § 1106(a)(2) – if the debtor has not already done so, file a list of creditors; schedule of assets and liabilities; schedule of income and expenses; statement of financial affairs; statement of monthly net income; and statement of any anticipated changes in income or expenses for the year following the petition date
 - § 1106(a)(6) – furnish information to taxing authority for any year the debtor didn’t file a tax return
- (6) If there is a claim for a domestic support obligation, perform the duties specified in § 704(c) (notice requirements)

(7) Facilitate the development of a consensual plan

(c) Termination of Trustee Service

- (1) If a plan is confirmed under § 1191(a), the trustee’s services terminate when the plan is substantially consummated
- See § 1101(2) for definition of “substantial consummation”
- (2) Within 14 days after the plan is substantially consummated, the debtor must file a notice of the substantial consummation and serve the same on the trustee and the US Trustee.

*Chapter 11 Trustee is a fiduciary for the creditors in lieu of a creditor's committee. *In re Deirdre Ventura*, 2020 WL 1867898 (Bankr. E.D.N.Y. 2020).

* Unlike a trustee appointed under § 1104(a), a Subchapter V trustee does not have the power to propose a Chapter 11 plan. *See In re Body Transit, Inc.*, 2020 WL 1486784 (Bankr. E.D. Penn. 2020).

§ 1184 – Rights and Powers of a Debtor-in-Possession

A debtor-in-possession shall have all the rights and shall perform all of the functions of a chapter 11 trustee (§ 1106(a)) except the following:

- § 1106(a)(2) – furnish information to taxing authority for any year the debtor didn't file a tax return
- § 1106(a)(3) – investigate the acts, conduct, assets, liabilities, and financial condition of debtor; the operation of the business and desirability of continuing the business; and any other matter relevant to the case or formulation of the plan
- § 1106(a)(4) – as soon as practicable file a statement of investigation and provide it to any committees and any other entity designated by the court

§ 1185 – Removal of Debtor-in-Possession

- (a) The court **shall**, on request of a party in interest and after notice and a hearing, order that a debtor is no longer a debtor-in-possession **for cause**, including the following:
- Fraud
 - Dishonesty
 - Incompetence
 - Gross mismanagement of the affairs of the debtor (pre- or post-petition)
 - Failure to perform obligations under a confirmed plan
- (b) On request of a party in interest and after notice and hearing, the court may reinstate the debtor as a debtor-in-possession

§ 1186 – Property of the Estate

- (a) If a plan is confirmed under § 1191(b) (cramdown), property of the estate includes the property listed in § 541 and the following:
- (1) All property acquired by the debtor post-petition but before the case is closed, dismissed or converted, whichever occurs first and
 - (2) Earnings from services performed by the debtor post-petition but before the case is closed, dismissed, or converted, whichever occurs first.
- (b) A debtor shall remain in possession of all property of the estate unless the debtor is removed as debtor-in-possession or the confirmed plan/order confirming plan provides otherwise.
-

§ 1187 – Duties and Reporting Requirements of Debtors

- (a) The debtor shall file the following documents:
- § 1116(1)(A) – most recent balance sheet, statement of operations, cash-flow statement, and Federal income tax return OR
 - § 1116(1)(B) – a statement under penalty of perjury that no balance sheet, statement of operations, cash-flow statement has been prepared and no Federal tax return has been filed.
- (b) A debtor shall comply with the following requirements:
- § 308 – Debtor Reporting Requirements
 - § 1116(2) – attend meetings scheduled by the court such as meeting of creditors
 - § 1116(3) – file schedules and statements of financial affairs
 - § 1116(4) – file all required post-petition financial and other reports
 - § 1116(5) – maintain insurance customary and appropriate to the industry
 - § 1116(6) – timely file tax returns and pay taxes entitled to administrative expense priority
 - § 1116(7) – allow the US Trustee to inspect books and records after reasonable notice

(c) If the court orders that § 1125 applies, subsection (f) applies

- (f)(1) The court may determine the plan provides adequate information and a separate disclosure statement is not necessary
- (f)(2) The court may approve a disclosure statement submitted on standard forms
- (f)(3)
 - (A) The court may conditionally approve a disclosure statement subject to final approval after notice and a hearing AND
 - (B) Acceptance/rejection of a plan may be solicited based on a conditionally approved disclosure statement, but the statement **shall** be mailed within 25 days before the confirmation hearing AND
 - (C) The hearing on the disclosure statement may be combined with the confirmation hearing.

