



IV YEARS OF SUBCHAPTER V: A SMALL BUSINESS BANKRUPTCY RETROSPECTIVE

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PROBLEM WITH SMALL BUSINESS CHAPTER 11 DEBTOR CASES PRIOR TO ENACTMENT OF SUBCHAPTER V

- Small business chapter 11 cases prior to Subchapter V were not working for small and middle market companies
 - Too time-consuming and expensive
 - Process needed drastic streamlining
 - Absolute priority rule put owner at substantial risk of losing business
- Distressed small businesses had to rely on non-bankruptcy alternatives
 - Assignment for the benefit of creditors
 - Receiverships
 - UCC Article 9 secured party sale
 - Closing the doors and walking away



SUBCHAPTER V SMALL BUSINESS CASES

- Enacted as Part of Small Business Reorganization Act of 2019 (SBRA)
 - Purpose is to reduce costs and increase efficiency
 - Subchapter V was initially available to businesses with liquidated, non-contingent, secured and unsecured debt of \$2,725,625 as of bankruptcy petition date (excluding debt to insiders/affiliates)
 - Limit increased to \$3,024,725 on April 1, 2022
- CARES Act increased Sub V debt limit to \$7,500,000 (Effective 3/27/2020)
 - At least 50% from commercial or business activities of the debtor
 - Bankruptcy Threshold Adjustment and Technical Corrections Act preserved \$7.5 million eligibility threshold
 - Increased debt limit sunset on June 21, 2024
 - Possibility of further extending \$7.5 million debt limit



| SUBCHAPTER V DEBTOR ELECTION

- Eligible chapter 11 debtors may elect Subchapter V small business case treatment by checking a box on the first page of the petition:

8. Under which chapter of the Bankruptcy Code is the debtor filing?
A debtor who is a "small business debtor" must check the first sub-box. A debtor as defined in § 1182(1) who elects to proceed under subchapter V of chapter 11 (whether or not the debtor is a "small business debtor") must check the second sub-box.

Check one:

Chapter 7

Chapter 9

Chapter 11. Check all that apply:

The debtor is a small business debtor as defined in 11 U.S.C. § 101(51D), and its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than \$3,024,725. If this sub-box is selected, attach the most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return or if any of these documents do not exist, follow the procedure in 11 U.S.C. § 1116(1)(B).

The debtor is a debtor as defined in 11 U.S.C. § 1182(1), its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than \$7,500,000, and it chooses to proceed under Subchapter V of Chapter 11. If this sub-box is selected, attach the most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return, or if any of these documents do not exist, follow the procedure in 11 U.S.C. § 1116(1)(B).

A plan is being filed with this petition.

Acceptances of the plan were solicited prepetition from one or more classes of creditors, in accordance with 11 U.S.C. § 1126(b).

The debtor is required to file periodic reports (for example, 10K and 10Q) with the Securities and Exchange Commission according to § 13 or 15(d) of the Securities Exchange Act of 1934. File the Attachment to Voluntary Petition for Non-Individuals Filing for Bankruptcy under Chapter 11 (Official Form 201A) with this form.

The debtor is a shell company as defined in the Securities Exchange Act of 1934 Rule 12b-2.

Chapter 12

- If the box is not checked, Subchapter V does not apply and Debtor is subject to Chapter 11 provisions applicable to non-Subchapter V debtors (including the "old" small business provisions!)

SUBCHAPTER V ELIGIBILITY LITIGATION ISSUES

- Subchapter V debtor eligibility presents a number of issues:
 - Has the debtor been engaged in the requisite commercial or business activities sufficient to qualify as a “small business debtor”?
 - Eligibility of liquidating debtors?
 - Eligibility of individual debtors?
 - Are potential contract rejection damage claims included in determining eligibility? Courts divided!
- Why contest eligibility?
- Because Subchapter V is significantly more debtor-friendly than ordinary chapter 11!



