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Subchapter V of Chapter 11, otherwise known as the Small Business Reorganization Act of 2019 is applauded by some as a mechanism to save more small businesses, others see it as the biggest hurdle yet for creditors—often small businesses themselves. What isn't up for debate, however, is that Subchapter V is a considerable shift in the bankruptcy process and lawyers need a firm understanding of how it differs from "ordinary" Chapter 11.

Background

Chapter 11 of the U.S. Bankruptcy Code is a well-known commodity and "is a form of bankruptcy relief that is typically used by businesses to reorganize their financial affairs." H.R. Report 116-171, 116th Congress. The vast number of businesses in the U.S. are considered "small", with more Americans employed by businesses with fewer than 5,000 workers than any other cohort.

Most Chapter 11 business cases are also filed by small business debtors and they are often "the least likely to reorganize successfully." Congress previously attempted to shore up the bankruptcy process for small business debtors through "heightened scrutiny" and "streamlining" the Chapter 11 reorganization plan for small business debtors. However, "[n]otwithstanding the 2005 Amendments [to the Bankruptcy Code], small business Chapter 11 cases continue[d] to encounter difficulty in successfully reorganizing.

The continued struggles of small business debtors provided the impetus behind the passage of the Small Business Reorganization Act of 2019, a provision and process in the Bankruptcy Code to help small business debtors improve their rates of successful reorganization through Subchapter V of Chapter 11 of Title 11 the United States Code, codified at **11 U.S.C. §§ 1181-1195**.

With the passage of Subchapter V, Congress created a streamlined Chapter 11 process to provide an economically feasible and efficient option for small business debtors, and to remove some of the obstacles—financial, temporal, and otherwise—to reorganization. Subchapter V is limited to individuals and entities that qualify as a "small business debtor"—defined as a person or entity engaged in commercial or business activities that has aggregate secured and unsecured debts as of the date of filing of less than $2,725,625.

This threshold debt amount was increased to $7.5 million by the Coronavirus Aid, Relief, and Economic Security Act of 2020 and while the increased limit was originally scheduled to sunset on March 26, 2021, the increased limit has since been extended to March 27, 2022. **11 U.S.C. § 1182(1)(A)**.

Key Changes & Differences from 'Ordinary' Chapter 11

In creating a more cost-efficient and streamlined process for small business debtors, Congress eliminated or altered in Subchapter V several provisions of "ordinary" Chapter 11. Congress made these changes to address the fact that "[w]hile the Bankruptcy Code envisions that creditors will play a major role in monitoring these cases, this often does not occur" because more often than not, "creditors in these smaller cases do not have claims large enough to warrant the time and money to participate actively in these cases."

Still other differences are designed to limit the cost and time spent in bankruptcy by small business debtors thereby hopefully increasing the likelihood of a successful reorganization. These changes are either huge advantages or disadvantages to proceeding under Subchapter V depending on the point of view of the impacted party.

Other key differences between the two types of Chapter 11 cases include:

• The elimination of an official Committee of Creditors in Subchapter V cases. Committees for general unsecured creditors are unnecessary and superfluous if viewed in light of the Congressional intent behind the need for Subchapter V, namely the lack of significant or meaningful creditor participation in small business cases. In addition, the exclusion of committees addresses another issue, the high cost of Chapter 11 for small business debtors. The lack of a creditors committee eliminates a substantial cost associated with paying professional fees that are incurred by such a committee in normal Chapter 11 cases. See **11 U.S.C. § 1181(b)**.

• In Subchapter V, the debtor is not required to file a Disclosure Statement in connection with its Chapter 11 Plan of Reorganization. The lack of a required Disclosure Statement is again a nod to a lack of creditor involvement, limiting the work required for debtors in providing information to creditors and, again, saving the costs associated with the drafting and approval of a Disclosure Statement. That said, Subchapter V debtors are not totally absolved from providing creditors with certain information that is normally included in a disclosure statement.

That information, required by **11 U.S.C. § 1190(a)(1)**, includes a brief history of the operations of the debtor, a liquidation analysis, and projections regarding the plan and the debtor's ability to make plan payments.

• A Chapter 11 Plan in Subchapter V may only be filed by the debtor, as opposed to an "ordinary" Chapter 11, where creditors are permitted, upon the expiration of the exclusivity period, to file competing plans. See **11 U.S.C. § 1121**. Again, this change streamlines the reorganization process for small business debtors, eliminating provisions that allow for the potential of even greater creditor involvement, and the increased time and costs associated with an "ordinary" Chapter 11. See **11 U.S.C. § 1189(a)**.

A key difference between Subchapter V and an "ordinary" Chapter 11 case is the elimination of the absolute priority rule found in § 1129(b)(2)(a)(i). In an "ordinary" Chapter 11, the absolute priority rule operates as a key creditor protection, providing in effect that in a "cram down" situation, equity security holders of the debtor cannot retain their interest in the debtor unless nonconsenting creditors receive full payment of their claims as of the petition date. See **11 U.S.C. § 1129(b)(2)(a)(i)**.

Without this protection, Subchapter V debtors may cram down plan terms on nonconsenting creditors, without paying claims in full, while retaining their equity interest. This change may be the single biggest change from the "ordinary" Chapter 11 process, allowing debtors in Subchapter V cases to confirm plans that would never be confirmable in "ordinary" Chapter 11 proceedings, widening the range of plan options and putting more tools in the toolbox of debtors. Conversely, for creditors, this change can act as a serious hindrance to creditors exerting leverage over and recovering financially from a debtor's reorganization.

