Subchapter V of Chapter 11: a User's Guide

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5:1. Introduction

President Reagan famously joked that "*I'm from the Government and I'm here to help*" are nine of the most terrifying words in the English language. Politics aside, few laws are as universally acclaimed as subchapter V of chapter 11 of the Bankruptcy Code. Maybe the Government helped this time.

Subchapter V works. It saves businesses. It helps the people who own those businesses. And it is cheap and fast, at least compared to "traditional" chapter 11.

Traditional chapter 11 (by which we mean any chapter 11 other than a pre-pack or a subchapter V) is far more expensive with a far less certain outcome than a subchapter V chapter 11 case.

Don't read too much into this. Traditional chapter 11 is powerful medicine, and for the right patient, it is the very best medicine. The problem is that while it was created to help businesses of all sizes, the way chapter 11 evolved has been influenced disproportionately by bankruptcy courts' decisions in massive cases. What makes sense and works well for the bankruptcy cases of Johnson & Johnson, United Airlines, Lehman Brothers, Pacific Gas and Electric, WorldCom, or Sears doesn't necessarily make sense for Joe's Pizza Shop or Mary's Motor Coach, Inc.[1] The result: traditional chapter 11 is often too expensive, time-consuming, and uncertain for the typical small business.[2]

This reality pushed smaller distressed companies (and their creditors) to look for alternatives to chapter 11 cases, with that trend growing since the late 1990s. These alternatives include chapter 7 bankruptcy, receiverships, assignments for the benefit of creditors (ABCs), and Article 9 sales.

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[1] Until subchapter V became law, little distinction existed between the rules and case law governing a small business debtor case and a mega-business reorganization case involving multimillion-dollar companies. For further discussion, *see generally* Friedland, Bernstein, Kuney and Ayer, *Chapter 11--101 The Nuts and Bolts of Chapter 11 Practice: A Primer*, NACM Oregon Informational Brief, Issue 8.15 (May 2009).

The addition of subchapter V to chapter 11 has given qualifying small businesses a distinct and formidable path through the bankruptcy process. To a great degree, this was predicted by Judge Bonapfel.

[2] These are only three of the reasons that have pushed small, distressed businesses away from Chapter 11 and into the arms of non-bankruptcy alternatives. For more discussion, *see generally* Jonathan Friedland, *RISE OF THE ALTERNATIVES: the increasing use of alternatives to chapter 11 bankruptcy for selling an insolvent business in the United States* (June 3, 2019), LinkedIn Pulse.

Cite this article as *Subchapter V of Chapter 11: a User's Guide*, by Jonathan Friedland, et al. (Financial Poise, February 6, 2024)

Like most things in life, traditional chapter 11 and its alternatives have pros and cons. The fairly new option of subchapter V will not always be the best solution, but it has already proven itself excellent in many cases, at least from the perspective of the company and its owner(s).[3] Why? Because in the hands of a skilled attorney, subchapter V can hold all the benefits and more of traditional chapter 11 at a fraction of the cost, time, and uncertainty.

We have organized this chapter with reference to the following questions:

1. Where did subchapter V come from?
2. Who *can* be a subchapter V debtor?
3. What is "qualifying" debt?
4. What are "commercial or business activities?"
5. Who *should* be a subchapter V debtor?
6. What is the difference between a "small business debtor" and a subchapter V debtor?
7. How does a debtor elect subchapter V treatment?
8. Why is subchapter V better than traditional chapter 11?
9. Why is confirmation easier in subchapter V than in traditional chapter 11?
10. How can subchapter V be used to kill a personal guaranty?
11. What is the role of a subchapter V trustee?
12. What's the bottom line about subchapter V?

5:2. Where did Subchapter V come from?

Subchapter V was created by the Small Business Reorganization Act of 2019 (the "*SBRA*"). The SBRA, which had bipartisan support in Congress, was drafted in consultation with the National Bankruptcy Conference ("*NBC*") and the American Bankruptcy Institute ("*ABI*"), with significant input from the National Conference of Bankruptcy Judges ("*NCBJ*") and the American College of Bankruptcy ("*ACB*"). The SBRA was designed to help small businesses and their owners by providing a new, simpler path through chapter 11 than a traditional chapter 11 filing.[4]

Subchapter V went into effect on February 19, 2020. Given its recent enactment, case law interpreting subchapter V's provisions is still developing. As a result, and because subchapter V is such a departure from prior law, some of what we write here remains speculation. But, hell, we've been known to run with scissors,[5] so away we go...[6]

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[3] According to the American Bankruptcy Institute, more than 6700 subchapter V cases were filed from the commencement of the statute on February 19, 2020, through November 30, 2023. *See* https://www.abi.org/sbra (Bankruptcy Statistics chart and related statistics).

[4] *See generally* H.R. Rep. No. 116-171 (2019); *see also*, Bonapfel, §I (citing the legislative history of the SBRA and statements in the Congressional Record in support of the SBRA's purpose to streamline chapter 11 for small business debtors).

[5] *See* https://www.youtube.com/watch?app=desktop&v=JXceET3-awc.

Subchapter V's provenance traces from the ABI's 2014 publication of its Final Report and Recommendations of the Commission to Study the Reform of Chapter 11 and numerous other reports, articles, and letters from various constituent parties and groups tendered in support of the subchapter V legislation. Collectively, these sources identified elements of conventional chapter 11 requirements, policy, and practice that rendered chapter 11 impractical-to-impossible for most smaller businesses to navigate, even after the 2005 amendments to the Bankruptcy Code (BAPCPA) that aimed to help small businesses.[7] The House Committee Report published in support of the legislation noted the following:

(a) So-called "small businesses"- privately-held businesses (e.g., "family businesses") ranging from 50 to 5,000 employees - collectively employ more workers than businesses that employ more than 5,000.

(b) As a group, only 50% of small businesses survive five years, and 33% survive ten years.

(c) Traditional chapter 11 requires a substantial investment in time and money for both the debtor and its creditors, who must engage in the process for it to succeed. The cost and timeline of a traditional chapter 11 were prohibitive for most small businesses, particularly given their typical time horizon. The vast majority of creditors in small business bankruptcies have claims that are too small to warrant active participation.

In devising subchapter V, the drafters looked primarily to chapter 12 (and to a lesser degree, chapter 13) for models. For example, subchapter V trustees fulfill a similar role to the panel trustees assigned to monitor chapter 12 family farm bankruptcies.[8]

In chapters 12 and 13, the trustee has no operational or possessory role in the case, but serves as a fiduciary to creditors, a resource for the debtor as it pursues reorganization, and an advisor to the court. As in chapter 12, the subchapter V trustee may also serve as the disbursing agent for creditor payments. But subchapter V differs from chapter 12 in significant ways--in particular, the confirmation requirements for chapter 12 closely resemble those of chapter 13, while subchapter V incorporates most (but not all) of the requirements of §1129(a). As case law

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6 Yes, Virginia, that is a Jackie Gleason reference.

7 *See* H.R. Rep No. 116-171, at 1 to 3 (2019) (discussing findings and recommendations of the ABI Final Report and other constituent parties). Subchapter V does not amend the small business provisions of BAPCPA but provides an alternative reorganization path for small businesses and individuals who qualify.

8 The House Report noted: "New section 1183 directs the United States trustee to appoint an individual serving as a standing trustee to serve as a trustee in any case under subchapter V. The trustee must perform many of the same duties performed by a chapter 12 trustee." H.R. Rep No. 116-171, at 6 (2019).

interpreting elements of subchapter V emerges, we see judges looking for guidance on the similarities and differences between subchapter V, chapter 12, and chapter 13 as they address the issues coming before them.[9]

5:3. Who can be a Subchapter V debtor?