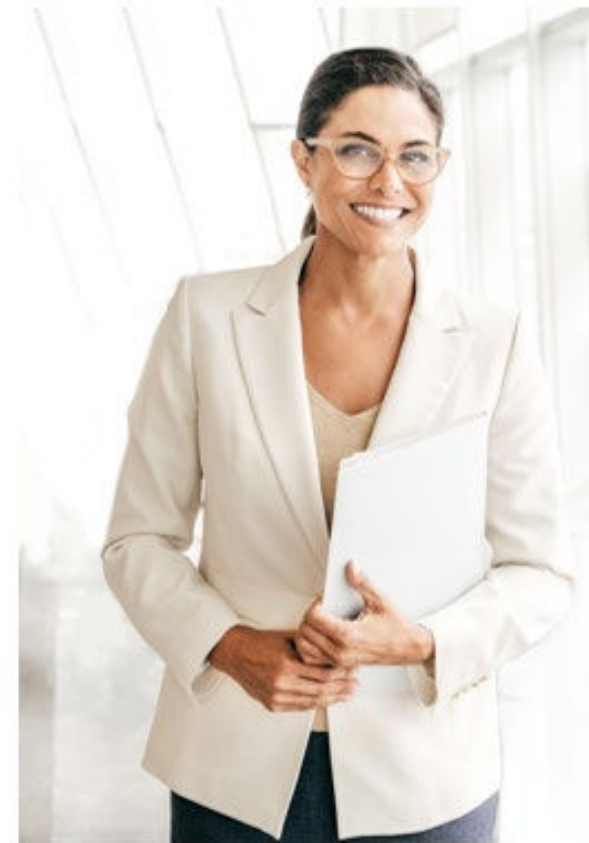
| SALIENT SUBCHAPTER V PROVISIONS

- No quarterly United States Trustee fees in Subchapter V cases
 - Quarterly fee payable in traditional chapter 11 cases
- No creditors' committees unless court orders otherwise for cause
 - Contrasts with traditional chapter 11 case where United States Trustee appoints creditors' committee and debtor must pay committee professionals' fees and expenses
 - Does anyone replace the creditors' committee?



| SUBCHAPTER V TRUSTEE

- Limited Power – More of an oversight role than a true trustee. Subchapter V trustee does not take possession of debtor’s assets or take control of the business
- Appears and may be heard at hearings/status conferences, and “shall appear” at any hearing that concerns:
 - The value of property subject to a lien
 - Sale of property of the estate
 - Confirmation of a plan under Subchapter V
 - Modification of the plan after confirmation
- **May be granted investigative duties for cause**
 - **Requires court approval**
- Takes over duties of chapter 7 or 11 trustee if debtor ceases to be a debtor in possession
- Facilitates the development of a consensual plan of reorganization
- Ensures debtor complies with plan/payment requirements for non-consensual plan
- In general, no trustee appointment in traditional chapter 11 cases unless extreme circumstances



SUBCHAPTER V PLAN CONFIRMATION PROCESS

OVERVIEW

- True Exclusivity! Debtor has sole right to file chapter 11 plan
 - In traditional chapter 11 case creditors may file a plan after lapse of exclusivity period
- Debtor must file plan within 90 days of petition date
 - This period may be extended if the extension is needed due to “circumstances for which the debtor should not justly be held accountable”
 - In traditional chapter 11, plan must be filed within 180 days (or longer, subject to 18 month limit)
- No separate Disclosure Statement unless court orders otherwise for cause
 - In general, separate Disclosure Statement in traditional chapter 11 case



SUBCHAPTER V PLAN CONFIRMATION PROCESS

PLAN REQUIREMENTS

- Plan requirements:
 - Proposed plan payments
 - Brief history of the business operations of the debtor
 - Liquidation analysis
 - Projections showing debtor's ability to make proposed plan payments
 - Must provide for future income to be provided to Trustee as necessary to execute the plan



SUBCHAPTER V PLAN CONFIRMATION PROCESS

CONFIRMATION

- Plan may be confirmed *even if rejected by all impaired classes* (“cramdown”)
 - In traditional chapter 11 case at least one impaired claim class must accept plan
- Administrative claims need not be paid in full on the effective date but can be stretched out over plan term if plan is confirmed by cramdown
 - In traditional chapter 11 case, administrative claims must be paid in full on the plan effective date
- No absolute priority rule!
 - Equity holders may retain their interests even if unsecured creditors are not paid in full, so long as the debtor contributes all of its projected disposable income over 3-5 years to fund plan payments
 - Can plan capture upside-additional actual disposable income over the life of the plan? Courts are split.
 - In traditional chapter 11 case, cramdown must satisfy absolute priority rule

SUBCHAPTER V PLAN CONFIRMATION PROCESS

CONFIRMATION

- Discharge:
 - On confirmation for a consensual plan
 - On completion of plan payments for a non-consensual plan
- Plan disbursement entity:
 - Under non-consensual plan – trustee receives funds for purposes of making distributions
 - Under consensual plan – trustee’s appointment terminates; the debtor makes plan payments