§ 1188 – Status Conference

- (a) Except as provided in (b), within 60 days of the petition date, the court **shall** hold a status conference to further the resolution of the case
- (b) The court may extend the 60- day period if the reason for the extension is not something for which the debtor should justly be held accountable
- (c) No later than 14 days before the status conference, the debtor **shall** file a report that details the efforts undertaken and to be undertaken to create a consensual plan and serve the same on the trustee and all parties in interest.

§ 1189 – Filing of the Plan

- (a) Only the debtor may file a Subchapter V Chapter 11 plan
- (b) The debtor **shall** file a plan within 90 days of the petition date, but the period may be extended if the reason for the extension is not something for which the debtor should justly be held accountable

§ 1190 – Contents of the Plan

A Subchapter V Chapter 11 plan

(1) **Shall** include:

(A) A brief history of the debtor's business operations

(B) A liquidation analysis

(C) Projections with respect to the ability of the debtor to make payments under the proposed plan

(2) **Shall** provide for submission for necessary amount of future earnings/future income to the supervision and control of the trustee for execution of the plan

(3) May modify the rights of secured creditors whose claim is secured by a lien on the principal residence of the debtor if the new value received in connection with the lien was:

(A) Not used primarily to acquire the real property AND

(B) Was used primarily in connection with the small business of the debtor

- Requires the court to determine if the primary purpose of the loan was to buy a residence.
- Factors to consider: (1) were the mortgage proceeds used primarily to further the debtor's business interests; (2) is the property an integral part of the debtor's business; (3) the degree to which the specific property is necessary to run the business; (4) do customer's need to enter the property to utilize the business; and (5) does the business utilize employees and other businesses in order to run its operations. *In re Deirdre Ventura*, 2020 WL 1867898.

§ 1191 – Confirmation of the Plan

(a) The court **shall** confirm a plan if all of the requirements of § 1129(a) (other than subsection (15)) are met

(b) If all of the requirements of § 1129(a) (other than subsections (8), (10), and (15)) are met, the court **shall** confirm the plan so long as the plan does not discriminate unfairly and is fair and equitable with respect to any objecting class

(c) For a plan to be fair and equitable, it must meet the following requirements:

(1) With respect to secured claims, the plan meets the requirement of § 1129(b)(2)(A)

- (A)(i) The plan provides:

- (I) Retain the lien to the extent of the allowed claim and
- (II) Receipt of deferred cash payments totaling at least the allowed amount of the claim of a value, as of the effective date of the plan, of at least the value of the interest in such property
- (A)(ii) The plan provides for the sale of property free and clear of liens with the liens attaching to the proceeds of such sale; or
- (A)(iii) The plan provides for the realization of the indubitable equivalent of the claim

(2) As of the effective date of the plan

(A) The plan provides that all of the projected disposable income of the debtor for a period of 3 – 5 years will be applied to make plan payments or

(B) The value of property distributed under the plan for a period of 3 – 5 years is not less than the projected disposable income of the debtor

(3)

(A)

(i) The debtor will be able to make all payments under the plan or

(ii) There is a reasonable likelihood that the debtor will be able to make all payments under the plan and

(B) The plan provides appropriate remedies, including liquidation of nonexempt assets, to protect the claim holders in the event payments are not made

(d) For purposes of Subchapter V Chapter 11s, “disposable income” means income received by the debtor that is not necessary

(1) For:

(A) The maintenance or support of the debtor or a dependent of the debtor; or

(B) A post-petition domestic support obligation or

(2) For payments necessary for the continuation, preservation, or operation of the debtor’s business.