We start with a simple hypothetical: meet BobCo. BobCo owes its bank $1 million and its trade vendors $2 million. BobCo's business could be sold as a going concern, at the most, for $500,000, and if sold piecemeal, the total sale proceeds would be far less. BobCo can elect to file chapter 11 under subchapter V. We don't need to know anything more.[10] The only real eligibility requirement for a business is a debt limit. At present, to elect subchapter V, a debtor must have no more than $7.5 million of *qualifying* debt.[11]

But what about Bob?[12] We forgot to mention that he guaranteed BobCo's bank debt. Can he file chapter 11 and elect it to proceed under subchapter V? To answer that, we need to know a little more about Bob: in addition to the BobCo debt he guaranteed, Bob also owes $200,000 on the mortgage loan on his house, has a $20,000 car loan, and $50,000 in credit card debt.

So, even if we have to count BobCo's $1 million bank debt, Bob is well under that qualifying $7.5 million debt cap even *assuming* all the debt we've mentioned is indeed qualified debt.

Notice that our hypothetical assumes that BobCo's debt + Bob's debt taken together is less than $7.5 million. Why did we write it that way? To keep it simple.

You see, the Bankruptcy Code tells us that if a debtor files for chapter 11, that debtor's qualifying debt on the petition date + the qualifying debt of its affiliates who are also debtors in

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9 See, e.g., *In re Cleary Packaging LLC*, 630 B.R. 466, 70 Bankr. Ct. Dec. (CRR) 112 (Bankr. D. Md. 2021) (discussing at length the nature and purpose of subchapter V and its relationship to chapters 12 and 13); *In re Baker*, 625 B.R. 27, 69 Bankr. Ct. Dec. (CRR) 164 (Bankr. S.D. Tex. 2020) (looking to chapter 12 for guidance on determining the circumstances by which the court should extend a plan filing deadline); *In re Seven Stars on the Hudson Corp.*, 618 B.R. 333, 69 Bankr. Ct. Dec. (CRR) 47 (Bankr. S.D. Fla. 2020) (same).

10 This assumes that BobCo is eligible to file traditional chapter 11, as most companies are.

11 The Coronavirus Aid, Relief and Economic Security Act ("*CARES Act*"), enacted into law on March 27, 2020, expanded the eligibility threshold for debtors filing under subchapter V from $2,725,625 to $7,500,000. The debt threshold reverted to $3,024,725 (due to regularly scheduled adjustments implemented by federal statute) on March 27, 2022, but was further extended (and made retroactive to March 28, 2022) by the Bankruptcy Threshold Adjustment and Technical Corrections Act, which took effect in late June 2022. *See* Keach & Prescott, ABI Journal August 2022, *President Biden Signs Bankruptcy Threshold Adjustment and Technical Corrections Act into Law*. At present, the debt threshold is set to revert again to $3,024,725 after two years. *See infra* at Sections 3 and 4 for critical additional discussion.

12 Yes, that is a theatrical pun. All good lawyers are, to at least some extent, actors, after all.

bankruptcy, taken together,[13] cannot be more than $7.5 million.

There's one other eligibility requirement that Bob has to meet because, unlike BobCo, he is a human being: at least 50% of his qualifying debt had to arise from his own "commercial or business activities."[14]

5:4. What is "qualifying" debt?

Again, a debtor cannot elect to proceed under subchapter V unless the debtor's qualifying debts are no greater than $7.5 million. We've been begging the question long enough; a debt is *qualifying* if it: (a) is not owed to an insider or an affiliate; (b) is not contingent; and (c) is liquidated. Let's illustrate each:

- If Ray owns RayCo and RayCo owes Ray $10 million, that $10 million simply doesn't count when calculating whether RayCo can elect subchapter V treatment because Ray is both an *insider* and *affiliate* of RayCo.

- If Ray has given a personal guaranty to a third party who has lent money to Ray's daughter's startup and that loan is not in default, then the amount Ray might one day owe to that third party doesn't count in determining whether Ray is eligible to elect subchapter V because that debt is *contingent*.[15]

- Suppose Ray sued a third party and hired a contingency fee attorney to represent him. In that case, the debt Ray owes his attorney doesn't count in determining whether Ray is eligible to elect subchapter V treatment because it is and will remain *unliquidated* unless and until the lawsuit is resolved.

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[13] *See* 11 U.S.C.A. §1182(1)(B) (defining who may *not* be a subchapter V debtor). In addition, §1182(1)(B) states that any corporate debtor subject to SEC reporting requirements under 15 U.S.C. §§78m, 78o(d); or any debtor that is an affiliate of an "issuer," defined by the Securities and Exchange Act of 1934 is ineligible to proceed under subchapter V. Commentators have argued that the latter provision's reference to affiliates of "issuers," included in subchapter V through CARES Act amendments to the Bankruptcy Code, may undermine Congress's goal of making chapter 11 more widely available to small businesses. *See* Kilborn, *SBRA technical amendments = technical foul?* (Sept. 24, 2021).

At least one court analyzing this issue has measured eligibility as of each affiliated debtor's petition date only. Thus, if one or more affiliated debtors file chapter 11 and elect subchapter V treatment because their collective qualifying debts do not exceed the eligibility threshold, the subchapter V election is not invalidated by a later chapter 11 filing by an affiliate entity whose aggregate debts, cross the threshold. The later-filing debtor, however, would be ineligible to elect subchapter V treatment in this scenario. *See, e.g.*, *In re Free Speech Sys., LLC*, 649 B.R. 729, 733-34 (Bankr. S.D. Tex. 2023).

[14] 11 U.S.C.A. §1182(1)(A). To be clear, this requirement also applies to entities. We simply mean to suggest that it will be rarely the case that an entity's debt does not arise from its commercial or business activities.

[15] We explain how to use subchapter V to kill personal guarantees in §4A:11. We also address in that Section how to analyze whether a personal guaranty is or is not contingent.

What about future lease obligations – for example, for a debtor who still has eight years left on a commercial lease? A debtor that has long-term lease obligations as of its petition date may (depending on where the case is filed) have the entirety of its lease obligations counted as a qualifying debt for purposes of determining eligibility to elect subchapter V treatment, despite the fact that a chapter 11 debtor generally has the ability to reject unexpired leases and to impose a cap on the amount a landlord can claim as rejection damages under Bankruptcy Code §502(b)(6).[16]

5:5. What are "commercial or business activities?"

In making changes to the Bankruptcy Code's definition of a "small business debtor" under §101(51D), the SABRA retained the requirement that a small business debtor must be engaged in "commercial or business activities." This requirement applies expressly to the definition of a subchapter V "debtor," under Bankruptcy Code §1182(1)(A).

Courts have split on what types of activity, alone or together, suffice to qualify as "*commercial or business activities*." A majority of courts that have considered the issue have held that a debtor does not need to be "actively operating," at the time of its subchapter V election, but must be *currently* or *presently* engaged in commercial or business activities to meet the definition of a debtor under §1182(1)(A).[17] By contrast, a minority of courts have held that subchapter V debtors do *not* need to be currently engaged in commercial or business activities to qualify for subchapter V and can use the subchapter V process to address matters like "residual" business debts.[18]

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[16] See *In re Macedon Consulting, Inc.*, 652 B.R. 480, 484-86 (Bankr. E.D. Va. 2023) (future rent due on an unexpired lease counts toward $7.5 million cap); compare *In re Zhang Medical PC*, 2023 WL 8286372 (Bankr. S.D.N.Y. Nov 30, 2023 (contingent lease liability not counted toward $7.5 million cap); *In re Parking Management*, 620 B.R. 544 (Bankr. D. Md. 2020) (same).