CREDITOR ABILITY TO CHALLENGE DISCHARGEABILITY OF CLAIMS

- Emerging issue in Subchapter V cases – Does exception to discharge under section 523(a) of the Bankruptcy Code apply only to individual debtors, or also to corporate debtors?
 - Section 523(a) provides for non-dischargeability of claim owing by individual debtor arising from:
 - Fraud
 - Willful and malicious injury
 - Other grounds listed in section 523(a)
- Applicability of exceptions to discharge to both corporate and individual Subchapter V debtors
 - Yes
 - Fourth Circuit decision – *In re Cleary Packaging* – held that section 523(a)(2) fraud exception to discharge applies to *both* corporate and individual Subchapter V debtors that have confirmed non-consensual plans
 - Recent Fifth Circuit decision agrees with Fourth Circuit – *In Matter of GFS Industry LLC*
 - No
 - Ninth Circuit Bankruptcy Appellate Panel decision – *In re Off-Spec Solutions, LLC* – exception to discharge applies only to individual Subchapter V debtors

POST-CONFIRMATION PLAN MODIFICATION

- Only the debtor may modify a Subchapter V plan after confirmation, after notice and a hearing before the court
- Different standards for post-confirmation modification, depending on whether the plan was consensual or non-consensual
 - Consensual plan may only be modified before “substantial consummation”
 - The modified plan must meet the classification and plan contents requirements of sections 1122 and 1123, respectively (other than section 1123(a)(8))
 - Non-consensual plan may be modified at any time during the 3-5 year period for payment of projected disposable income
 - Debtor must satisfy cramdown requirements of Subchapter V

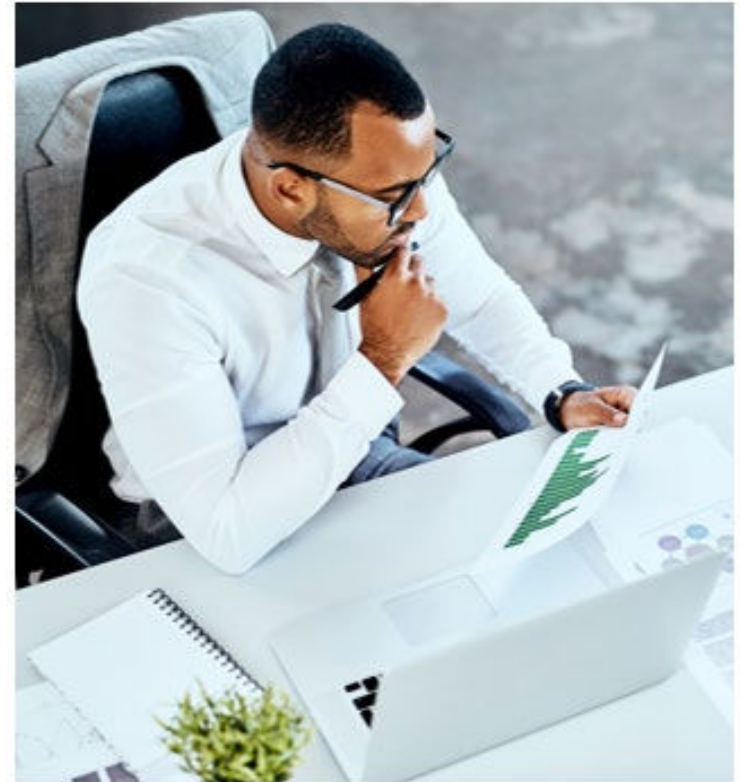
| CREDITOR STRATEGIES

- Be assertive!
- Consider objecting early to Subchapter V case if debtor is ineligible
- Utilize chapter 11 creditor remedies, such as critical vendor status, 503(b)(9) priority status, objections to dischargeability of claim
- While there is no creditors' committee, creditors can move for the court to direct appointment of a committee for cause
- ***The Subchapter V Trustee is not a fiduciary for unsecured creditors***
 - Creditors can seek to have Subchapter V trustee investigate possible claims against the Debtor and third parties, such as insiders
 - Court approval required



| CREDITOR STRATEGIES

- Challenge plan payments
 - Debtor must contribute all projected disposable income to the plan
 - Creditors should be prepared to examine the Debtor's projections, which can be manipulated
 - Creditors could seek to expand plan period to 5 years
 - Creditors could seek recovery of the upside if the Debtor exceeds projections
 - Creditors should consider working with Trustee on plan issues
- Object to any extended repayment of administrative claims under the plan



| HOW HAS SUBCHAPTER V FARED?

