



Subchapter V of Chapter 11: New Rules and New Players to Help with Small Business Reorganization

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Last year, while your life shifted to monitoring COVID-testing statistics, masking protocols, and your progress toward finding the end of the internet, a new facet of Chapter 11 of the Bankruptcy Code came into being. You may not have noticed because bankruptcy filings have been down. However, government support cannot last forever, and most bankruptcy professionals think that filings will resume sometime during 2022. This might just be the right time to get acquainted with Subchapter V of Chapter 11.[1]

The History of Chapter 11's New Little Sibling: Subchapter V

In August of 2019, the Small Business Reorganization Act (SBRA) was signed into law, and it quietly went into effect in February of 2020, creating a new subsection of Chapter 11, Subchapter V. This new subsection of Chapter 11 is a safe haven for small businesses, where they can reorganize within the Federal Bankruptcy system, but with more streamlined requirements than those imposed in large Chapter 11 cases.[2] Specifically, Subchapter V debtors are not burdened by U.S. Trustee fees[3] the demands of Official Committees of Unsecured Creditors (and their fees)[4] or the disclosure statement process (and the associated time delays and fees).[5] Further, only a Subchapter V debtor can propose a plan of reorganization,[6] and the debtor must have a plan on file within 90 days of the petition date[7] which can speed up the reorganization process (and also reduce fees). Perhaps the most important difference in a Subchapter V case compared to a standard Chapter 11 case, especially to the individual owner of a corporate or other business entity debtor that might elect to file a Subchapter V case, is the fact that the debtor's individual owner may keep his or her equity in the business under a confirmed plan.[8]

When the SBRA went into effect in February of 2020, businesses with \$2.7 million in debts, or less, were permitted to take advantage of this new facet of the Bankruptcy Code. Just as quietly as when the SBRA went into effect, and after the realities of COVID were just starting to be realized, in March of 2020, the president signed into law the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act), which increased the debt limits for Subchapter V cases up to \$7.5 million. This relief was initially granted through March 27, 2021.

In December of 2020, the Consolidated Appropriations Act of 2021, further extended the \$7.5 million dollar debt cap for Subchapter V cases filed through March of 2022.

So, for now, a Chapter 11 Debtor that owes \$7.5 million or less to its creditors, can take advantage of this new, cheaper, fast-moving subchapter of the Bankruptcy Code to reorganize.

Why should a creditor get to know Subchapter V in advance?

First, its friends call it "Sub 5" or "Sub V." Second, without a creditors' committee to provide oversight to the debtor's decisions, creditors need to pay close attention to these fast-moving Sub V cases to preserve their rights. Third, when you find yourself involved in a Sub V case, you will shortly be introduced to your Sub V trustee, who is an individual appointed by the U.S. Trustee's Office on a "case by case" basis to "oversee and monitor the case, to appear and be heard on specific matters [like status conferences and hearings on asset sales], to facilitate a consensual plan, and to make distributions under a nonconsensual plan . . ."[9] all within the tight time constraints permitted for Sub V cases.

Who is a Sub V Trustee?

The U.S. Trustee Program has appointed "case-by-case" trustees to facilitate primarily consensual plan formulation between debtors and their creditors.[10] In order to be approved to serve in a particular case, the Bankruptcy Code requires a Sub V Trustee to be a disinterested person.

Sub V Trustees are expected to appear and be heard at special Subchapter V status conferences and at any hearing that concerns the value of a property subject to a lien, confirmation of a plan filed under the subchapter, a plan modification, or the sale of any estate property.[11]

A Sub V Trustee can be called upon to ensure that the debtor commences making timely payments under its confirmed plan.[12]

If the Subchapter V debtor ceases to be the debtor in possession, a Sub V Trustee can be called upon to ensure

1. that the debtor's tax returns are filed;
2. to make reports on the operation of the business, including statements of receipts and disbursements, and other information required by the U.S. Trustee's Office or the courts;
3. Perform the duties of a trustee as specified in paragraphs (2), (5), and (7)-(12) of section 704(a) of the Bankruptcy Code (which are all traditional duties of a Chapter 7 Trustee);[13]

prepare and file schedules and statements for the debtor; and furnish tax information to governmental entities based on the debtor's books and records.