[17] See *In re Christina Fama-Chiarizia*, 2023 WL 6051283 (Bankr. E.D.N.Y. Sept. 15, 2023) (collecting and discussing cases and "totality of the circumstances" analysis); *In re RS Air, LLC*, 638 B.R. 403, 409 (B.A.P. 9th Cir. 2022) (collecting cases); *In re Blue*, 630 B.R. 179, 70 Bankr. Ct. Dec. (CRR) 95 (Bankr. M.D. N.C. 2021) (subchapter V debtor must be "presently engaged in commercial or business activities"); *In re Offer Space, LLC*, 629 B.R. 299, 305-06, 70 Bankr. Ct. Dec. (CRR) 45 (Bankr. D. Utah 2021) (requiring that a subchapter V debtor be "currently," not formerly, engaged in business); *In re Ikalowych*, 629 B.R. 261, 70 Bankr. Ct. Dec. (CRR) 44 (Bankr. D. Colo. 2021) (holding that "currently engaged" in commercial or business activities encompasses time periods "immediately preceding and subsequent to the Petition Date"); *In re Thurmon*, 625 B.R. 417, 69 Bankr. Ct. Dec. (CRR) 165 (Bankr. W.D. Mo. 2020); *In re Johnson*, 2021 WL 825156, *6-*8 (Bankr. N.D. Tex. 2021) (holding that a debtor that manages a business is an employee, not an owner, and was therefore not engaged in commercial or business activities solely on the basis of the debtor's employment); *In re Vertical Mac Construction*, LLC, 2021 WL 3668037, *3-4 (Bankr. M.D. Fla. 2021) (holding that a debtor with no operations at the time of filing but which did engage in activities such as maintaining bank accounts and dealing with insurance issues and claims, and which sought to sell its business in subchapter V did thereby conduct sufficient commercial or business activities to qualifying as a debtor under subchapter V).

[18] See *In re Wright*, 2020 WL 2193240, *1 (Bankr. D. S.C. 2020) (rejected by *In re Ikalowych*, 629 B.R. 261, 70 Bankr. *Ct*. Dec. (CRR) 44 (Bankr. D. Colo. 2021)); *In re Blanchard*, 69 Bankr. Ct. Dec. (CRR) 16, 2020 WL

The eligibility of nonprofit entities to proceed under subchapter V has also been tested under the "commercial or business activities" standard. At least two courts have concluded that there is no requirement that a subchapter V debtor be engaged in for-profit business to qualify for subchapter V.[19]

5:6. Who should be a Subchapter V debtor?

As we say in our introduction, because traditional chapter 11 is not a panacea for smaller businesses, many of them have availed themselves of chapter 11 alternatives. Principal among such alternatives are "friendly" Article 9 foreclosures, assignments for the benefit of creditors, and out of court workouts.

A detailed discussion of such alternatives is beyond the scope of this chapter, but here is a concise summary of the three most likely options:[20]

- **Article 9 "friendly" foreclosure.** Article 9 of the Uniform Commercial Code gives commercial lenders a mechanism for liquidating their collateral through a sale that can be public (auction) or private. In a "friendly" Article 9 foreclosure, an owner of the collateral assets agrees to the process, typically in exchange for relief on a loan guaranty or similar benefit. The sale itself might be nominally "public" (with limited notice of sale) but is essentially a private sale to a previously identified buyer, who may also be a friendly (and a potential source of continued employment for the current owner). A friendly foreclosure conducted to sell a struggling business as a going concern can be quick and cost-effective alternative to selling the same assets in a §363 sale in bankruptcy. But there potential pitfalls lurk. Failure to comply with strict statutory requirements or to conduct the process in a commercially reasonable manner can draw legal challenges to the sale. The buyer may face successor liability issues. Finally, and this is critical: an Article 9 sale can be used to sell only personal property, not real estate.[21]

4032411, *2-3 (Bankr. E.D. La. 2020) (rejected by *In re Ikalowych*, 629 B.R. 261; *In re Bonert*, 619 B.R. 248, 255 (Bankr. C.D. Cal. 2020) (rejected by *In re Ikalowych*, 629 B.R. 261); *cf. In re Port Arthur Steam Energy, L.P.*, 629 B.R. 233 (Bankr. S.D. Tex. 2021) (holding that subchapter V debtor does not need to maintain core or historical business operations to be engaged in business or commercial activities sufficient to qualify for subchapter V).

19 See *In re Ellingsworth Residential Community Association, Inc.*, 619 B.R. 519 (Bankr. M.D. Fla. 2020); *accord* In re RS Air, LLC, 638 B.R. 403, 405, 413 (B.A.P. 9th Cir. 2022) (concluding that no profit motive is required for a debtor to qualify for subchapter V relief).

20 For more information about these (and all) alternatives, *see* §§1:1 et seq., 6:1 et seq. to 9:1 et seq., 11:1 et seq. to 13:1 et seq., and 16:1 et seq.; *see also* Friedland, O'Connor, Jouglaf, *Dealing with Corporate Distress 07: Chapter 11 is Not Always the Answer: Strategic Alternatives For and Against Distressed Businesses* (April 27, 2021).

21 For more about Article 9, see *Dealing with Corporate Distress 12: Meet Our Little Friend, The UCC* and *Dealing With Defaults Under Article 9 of UCC: A Player's Guide for the 21st Century*.

• **Assignment for the benefit of creditors (ABC).** An ABC is either a statutory or common law process (depending on the state) that provides a comprehensive, orderly scheme to address all assets and liabilities of the business (although not quite to the extent available in bankruptcy). In an ABC, the business assigns its assets to an "assignee" (a trustee) who administers the assets of the business for the benefit of creditors. Not all states recognize ABCs. Some states that recognize them have comprehensive statutes to govern them. Others do not; in some states, ABCs are court-supervised, and in others, they are not. Irrespective of these differences, ABCs in every state that recognizes them have some clear similarity to chapter 7 bankruptcy: creditors receive notice, file claims, and are paid under a priority scheme. An ABC can be a vehicle for ownership to recapture their business by purchasing the company/assets from the assignee, free of claims. Three critical (but by no means the only) differences between bankruptcy and an ABC are that an ABC has no automatic stay, the assignment of a lease or contract requires the counterparty's consent, and there is usually no authority to pursue preference actions.[22]

• **Out of court workout.** This is what it sounds like: a direct negotiation with one or more creditors (typically, no more than a small handful) leading (they hope) to a resolution and path forward. An out of court workout is a viable path primarily for dealing with just a few creditors (*e.g.*, a senior lender, landlord, one or two major vendors) while conducting business as usual with other creditors and business parties. The more parties to negotiate with, the more unwieldy this approach becomes, and there is no protection from creditor action (*e.g.*, no automatic stay) while the negotiations are ongoing.

The limitations and other negatives of these alternatives, as compared to subchapter V, may make subchapter V the best option, but maybe not. It may be that the debtor's goals (or the goals of a prospective buyer of the business with whom the debtor wants to do a deal, or the goals of a secured creditor who is calling the shots[23]) are limited in a way that makes the

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[22] For more information information about ABCs, see *The Road to an Assignment for the Benefit of Creditors (ABC): A Case Study*.

[23] Outside of bankruptcy, senior secured lenders whose liens cover substantially all assets of the distressed debtor's business have considerable control through the loan agreements. When a debtor defaults under such loan agreement, the debtor may request the secured lender's forbearance from executing on its collateral. But such forbearance comes at a price, including sometimes drastic concessions by the debtor. Lacking another source of financing (distressed debtors typically cannot get alternative financing since all their assets are already pledged to secure their existing indebtedness), the debtor may accede to a number of creditor demands, including granting the secured creditor: veto power over the debtor's expenditure of funds; plus significant authority over the debtor's business decisions, such as which creditors will be paid and when, as well as the manner in which the debtor will conduct its business, whom the debtor will retain and hire (including turnaround advisors), which assets will be held and which sold, and whether the debtor will file chapter 11 to reorganize or liquidate its assets.

The strategy a creditor is likely to push on the debtor will depend on whether creditor is *undersecured* or *oversecured*.

Within a bankruptcy case, senior secured creditors often continue to indirectly maintain substantial control over the

advantages of subchapter V irrelevant.