In addition to the elimination of the absolute priority rule in Subchapter V, a Subchapter V plan can be confirmed without a consenting creditor. **11 U.S.C. § 1191**. In yet another nod to the view that many small business Chapter 11s fail because of a lack of creditor involvement, in addition to aiding the goal of streamlining the process and increasing the likelihood of a successful reorganization for small business debtors, Congress has allowed for the confirmation of a Subchapter V plan without any consenting creditors.

Such a result would not be permissible in an "ordinary" Chapter 11, which requires some creditor involvement and often results in increased costs for the debtor to solicit accepting votes ofat least one impaired class of creditors. See **11 U.S.C. § 1129(a)(10)**. From a creditor perspective this eliminates another check on the debtor through plan confirmation, increasing the likelihood that plan terms not previously confirmable may be confirmed in Subchapter V cases.

In another break from an "ordinary" Chapter 11 case, Subchapter V debtors may modify the rights of the holder of a claim secured by real property that is the principal residence of the debtor if the new value received in connection with the granting of the security interest was not used primarily to acquire the real property, but rather was used in connection with the small business of the debtor. **11 U.S.C. Section 1190(3)**. This is a clear departure from an "ordinary" Chapter 11 (see **11 U.S.C. § 1123(b)(5)**) and an acknowledgment that so often small business owners will leverage their own personal assets, including their homes, for the benefit of and sometimes survival of their businesses.

In the context of Plan confirmation, another major difference is that there is no voting in Subchapter V cases, with **11 U.S.C. § 1125** having been made inapplicable to Subchapter V cases by § 1181. In the Subchapter V context, the process to confirm a plan is the same whether creditors agree or disagree with the debtor's proposed plan. This fact, coupled with the aspects of Subchapter V that make it easier to cram down plans on dissenting creditors, represents a huge change from "ordinary" Chapter 11 proceedings, and tip the scales decidedly in favor of the confirmation of small business debtors' Plans under Subchapter V.

While the major changes detailed above are intended to be pro-small business debtor, certain provisions of Subchapter V ensure that some amount of creditor protection is retained. Subchapter V has its own application of certain standards used in an "ordinary" Chapter 11. For instance, to confirm a plan in Subchapter V, the Plan must satisfy the "fair and equitable test." **11 U.S.C. § 1191(b)**.

While a common phrase throughout the bankruptcy code, in this context, the fair and equitable test is met, and a plan is confirmable when, a plan provides for the payment of a Subchapter V debtor's "disposable income" to creditors through the plan during a three- to five-year period. Disposable income references the company's income that is not used to maintain and support the company or pay the company's necessary expenses.

This ensures that the debtor in a Subchapter V plan is providing value to creditors and especially unsecured creditors, however small, in a not dissimilar fashion to that required in a bankruptcy proceeding under Chapters 12 or 13. Additionally, **11 U.S.C. § 1191(c)(3)** requires that the debtor be able to make all payments proposed under the plan, or there is a reasonable likelihood of that occurring. This further protects creditors with respect to the confirmation of a debtor's plan.

A second option for debtors in Subchapter V to satisfy the fair and equitable test in lieu of payments is for the Subchapter V plan to provide for the distribution of some or all of the debtor's property to the Subchapter V trustee for the benefit of its creditors. This property must be not less than the projected disposable income during the company's next three to five years.

New to Chapter 11 and found exclusively in Subchapter V cases is the appointment of a standing Subchapter V trustee. The trustee, similar to the trustee appointed in the Chapter 13 or Chapter 12 context, ensures that the small business debtor stays on track. The trustee's role and responsibilities encompass a broad range of functions: accounting for property, examining and rejecting claims against the estate, reviewing the company's financial condition and business operation, and reporting any fraud or misconduct to the bankruptcy court, distributing property in accordance with a plan of reorganization and assisting as necessary in the facilitation of the plan of reorganization.

However, in a departure from what is seen in other trustee contexts, the broad duties of the Subchapter V trustee do not include the duty to investigate the financial affairs of the debtor., except if the court so rules at the request of a party in interest as detailed in **11 U.S.C. § 1183(b)(2)** and 1106(a), The Subchapter V trustee's role is more like that of guide and gatekeeper, ensuring that small business debtors in Subchapter V "keep it between the navigational beacons" while assisting and working towards the consensual confirmation of a Subchapter V plan.

Key Differences Between 'Ordinary' Chapter 11 and Subchapter V

	"Ordinary" Chapter 11	**Subchapter V**
Creditors' Committees?	Yes	No
Disclosure Statement?	Yes	No
Competing Plans?	Yes	No
Absolute Priority Rule?	Yes	No
Confirmation without a consenting creditor?	No	Yes
Modification of claim secured by the principal residence of the debtor?	No	Yes (if the new value received was used in connection with the small business of the debtor)
Plan Voting?	Yes	No

Conclusion

Bankruptcy practitioners might disagree over the necessity or merits of the changes ushered in by Subchapter V, but none can deny the significant effects it has had on Chapter 11 practice around the country. While advantageous for small business debtors, this more streamlined, cost-effective, mechanism to effect reorganization puts creditors at a potential disadvantage by eliminating many of the protections and processes historically available to them to leverage the bankruptcy process for better, fairer, outcomes.

No matter the perspective, a strong grasp of the differences between Subchapter V and "ordinary" Chapter 11 cases will be key for bankruptcy lawyers advocating for various clients and navigating the world of business bankruptcy moving forward.