(e) A plan that provides for the payment through the plan of the following claims may be confirmed under subsection (b) (cramdown):

- § 507(a)(2) – Administrative expenses
 - § 507(a)(3) – unsecured claims
-

§ 1192 – Discharge

If the plan is confirmed under subsection (b) (cramdown), as soon as practicable after completion of all plan payments, the court shall grant the debtor a discharge of all debts provided in § 1141(d)(1)(A) and all other debts allowed under § 503 and provided for in the plan except:

- (1) Any debt on which the last payment is due after the plan period or
 - (2) Of the kind specified in § 523(a) (nondischargeable debts)
 - § 1141(d)(1)(A) – any debts that arose pre-confirmation and any debt of a kind specified in § 502(g) (claim for rejection of lease/contract), (h) (claim arising from recovery of property), or (i) (post-petition tax claim)
-

§ 1193 – Modification of the Plan

- (a) The debtor may modify a plan at any time pre-confirmation so long as it continues to comply with §§ 1122 and 1123 (does not have to comply with § 1123(a)(8)). Once filed, the modified plan becomes the plan
 - (b) The debtor may modify a confirmed consensual plan before substantial consummation so long as it continues to comply with §§ 1122 and 1123 (does not have to comply with § 1123(a)(8)). The modified plan only becomes the plan if circumstances warrant the modification and the court, after notice and a hearing, confirms the modified plan.
 - (c) If the plan has been confirmed in a cramdown, the debtor may modify it during the 3 – 5 year period so long as it continues to comply with § 1191(b). The modified plan only becomes the plan if circumstances warrant the modification and the court, after notice and a hearing, confirms the modified plan.
 - (d) If a plan has been consensually confirmed, all creditors are deemed to have accepted/rejected the modified post-confirmation plan unless the creditor changes the previous acceptance/rejection.
-

§ 1194 – Payments

- (a) Payments received by the trustee shall be retained until confirmation/denial of confirmation. If a plan is confirmed, the trustee will make distributions in accordance

with the plan. If a plan is not confirmed, the trustee shall return the payments after deducting:

- (1) Any unpaid claim allowed under § 503(b) (administrative expenses)
 - (2) Any adequate protection payments
 - (3) Any fee owing to the trustee
- (b) If a plan is confirmed in a cramdown, the trustee shall make payment to creditors under the plan
- (c) Pre-confirmation, the court, after notice and a hearing, may authorize the trustee to make adequate protection payments

§ 1195 – Transactions with Professionals

- (a) A person is not disqualified for employment by debtor solely because the person holds a pre-petition claim of less than \$10,000.00

§ 547(b)

- This section has been amended (change in bold):
- (b) Except as provided in subsection (c) and (i) of this section, the trustee may, **based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses under subsection (c)**, avoid any transfer of an interest of the debtor in property –

	Regular Small Business Chapter 11	Subchapter V Chapter 11
Trustee	No	Yes
US Trustee Fees	Yes	No
Exclusive Plan Provider	No (but 180-day instead of 120-day exclusivity period)	Yes
Consensual Plan Required	No	No, but highly encouraged
Disclosure Statement	Yes, unless the court determines it's not necessary under § 1125(f)	No, unless ordered by the court for cause
Required to File Financial Documents	Yes	Only those required under § 1187(a)
Status Conference Required	No	Yes, within 60 days of petition date
Deadline to File Plan	Yes, no later than 300 days after the petition date	Yes, no later than 90 days after the petition date
Creditors' Committee	Yes	No, unless the court orders otherwise for cause
Absolute Priority Rule	Yes	No
New Value Rule	Yes	No
Modify Mortgage on Primary Residence	No	Yes, if conditions in § 1190(3) met
Required to Pay Administrative Fees on Effective Date	Yes	No
Impaired Class Required	Yes	No
Projected Period for Disposable Income	No	Yes, 3 – 5 years
Attorney Disinterested if Owed Money Pre-Petition	No	Yes, so long as amount owed is less than \$10,000