5:7. What is the difference between a small business debtor and a Subchapter V debtor?

This can be a confusing question, even to many bankruptcy attorneys, because the plain language of the Bankruptcy Code is not as straightforward as it could be on the subject. It's not that complicated, however:

- Section 1182(1)(A), recall, provides the definition of a subchapter V debtor, which includes the $7,500,000 cap on qualifying debt.

- A chapter 11 debtor is a "small business debtor" if its eligible debts are less than $3,024,725. *See* Bankruptcy Code §101(51D). That section's definition of the term is essentially identical to the definition of the term "debtor" found in §1182(1)(A).

- One other key difference, however, is that it appears that a chapter 11 debtor that qualifies as a "small business debtor" and does not elect subchapter V *must* proceed in a "small business case," which has certain unique attributes that are supposed to be beneficial to the debtor (but are not, in all cases, in the authors' opinion). We outline some of these differences in the chart in the next section.

- If the debtor is a small business debtor, then it may *elect* to have subchapter V apply. If it so elects, it must do so when it files its voluntary petition[24], and then it is a debtor under

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debtor's business. A debtor's major pre-petition lenders commonly provide or participate in a debtor-in-possession ("*DIP*") loan to the debtor. As a DIP lender, a pre-petition creditor can use the terms of the DIP financing agreement to direct or constrain the debtor's management, by, for example, requiring the debtor to meet certain cash-flow milestones or requiring it to confirm a plan of reorganization within a specific amount of time (possibly effectively requiring, if such milestones are not met, the debtor to sell its assets under section 363 of the Bankruptcy Code, in which sale the secured creditor may purchase the assets of the debtor by credit bidding).

Sometimes, a secured creditor may try to use the DIP financing to make a play for ownership of the reorganized entity post-emergence. Upon entering chapter 11, such a debtor may seek to finance its operations using encumbered cash over which the secured creditor has control. The debtor typically files a "cash collateral motion," which frequently contains terms similar to those found in motions for DIP financing, asking the court to permit the debtor to use senior creditor's cash collateral. The debtor's ability to strike a deal with its secured creditor on cash collateral and DIP financing, at minimum, affects the timing of a bankruptcy filing. For an in-depth discussion of the often-intertwined processes of DIP financing and authorizations of use of a secured creditor's cash collateral, *see* Friedland, *et al.*, Commercial Bankruptcy Litigation §§5:1 et seq.

However, the more control the creditor asserts, the greater the risk of incurring liability for financial losses directly or indirectly caused by the secured creditor's wrongful conduct. For an in-depth discussion about lender liability, *see* §§15:1 et seq.

[24] Fed. R. Bankr. P. 1020(a).

subchapter V.[25] If it does not so elect, then it is a small business debtor proceeding in a "small business case."[26]

With all of that as background, the punch line is that a small business case is not all that different than a traditional chapter 11 case. Both, however, are pretty different than a subchapter V case-or else this chapter would have been a waste of time for us to write and a waste of your time to read.

We juxtapose for you some of the key differences between all three:

Comparison Chart

	Traditional Chapter 11 Case	Small Business Case	Subchapter V Case
Debt Limit	No limit	Not more than	Not more than

[25] This should not be right, technically speaking. The reason is because the Bankruptcy Code's definition of "small business debtor" was not amended by the CARES Act, even though it amended §1182(1) to expand the debt threshold for debtors electing subchapter V administration. The result is that without some additional changes to the language, the definitions would not work. Let us explain it from a different angle: the definition of "debtor" in §1182(1) *before* the CARES Act was short and sweet; the entirety of its language was: "[t]he term 'debtor' means a small business debtor." That's it; just eight words. It had to be amended, however, to the way it reads now, to take into account the change in the debt limit in subchapter V in the face of §101(51D) not being similarly revised. The terms "subchapter V debtor" and "subchapter V case," by the way, are not defined by the Code. They are just shorthand. Subchapter V of the Code is titled "Small Business Debtor Reorganization" (which itself is confusing, given that if a small business debtor does not elect subchapter V status, then it is in a "small business case.").

[26] 11 U.S.C.A. §101(51C). The language in Section 101(51C) and Bankruptcy Rule 1020(a) suggest that a "small business debtor" is automatically subject to certain rules unique to a "small business case"-including certain reporting and compliance requirements which are more onerous than a conventional chapter 11 case and a shortened plan timeline that limits the debtor's flexibility. In other words, a small business debtor cannot elect to proceed in a conventional chapter 11, which has more flexibility. *See, e.g., In re Roots Rents, Inc.*, 420 B.R. 28, 52 Bankr. Ct. Dec. (CRR) 130, Bankr. L. Rep. (CCH) P 81650 (Bankr. D. Idaho 2009); *In re Childs*, 64 Collier Bankr. Cas. 2d (MB) 1305, 2010 WL 5108754 (Bankr. D. Utah 2010) (unpublished).

In both cases, the debtors had elected to proceed in a small business case and then tried to rescind the election. In *Roots Rent*, the court denied the attempt, finding that the debtor did not prove that its petition date debts exceeded the small business debtor ceiling. In *Childs*, the court determined that the debtor, for other reasons, was not, in fact, a small business debtor and could proceed in a conventional chapter 11. See also *In re Swartville, LLC*, 483 B.R. 453 (Bankr. E.D. N.C. 2012) (debtor could rescind erroneous election as small business debtor). Although *Roots Rent*, in particular, contains a lengthy discussion about the mandatory nature of a small business debtor proceeding in a small business case, none of these decisions address what would happen to a debtor that qualified to be a "small business debtor" but did not designate itself as one. Curiously, at least one preeminent treatise on current legal practice, in its chapter on small business cases (which chapter expressly excludes subchapter V), repeatedly refers to proceeding in a small business case as an election. *See Small Business Chapter 11 Case: Overview* (West Practical Law, Thompsons Reuters, 2021). In the authors' opinion, there are practical and legal problems with forcing an eligible chapter 11 debtor to proceed in a small business case if it elects not to--a discussion for another time.

	Traditional Chapter 11 Case	Small Business Case	Subchapter V Case
		$3,024,725	$7,500,000
Categorization / Identification	Applies to a chapter 11 debtor that does not proceed as a small business debtor in a small business case.	Debtor indicates it is a "small business debtor" by checking a box on the Petition. Proceeding as a small business case may be mandatory for a "small business debtor" as defined in §101(51D) even if it does not indicate that status on the Petition and also doesn't elect to proceed under subchapter V. *See* Note 22, *supra*.	Requires election to proceed under subchapter V and the Debtor must meet the requirement.
Business / Property Type	Limited restrictions[27]	Must not have its primary business be ownership of single asset real estate. *See* §101(51D).[28] Must not be a corporation or its affiliate of a corporation that is subject to reporting requirements under §13 or 15(d) of the Securities and Exchange Act of 1934. *See* 15 U.S.C.A. §§78m & o(d).	Same as small business case.
Creditors Committee	Mandatory (subject to eligible creditors	Not appointed unless the court appoints one	Same as small business case.

[27] A municipality or similar governmental unit must proceed under chapter 9 in those jurisdictions that authorize such filings. Railroads and broker/dealers may proceed under chapter 11 but subject to certain unique requirements.

[28] What constitutes "single asset real estate" - or SARE in bankruptcy-speak - can be a point of contention in bankruptcy cases. See, e.g., In re Evergreen Site Holdings, Inc., 2023 WL 4503880 (Bankr. S.D. Ohio, June 21, 2023) (debtor whose income derived entirely from two contiguous parcels of real estate leased for different commercial uses was not a SARE and therefore remained eligible for subchapter V).