- Subchapter V is popular with debtors
- Filings significantly increased each year since enactment of the SBRA
- Subchapter V filings in 2023 Increased by 30% compared to 2022
 - 45% of chapter 11 debtors used Subchapter V
- First half of 2024:
 - Subchapter V filings increased 34% compared to first half of 2023
 - Total bankruptcy filings – increase of only 15% over same period
- Substantial increase in filings likely attributed to risk \$7.5 million debt limit would not be extended...



| HOW HAS SUBCHAPTER V FARED?

- Industries where Subchapter V has been more widely utilized:
 - Retail
 - Construction
 - Health care
 - Hospitality/Hotel/Lodging
 - Restaurants/Bars
 - Trucking/Transportation



| HOW HAS SUBCHAPTER V FARED?

- Subchapter V has been lauded as being “successful” based largely on the number of cases filed and plans confirmed, but . . .
 - *Are Debtors truly achieving an effective reorganization?*
 - *Are Debtors making all of their required plan payments?*
 - *How is Subchapter V working for unsecured creditors?*



AMERICAN BANKRUPTCY INSTITUTE SUBCHAPTER V TASK FORCE

- Reviewed the implementation and administration of Subchapter V
- Presented its final report and recommendations on Subchapter V
 - Debtor eligibility recommendations
 - Subchapter V debt limit should be permanently set at \$7.5 million with inflation adjustment
 - While the \$7.5 million debt limit was in effect, only approximately 26.2% of Subchapter V debtors would have been ineligible for Subchapter V without the temporary \$7.5 million limit
 - Debt limit should not include future rent payments



AMERICAN BANKRUPTCY INSTITUTE SUBCHAPTER V TASK FORCE (CONT'D.)

- More ABI Subchapter V Task Force recommendations:
 - Role of Subchapter V trustee
 - Case administration recommendations
 - Plan and confirmation recommendation
 - Silent non-voting class deemed to accept plan
 - Debt dischargeability recommendation
 - Non-dischargeability claims only against individual debtor
 - Post confirmation administration matters



| QUESTIONS





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Education

Seton Hall University School of Law
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New Jersey
U.S. Court of Appeals for the First Circuit
U.S. Court of Appeals for the Third Circuit
U.S. District Court for the Southern District of Texas

Andrew Behlmann leverages his background in corporate finance and management to approach restructuring problems, both in and out of court, from a practical, results-oriented perspective. With a focus on building consensus among multiple parties that have competing priorities, Andrew is equally at home both in and out of the courtroom, and he has a track record of turning financial distress into positive business outcomes. Clients value his counsel in complex Chapter 11 cases, where he represents debtors, creditors' committees, purchasers, and investors.

Andrew writes and speaks frequently about bankruptcy matters and financial issues. Before becoming a lawyer, he worked in senior financial management at a midsize, privately held company.



MICHAEL PAPANDREA

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Education

Rutgers Law School (J.D. 2014),
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The College of New Jersey (B.S. 2010),
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Admissions

New York
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U.S. Court of Appeals for the
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Michael Papandrea provides counsel to debtors, creditors' committees, individual creditors, liquidating trustees, and other interested parties with respect to corporate bankruptcy and creditors' rights matters, including bankruptcy-related litigation.

Reliable and efficient, Mike is appreciated for his innate ability to effectively apply and convey his understanding of the law and general business principles with respect to complex issues, both while providing advice to clients and while aggressively advocating on their behalf. Mike works tirelessly to understand clients' needs and provide practical solutions that are reasonable, balanced, and favorable to the clients he serves.

Mike enjoys keeping clients and relevant industry professionals in the loop regarding bankruptcy, insolvency, and creditors' rights issues, regularly writing articles for and speaking to professionals in the credit and risk management space. Mike also takes pride in his commitment to the community and provides pro bono representation to individuals and nonprofit organizations regarding bankruptcy and foreclosure-related matters.

Prior to joining the firm, Mike held multiple clerkships in the U.S. Bankruptcy Court; he clerked for the Hon. Jerrold N. Poslusny, Jr. (District of New Jersey), the Hon. Ashely M. Chan (Eastern District of Pennsylvania), and the Hon. Gloria M. Burns (Chief Judge, District of New Jersey). Mike applies the valuable insights learned from working closely and directly with these members of the judiciary to his everyday practice..

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