The Bankruptcy Code establishes that a Sub V Trustee's duties also include the following:

1. accountability for all property received from the estate (if any);[14]
2. if purpose would be served, examining proofs of claim and objecting to the allowance of any claim that is improper;[15]
3. if advisable, opposing the discharge of the debtor;[16]
4. unless the court orders otherwise, furnishing such information concerning the estate and the estate's administration as is requested by a party in interest;[17] and
5. making a final report and filing a final account of the administration of the estate.[18]

The bankruptcy court may call upon a Sub V Trustee, upon a showing of cause and on the request of a party in interest, to do the following:

1. investigate the acts, conduct, assets, liabilities, and financial conditions of the debtor, the operation of the debtor's business, the desirability of the continuance of such business, and any other matter relevant to the case or the formulation of a plan;[19]
2. file a statement of any investigation conducted, including facts ascertained as to the debtor's dishonesty, fraud, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or as to a cause of action available to the estate; and/or[20]
3. after plan confirmation, file such reports as are necessary or as the bankruptcy court orders. [21]

Notwithstanding all of these potential duties, the most important duty of a Sub V Trustee is to facilitate the development of a consensual plan of reorganization.

The Sub V Trustee's role in a case is typically considered complete upon substantial consummation of a confirmed, consensual plan. For a confirmed, nonconsensual plan, a Sub V Trustee may be asked by the creditors to continue in his or her role and distribute funds to all of the creditors under the plan.

What should you expect from your Sub V Trustee?

The Sub V Trustee can be expected to work to build consensus among the creditors that express an interest in the outcome of the debtor's case, to help the creditors understand the bankruptcy process and the rules that are required to be followed by the debtor, and to help familiarize the creditors with areas of the bankruptcy process that permit creative problem solving. Once everyone understands the rules governing the reorganization process, then the plan formulation exercise can get underway.

The Sub V Trustee is paid for his or her efforts through the estate. Accordingly, the more efficient the plan formulation process, the more proceeds will remain available to pay creditors and the Sub V

Trustee.

Final Takeaways

Parties familiar with Sub V see this new case format as a breakthrough for small estates and the creditors of such debtors. A preliminary estimate was that approximately 40 percent of debtors in Chapter 11 cases filed after October 1, 2007, would have qualified as a Subchapter V debtor and about 20 percent of individuals in Chapter 11 cases.^[22] These estimates do not take into account the increased debt limits created by the CARES Act, allowing debtors with debts up to \$7.5 million to use Sub V.

There is a genuine hope that, between the cost savings and quick process, Subchapter V will have a meaningful impact on the small business bankruptcy experience for creditors and debtors.

[1] See 11 U.S.C. §§ 1181-1195.

[2] See *Paul W. Bonapfel, A Guide to the Small Business Reorganization Act of 2019*, here (last viewed October 4, 2021) (these materials are maintained and updated as the law surrounding Subchapter V develops).

[3] *Id.* at 8.

[4] *Id.* at 1-2, 8.

[5] *Id.* at 8.

[6] *Id.* at 7.

[7] *Id.*

[8] *Id.* at 108-109.

[9] *Id.* at 8.

[10] 11 U.S.C. § 1183(b)(7).

[11] 11 U.S.C. § 1183(b)(3).

[12] 11 U.S.C. § 1183(b)(4).

[13] The duties under these sections include being accountable for all property received by the estate; examining the proofs of claim and objecting as necessary; furnishing case information requested by parties in interest, unless the Court orders otherwise; making reports usually required to be filed by the debtor; making a final report and filing a final account of the administration of the estate; providing the applicable notice if a domestic support obligation is involved; if the debtor had ERISA administrator obligations, continuing to perform the obligations required of the administrator; if the debtor's business is a healthcare operation, using all reasonable and best efforts to transfer patients to an appropriate healthcare business.

[14] 11 U.S.C. § 1183(b)(1); 11 U.S.C. §704(a)(2).

[15] *Id.*; see also 11 U.S.C. §704(a)(5).

[16]

Id.; see also 11 U.S.C. §704(a)(6).

[17] *Id.*; see also 11 U.S.C. §704(a)(7).

[18] *Id.*; see also 11 U.S.C. §704(a)(9).

[19] 11 U.S.C. § 1183(b)(2).

[20] *Id.*

[21] *Id.*

[22] *Id.* at 4.

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- Jennifer McLain McLemore ? 804.420.6330 ? jmclmore@williamsmullen.com

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