	Traditional Chapter 11 Case	Small Business Case	Subchapter V Case
	willing to serve). *See* §1102	for cause. *See* §1102(a)(3).	
Trustee	Chapter 11 trustee can be appointed for cause. *See* §1104.	Chapter 11 trustee can be appointed for cause (§1104)	subchapter V trustee is automatically appointed. *See* §1183. Duties expand pursuant to §1183(b)(4) if debtor is removed as debtor in possession under §1185(a).
Reporting requirements	Monthly reports of cash receipts and disbursements (operating reports)	§308(b) provides that a debtor in a small business case shall file "periodic financial and other reports" detailing: --Profitability -- Projections of future receipts and disbursements --Actual v. projected receipts and disbursements -- Compliance (reporting, etc)	Must comply with the requirements of §1116(1)(A) and (B) as well as the requirements for small business case under §308 (*see* §1187(1) and (2)). *See also* Fed. R. Bankr. P. 2015(a)(6).
Initial Debtor Interview	None	U.S. Trustee must conduct initial interviews with small business debtors prior to the first meeting of creditors (28 U.S.C.A. §586(7)).	Same as small business case.
Meeting of Creditors (§341)	Shall be convened by the US Trustee within a reasonable time after the Petition Date.	Same	Same
Automatic Stay	Applies with very limited exceptions. *See* §362.	Small business debtor is not entitled to the protection of the automatic stay if it had been a debtor in a case dismissed within one year prior, or if it had been a debtor in a case	Same as small business case.

	Traditional Chapter 11 Case	Small Business Case	Subchapter V Case
		for which a plan was confirmed within two years prior, or if the debtor had acquired substantially all the assets of a small business debtor within two years prior. *See* §362(n).	
Absolute Priority Rule	Applies	Applies	Does not apply.
Equity	Wiped out unless creditors paid in full or new value contributed.	Wiped out unless creditors paid in full or new value contributed.	Equity can be retained without paying creditors in full
Plan Filing and Confirmation Deadline	No absolute time limit.	Plan must be filed within 300 days of the filing date (§1121(e)) and confirmation must occur within 45 days of the filing of the plan (§1129(e)) unless the court extends the deadline for cause.	Plan must be filed with 90 days of the Petition Date, unless extended for cause §1189(b). The Bankruptcy Code does not state what happens if this deadline is not met.
Plan Exclusivity[29]	120 days after the Petition Date (extendable for cause). *See* §1121(b).	180 days after the Petition Date (extendable for cause) but not later than 300 days unless period is further extended upon proof that it is more likely than not the court can confirm a plan within a reasonable period. *See* §1121(e)(1) and (2).	Only the debtor may file a plan *See* §1189(a).
Disclosure Statement	Disclosure statement must be filed unless court excuses upon	Must file a disclosure statement, except that court may allow plan to	No disclosure statement is required, as §1125 does not apply in subchapter V

29 Refers to the period in which the debtor has the exclusive right to file a plan.

	Traditional Chapter 11 Case	Small Business Case	Subchapter V Case
	motion. *See* §1125.	proceed without separate disclosure statement if plan itself contains "adequate information" for creditors. *See* §1125(f).	unless the court orders otherwise for cause. *See* §1181(b).
US Trustee Quarterly Fees	Payable per statute. *See* 28 U.S.C.A. §1930(a)(6).	Payable per statute. *See* 28 U.S.C.A. §1930(a)(6).	No UST fees

5:8. How does a debtor elect Subchapter V treatment?

A debtor must affirmatively elect[30] for its case to proceed under subchapter V at the time it files its chapter 11 petition. Parties in interest have 30 days after the conclusion of the §341 meeting of creditors (or 30 days after the debtor amends its petition electing such treatment, if later) to object to a debtor's subchapter V election.[31]

5:9. Why is Subchapter V better than traditional Chapter 11?

Funny but true answer #1: it's not. Not if you are an unsecured creditor.

Funny but true answer #2: how much time do you have?

There are four main advantages, as compared to a traditional chapter 11:

(a) Creditors' committees are the exception rather than the rule;[32]

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30 The statute doesn't explicitly discuss how the debtor can make the subchapter V election. However, Official Form 201 (Voluntary Petition for Non-Individuals Filing for Bankruptcy) has added a section requiring the debtor to check a box indicating it seeks subchapter V treatment.

31 See Fed. R. Bankr. P. 1020(b). *See also*, Best, ABI Journal December 2020, *Challenging the Sub-V Election* (discussing potential means for parties to attack a debtor's subchapter V election under §1182(1)(B)).

32 11 U.S.C.A. §1102 provides for the appointment of creditors' committees in chapter 11 cases. 11 U.S.C.A. §1103 sets forth the powers and duties of such committees. 11 U.S.C.A. §1181(b) provides that, excepting 11 U.S.C.A. §1102(a)(3), neither 11 U.S.C.A. §1102 nor 11 U.S.C.A. §1103 applies to a subchapter V case, unless the court orders otherwise. 11 U.S.C.A. §1102(a)(3) expressly provides that "[u]nless the court for cause orders otherwise," a committee may not be appointed in a small business case or a subchapter V case.

The co-sponsor (Rep. David Cicilline (RI)) of the Small Business Reorganization Act stated that the bill sought to "streamline the financial reorganization of small business" and redress the gap in the Bankruptcy Code deriving from its design being keyed to large and complex corporations "by requiring the appointment of a trustee to monitor these cases and giving cases greater flexibility to approve small business reorganization plans in a fair and equitable

(b) There are no United States Trustee quarterly fees;[33]

(c) Disclosure statements are the exception rather than the rule;[34] and

(d) Plan confirmation is easier to achieve--for a variety of reasons but most notably because the owner(s) of a subchapter V debtor may confirm a plan that provides for the owner(s) to retain 100% of the debtor's equity even if even if non-accepting unsecured creditors are not paid in full.

This elimination of the Absolute Priority Rule (defined below) in subchapter V is groundbreaking and is the single most critical distinction between a traditional chapter 11 and one that proceeds under subchapter V.[35]

Don't think, however, that subchapter V is a cakewalk.[36]

There remain stringent substantive and procedural protections for parties in interest. In the confirmation context, for example, if a subchapter V debtor crams down its plan under §1191(b), then there are two consequences:

(a) §1192 provides that the debtor will not receive a discharge until all plan payments are made;[37] and

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manner." 165 Cong. Rec. H7217-41, 2019 WL 3307648 (July 23, 2019). The monitoring function of the committee in traditional Chapter 11 cases consumes debtor resources, which may be a good trade-off in larger cases but a bad trade-off in small cases, which each have a Subchapter V trustee appointed.

[33] 28 U.S.C.A. §1930(a)(6) requires each chapter 11 debtor except, expressly subchapter V debtors, to pay a quarterly fee to the United States Trustee, for deposit into the United States Treasury Department. It is axiomatic that small debtors are more burdened than large debtors by quarterly chapter 11 fees. It follows that eliminating such fees will encourage more small businesses to reorganize under subchapter V.

[34] A subchapter V debtor is not required to file a disclosure statement unless the court orders otherwise for cause. If the court does so order, the existing disclosure statement requirements for small business cases in 11 U.S.C.A. §1125(f) will apply.

[35] *See* §5:10.

[36] The etymology of this word is fascinating, and troubling. *See* "The Extraordinary Story Of Why A 'Cakewalk' Wasn't Always Easy" by Lakshmi Gandhi and published by NPR on Dec. 23, 2013, visited on Jan. 25, 2024.

[37] In subchapter V, if the debtor confirms a consensual plan, the debtor receives a discharge of pre-petition debts upon confirmation. See §1191(a), incorporating §1141(d).

In a cramdown, §1192 makes that discharge conditional on completion of plan payments. And, in either case, the Code's nondischargeability provisions under §523(a) may apply to specific debts and creditors. §523(a)

(b) §1186 provides that "property of the estate" includes more than the property specified in §541. Specifically, it will also include:

i. all property of the kind specified in §541 that the debtor acquires between the date the case commenced and closing, dismissal, or conversion of the case; and

ii. all earnings from services the debtor performs during that same period.

5:10. Why is confirmation easier in Subchapter V than in traditional Chapter 11?—Exclusivity

Unlike traditional chapter 11, where parties other than the debtor are allowed to file a plan, §1189(a) allows only the debtor to file a plan. The debtor, however, must file a plan within 90 days after the bankruptcy filing (unless the court extends the deadline).[38]

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lists categories of wrongdoing – for example, fraud or intentional harm - by the debtor that can lead to debts being non-dischargeable as to a specific creditor or creditors.

In a conventional chapter 11, §523 exceptions to discharge apply solely to individual debtors. In subchapter V, notably, a split has developed with respect to whether §1192 makes the nondischargeability provisions of §523(a) applicable to corporate debtors in addition to individual subchapter V debtors. The Fourth Circuit has adopted the view that §1192 applies to all subchapter V debtors. *In re Cleary Packaging, LLC*, 36 F.4th 509 (4th Cir. 2022). However, several bankruptcy courts in other circuits have concluded that it applies only to individual debtors in subchapter V. *See In re GFS Indus., LLC*, 647 B.R. 337 (Bankr. W.D. Tex. 2022), motion to certify appeal granted, No. 22-50403-CAG, 2023 WL 1768414 (Bankr. W.D. Tex. Feb. 3, 2023); *In re Hall*, No. 3:22-AP-00062-BAJ, 2023 WL 2927164 (Bankr. M.D. Fla. Apr. 13, 2023); *In re 2 Monkey Trading, LLC*, No. 6:22-BK-04099-TPG, 2023 WL 3145124 (Bankr. M.D. Fla. Apr. 28, 2023); *In re Lapeer Aviation, Inc.*, No. 21-31500-JDA, 2022 WL 1110072, at *2 (Bankr. E.D. Mich. Apr. 13, 2022); *In re Rtech Fabrications, LLC*, 635 B.R. 559, 564 (Bankr. D. Idaho 2021); *In re Satellite Restaurants Inc. Crabcake Factory USA*, 626 B.R. 871, 876 (Bankr. D. Md. 2021).

[38] The standard delineated in 11 U.S.C.A. §1189(b) is that "the court may extend the period if the need for the extension is attributable to circumstances for which the debtor should not be held accountable." In *In re Trinity Legacy Consortium, LLC*, 2023 Bankr. LEXIS 2349, at *18-26 (Bankr. D.N.M Sept. 25, 2023) the court considered equitable factors to determine whether to grant an extension under §1189(b) and held that the debtor's efforts to reach settlements, the positive effect of settlements on a successful plan, the potential prejudice to all parties if there is no agreement, and the reasonable length of the requested extension all supported granting an extension.

In *In re Baker*, 625 B.R. 27, 36 (Bankr. S.D. Tex. 2020), the court considered (1) whether the circumstances raised by the debtor were within his control; (2) whether the debtor had made progress in drafting a plan; (3) whether the deficiencies preventing that draft from being filed are reasonably related to the identified circumstances; and (4) whether any party in interest has moved to dismiss or convert the debtor's case or has objected to the requested extension; *see also In re HBL SNF, LLC*, 635 B.R. 725, 730-31 (Bankr. S.D. N.Y. 2022) (granting a motion to extend the debtor's plan filing deadline where plan provisions relating to rent payments were contingent on the bankruptcy court's resolution of a dispute between nondebtor parties); *In re Greater Blessed Assurance Apostolic Temple, Inc.*, 624 B.R. 742, 744-345 (Bankr. M.D. Fla. 2020) (denying debtor's request to extend plan filing deadline where debtor could have redesignated under subchapter V months earlier, had failed two times to confirm plans in non-subchapter V cases and "repeatedly violated this Court's rules and the Bankruptcy Code"); and *In re Online King LLC*, 629 B.R. 340, 347 (Bankr. E.D. N.Y. 2021) (nothing in §1189 prohibits the Court from extending

5:12. Why is confirmation easier in Subchapter V than in traditional Chapter 11?--Exclusivity-- Different confirmation standards-- Confirmation in traditional Chapter 11

Stop the train! And back it up a bit. That is, if you do not happen to be a business bankruptcy attorney, then we need to give you at least a basic understanding of what it takes to confirm a plan in a *traditional* chapter 11. Only then can we contrast it to the requirements in subchapter V.

The Bankruptcy Code is well-organized and easy to navigate (at least compared to many other statutes). In traditional chapter 11, a plan must meet the requirements set out in §1129 in order to be *confirmed*. Think of §1129(a) as a checklist of all the things a plan has to include or provide to be confirmed. Then think of §1129(b) as a second pathway to confirmation if the plan cannot satisfy each element of §1129(a).

There are 15 separate requirements in §1129(a), numbered (a)(1) through (a)(15).[39] Some are usually harder to satisfy than others. One in particular--(a)(8)--is excused by §1129(b)(1) if the plan "does not discriminate unfairly" and is "*fair and equitable* as to each *class of claims or interests* that is *impaired* under, and has not *accepted*, the plan."[40]

The italicized words cannot be understood simply by using one's common sense and comprehension of the English language. Each is a legal term of art defined elsewhere in the Bankruptcy Code, by case law, and in some cases both. The term "fair and equitable," for example, is defined by §1129(b)(2).

(Don't allow your eyes to start glossing over now; we're just about to get to the critical part.)

We need to back up just a little more before we move on.

What does §1129(a)(8) require? It requires every class under the plan either to accept the plan or to not be impaired by the plan. So, if neither is the case, the plan can't be confirmed under §1129(a). And *that* is where §1129(b)(1) comes in.

Section 1129(b)(1), again, essentially says, "if your plan meets every requirement of

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the plan filing deadline after the original deadline has expired).

39 A detailed discussion of confirmation in traditional chapter 11 is beyond the scope of this chapter. For a couple of plain English summaries, *see* Friedland, *et al.*, Commercial Bankruptcy Litigation §§10:1 *et seq.* (2021 ed.); Kuney and Friedland, *Dealing with Distress for Fun and Profit--Installment 7--Plan Confirmation*, *DailyDAC* (Feb. 16, 2016); Friedland and O'Connor, *Dealing with Distress for Fun and Profit--Installment 18--How to Confirm a Chapter 11 Plan*, *DailyDAC* (Oct. 18, 2018); and Friedland and O'Connor, *Dealing with Distress for Fun and Profit--Installment 19--Chapter 11 Plan Acceptance, Getting a Class to Accept a Plan*, *DailyDAC* (Feb. 19, 2019).

40 11 U.S.C.A. §1129(b)(1) (emphasis added).

§1129(a) except §1129(a)(8), you can still confirm your plan under §1129(b).” This manner of confirmation is what is popularly called “*cramdown*.” When a plan proponent crams down a plan, it does so on a class (or more than one class) that both is impaired under the plan, and which has not accepted the plan.

Now we can go back to §1129(b)(2). Again, it defines “fair and equitable,” and it does so differently depending on whether the class at issue is composed of a secured claim, composed of unsecured claims, or composed of equity interests.

(*Stay with us, we're almost there.*)

A plan is fair and equitable as to a class of unsecured claims if the plan provides that *either* (a) each holder of a claim in that class “will receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; *or* (b) no junior class will receive or retain anything under the plan on account of its claim.”[41]

Now we'll say it in plain English: a plan in a traditional chapter 11 or non-subchapter V small business chapter 11 satisfies the test as to a class of unsecured claims if either: (a) members of the class will be paid in full on their allowed claims, either in full on the effective date or over time and with a market rate of interest; or (b) no junior class gets anything under the plan. This, which we mention in Section 5:9 above, *is the “Absolute Priority Rule”*[42] and, again, *the existence of the Absolute Priority Rule in chapter 11 cases (and its nonexistence in subchapter V chapter 11 cases) is the principal reason why subchapter V is so good.*

Assume you (or your fund, family office, etc.) owns XYZ, Inc. You are considering a chapter 11 filing for XYZ, Inc. because the debt on its balance sheet is killing the company. You can use traditional chapter 11 to restructure the balance sheet and right-size the company, no problem. But unless you can pay all unsecured classes 100% of what they are owed, or you know they will voluntarily agree to less, your equity will be wiped clean. Stated another way, the company can emerge from traditional chapter 11 with a beautifully clean balance sheet, but the only problem is that the equity will be owned by someone else.

This is the most challenging problem a debtor faces in traditional chapter 11 that subchapter V solves.

5:13. Why is confirmation easier in Subchapter V than in traditional Chapter 11?--Exclusivity-- Different confirmation standards-- No absolute priority rule in Subchapter V in a cramdown of unsecured creditors

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41 11 U.S.C.A. §1129(b)(2)(B).

42 For more about the Absolute Priority Rule, *see* Friedland, *et al.*, Commercial Bankruptcy Litigation §10:20 (2021 ed.); Mark Melickian, *Legacy of the Jevic Case: Structured Dismissals Five Years After the Fall*, *DailyDAC* (Jan. 19, 2022) .

The Absolute Priority Rule simply doesn't exist in subchapter V. To be more precise, to cramdown a subchapter V plan on a class of unsecured claims or interests, the plan *still* cannot discriminate unfairly, and *still* must be fair and equitable. *The difference is that the definition of "fair and equitable" is different in subchapter V.* No longer does cramdown require that members of the crammed down class be paid in full or, in the alternative, that classes junior to it get nothing.

Instead, Bankruptcy Code §1191(c)(2) now provides that a plan is fair and equitable as to a class of unsecured creditors or to a class of interests if at least one of two things is true: either the plan applies all of its "projected disposable income" over three to five years to payments under the plan;[43] or the value of the property to be distributed under the plan in that same timeframe is not less than the debtor's projected disposable income.[44]

The latter standard is modeled on §1225(b)(1)(C), which was added to chapter 12 of the Bankruptcy Code in the 2005 BAPCPA amendments to provide family farmers with more flexibility in the timing of their plan payments to accommodate the cyclical nature of farming. As one court has noted, "§1191(c)(2)(B) allows subchapter V debtors to pay more than, but not less than, their projected disposable income in a particular period and to control the timing of payments."[45]

5:14. Why is confirmation easier in Subchapter V than in traditional Chapter 11?-- Exclusivity-- Different confirmation standards-- Cramdown excuses more than just §1129(a)(8)

We wrote in Section 5:12 above that in a traditional chapter 11 case:

> §1129(b)(1) ... essentially says, 'if your plan meets every requirement of §1129(a) except §1129(a)(8), you can still confirm your plan under §1129(b). This manner of confirmation is what is popularly called 'cramdown.'

Another key difference between traditional chapter 11 and subchapter V is that in subchapter V cases the debtor can satisfy the cramdown requirements and confirm a plan that, in addition to failing to satisfy §1129(a)(8), may also fail to satisfy §1129(a)(10) and (a)(15).

Bankruptcy Code §1129(a)(10) requires that, in a traditional chapter 11 case, if a class of claims is impaired under a plan, at least one class of impaired claims must accept the plan (determined without including any acceptance of the plan by any insider). By doing away with

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43 11 U.S.C.A. §1191(c)(2)(A).

44 11 U.S.C.A. §1191(c)(2)(B).

45 See *In re Young*, 2021 WL 1191621, *4, n.9 (Bankr. D. N.M. 2021) (debtor's plan which included variable distributions to creditors based on seasonal variations in the debtor's business income satisfied §1191(c)(2)(B)).

this requirement, a subchapter V debtor can cramdown a plan even if *no* impaired class of claims accepts the plan.

Bankruptcy Code §1129(a)(15) pertains to individual chapter 11 debtors and requires that:

> In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan—
>
> (A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in §1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.[46]

Subchapter V cramdown does not, therefore, require that an individual debtor's plan meet the projected disposable income requirement of §1129(a)(15) if the subchapter V debtor is cramming its plan down under §1191(b). But as we discuss in below, every subchapter V debtor (not just an individual) seeking to cramdown a subchapter V plan) must meet a distinct projected disposable income standard.

In the case of an individual debtor, as Judge Bonapfel notes in *A Guide to the Small Business Reorganization Act of 2019*, the projected disposable income rule in subchapter V comes into play only if one or more *classes* do not accept the plan, because in a non-subchapter V case, a single creditor can hold up confirmation by invoking §1129(a)(15).[47]

5:15. Why is confirmation easier in Subchapter V than in traditional Chapter 11?--Exclusivity-- Different confirmation standards-- Administrative claims may be paid over time under a cramdown plan

In traditional chapter 11, a plan must pay administrative and gap claims in full on the plan's effective date unless the particular claim holder agrees otherwise.[48] Bankruptcy Code

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46 11 U.S.C.A. §1129(a)(15).

47 Hon. Paul W. Bonapfel, A Guide to the Small Business Reorganization Act of at 122 (last rev'd and updated June 2022) ("*Bonapfel*"). In this seminal work, United States Bankruptcy Judge for the Northern District of Georgia thoroughly analyzed subchapter V's provisions before it took effect. He later updated it in May 2020 to reflect the influence of the CARES Act amendments to the Bankruptcy Code affecting subchapter V, among other things, and again in June 2022). The authors thank Judge Bonapfel for compiling an indispensable resource for any practitioner unfamiliar with the provisions of subchapter V and its potential effects on business bankruptcy practice.

48 11 U.S.C.A. §1129(a)(9)(A).

§1191(e), however, provides that a plan crammed down in subchapter V may provide for payments of these claims over time.[49]

5:16. Why is confirmation easier in Subchapter V than in traditional Chapter 11?--Exclusivity-- Different confirmation standards-- Projected disposable income

Bankruptcy Code §1191(c)(2)(a) requires that, for a subchapter V debtor to confirm a plan without consent (*i.e.*, cramdown), the plan must provide that all of the debtor's "projected disposable income" during the life of the plan be committed to paying claims. As observed by the court in *In re Moore Properties of Pers. Cty.*,[50] this projected income requirement is, in essence, the subchapter V substitute for the Absolute Priority Rule applicable in non-subchapter V chapter 11 cases.

This "projected disposable income," or "best efforts," test is not a new concept in bankruptcy, but its incorporation into subchapter V (and specifically its application to non-individual chapter 11 debtors) is. In chapters 12 and 13 of the Bankruptcy Code, the term "disposable income" is a defined term.[51] And in individual chapter 11 cases, §1129(a)(15) incorporates the definition from chapter 13.

Section 1191(d) tells us that in subchapter V, a debtor's "disposable income" is "the income that is received by the debtor and that is not reasonably necessary to be expended" for the following specific purposes:

(a) maintenance or support of the debtor or a debtor's dependent;

(b) domestic support obligations arising after the petition date of the subchapter V case; or

(c) payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor.

This definition is nearly identical to the chapter 12 and 13 definitions,[52] with the most

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[49] In a subchapter V case cramdown, unsecured creditors are to receive their portion of the stream of monthly payments of projected disposable income of the debtor, as provided in 11 U.S.C.A. §1191. 11 U.S.C.A. §1191(e) permits confirmation of a plan in which administrative claims are not paid in full at confirmation but rather are paid over time- like unsecured claims. The expected effect is to enhance the monthly recovery of unsecured claimholders throughout the initial post-confirmation period. That should increase buy-in by unsecured creditors. A similar effect is achieved by having debtor's counsel-an administrative claimant-accept payment over time.

[50] *In re Moore Properties of Person County, LLC*, 68 Bankr. Ct. Dec. (CRR) 123, 2020 WL 995544, *5 (Bankr. M.D. N.C. 2020).

[51] See 11 U.S.C.A. §§1225(b)(2) and 1325(b)(2).

[52] The chapter 12 definition of "disposable income" for family farmer or fishermen debtors, is "income which

notable difference being that the chapter 13 definition permits debtors to deduct charitable contributions from their disposable income.

Few cases have addressed whether a debtor's plan met the projected disposable income test in subchapter V. In *In re Sizzler USA Acquisition, Inc., et al.*,[53] the Subchapter V trustee objected to confirmation, arguing the plan did not commit the debtor's "actual" disposable income, if higher than the debtor's projections, to pay claims over the life of its plan. The court rejected this argument and confirmed the plan over the subchapter V Trustee's objection.[54] In *In re RS Air, LLC*, the Ninth Circuit Bankruptcy Appellate Panel affirmed confirmation of a subchapter V plan despite the fact that the debtor would have no disposable income in the five years following plan confirmation, and whose primary financial benefit was to provide flow-through tax deductions.[55] Based on an alternative analysis emphasizing this and other benefits, and because the plan was funded by the debtor's sole member and manager in excess of the debtor's *de minimis* expected disposable income, the plan was confirmable.[56]

At least one court has denied confirmation of a subchapter V plan where the debtor failed to adequately support a projected disposable income analysis. In *In re Double H Transportation, LLC*, the court denied confirmation where it found that the debtor "failed to introduce credible evidence supporting its projected disposable income" after conducting a hearing at which the debtor admitted that it had submitted conflicting financial projections in support of its plan and could not give consistent figures to the court in support of the plan.[57]

Looking outside of subchapter V, as Judge Bonapfel did in *A Guide to the Small Business*

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is received by *the* debtor and which is not reasonably necessary to be expended (A) for the maintenance or support of the debtor or a dependent of the debtor or for a domestic support obligation that first becomes payable after the date of the filing of the petition; or (B) for the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business." 11 U.S.C.A. §1225(b)(2).

53 Case No. 20-30748 (Bankr. C.D. Cal. 2020).

54 For a *full* discussion of the *Sizzler* case and its implications, *see* Friedland, Melickian, and Jouglaf, *There Is No Post-Confirmation True-Up of Projected Disposable Income In subchapter V*, The Bankruptcy Strategist, May 2021. *See also In re Pearl Resources LLC*, 622 B.R. 236, 268-69 (Bankr. S.D. Tex. 2020) (the court was not faced with a close decision: the court found that a debtor met the disposable income test where the plan proposed paying the claims of objecting secured creditors in full and provided significant alternative assets from which the creditors' claims could be satisfied in the event the debtor failed to make its plan payments in full within three years); and *In re Ellingsworth Residential Community Association, Inc.*, 2020 Bankr. LEXIS 2897, at *6 (Bankr. M.D. Fla. Oct. 16, 2020) (holding a plan met the disposable income test when it devoted more than the debtor's projected disposable income (in the form of $300,000 special assessment on its members) to pay creditors).

55 *In re RS Air, LLC*, 638 B.R. 403, 407, 415 (B.A.P. 9th Cir. 2022).

56 Id.

57 *In re Double H Transportation LLC*, 2022 WL 1916686, *5-6 (W.D. Tex. 2022).

Reorganization Act of 2019, may prove useful in the near term. In discussing how "projected disposable income" may be interpreted in the context of Subchapter V *business* reorganizations, Judge Bonapfel anticipates that chapter 12 precedent can provide guidance to business debtors who may wish to include plan provisions for establishing cash reserves over time to use for things like anticipated capital expenditures or reinvesting in and growing a business.[58]

5:17. Why is confirmation easier in Subchapter V than in traditional Chapter 11?-- Exclusivity-- Different confirmation standards-- Two words about secured creditors and Subchapter V: "So What?"

The requirements to cramdown a secured creditor are the same in subchapter V as in traditional chapter 11, and the right of a secured creditor to make a §1111(b) election also persists unaltered in subchapter V.[59] Furthermore, the power to make an 1111(b) election gives the secured creditors important leverage in subchapter V, in some cases giving them the power to block a plan, as the debtor must still submit a feasible plan in the event of an 1111(b) election[60] and an 1111(b) election could make the plan payments unfeasible. This is not to suggest (despite our snarky header) that secured creditors are immune from harm in subchapter V, but rather that the degradation of their position in subchapter V is far less than that of unsecured creditors.

5:18. Why is confirmation easier in Subchapter V than in traditional Chapter 11?-- Exclusivity-- Different confirmation standards-- Protecting creditors from plan default

As discussed in Section 5:13 above, even if *all* classes reject a subchapter V debtor's plan, it can still be crammed down on creditors if the plan does not discriminate unfairly[61] and is

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58 See Bonapfel at n. 392 (citing to a host of instructive chapter 12 precedent).

59 There may be some action by courts in interpreting this section in the coming years. *See e.g. In re Caribbean Motel Corp.*, 2022 Bankr. LEXIS 25, at *13-15 (Bankr. D.P.R. Jan. 5, 2022) (finding that congress did not modify section 1111(b)'s application in Subchapter V and collateral valued at 15% of a claim was not inconsequential); *In re VP Williams Trans, LLC*, 2020 WL 5806507 (Bankr. S.D. N.Y. Sept. 29, 2020) (finding that collateral valued at 15.6% of the claim was more than "inconsequential" in value); *see also In re Body Transit, Inc.*, 619 B.R. 816, 834-38, (Bankr. E.D. Pa. 2020) (generally discussing section 1111(b) in the context of subchapter V and rejecting a formulaic approach in holding that 8.2% collateral to claim value was "inconsequential"). Note that a court may, by local rule, limit the time period in which a secured creditor must make its election. *See e.g.*, Local Rule 3014-1, United States Bankruptcy Court, District of Columbia (limiting period to 14 days after filing of plan unless another date is selected by the court).

60 See *In re VP Williams Trans, LLC*, 2020 WL 5806507, at *11-12.

61 Subchapter V still does not allow plans that discriminate unfairly, such as in *In re Topp's Mech.*, 2021 Bankr. LEXIS 3235, at *11-16 (Bankr. D. Neb. Nov. 23, 2021) were the court denied confirmation of a Subchapter V plan with an 1111(b) election on the grounds it discriminates unfairly were the secured creditor would receive an excess payment of over $500,000 more than its claim (in interest) and there is less money available to pay unsecured creditors. This is more than what the 1111(b) election allows as a subchapter V debtor can't pay a secured creditor who makes an 1111(b) election more in interest than the total amount of the claim when a portion of that interest diminished the debtor's disposable income, and thus is at the expense of unsecured creditors.

"fair and equitable" with respect to each class of claims or interests. Bankruptcy Code §1191(c) defines what constitutes "fair and equitable" in a subchapter V case, replacing the "fair and equitable" requirements set forth in Bankruptcy Code §1129(b) for traditional chapter 11 cases. Section 1191(c) institutes a "rule of construction" for determining whether a plan is fair and equitable sufficient to cramdown a subchapter V plan.

With respect to secured claims in subchapter V, §1191(c) does not change the requirement that a plan meet §1129(b)(2)(A)'s requirements for cramming down secured claims under a plan. But partially secured creditors with unsecured deficiency claims are limited in their ability to block confirmation of a subchapter V plan.[62]

Section 1191(c), however, defines "fair and equitable" with respect to unsecured claims and interests to mean that the subchapter V plan, as of its effective date, must either: (a) provides that all of the debtor's "projected disposable income," be received during the 3-5 year term of the subchapter V plan, or that (b) the value of property to be distributed under the plan is not less than the debtor's projected disposable income over the term of the subchapter V plan. 11 U.S.C. §1191(c)(2)(A), (B). We discuss the "projected disposable income," requirement in greater detail in Section 9(b)(ii) above.

Finally, §1191(c) requires that, for a subchapter V plan to be fair and equitable, the debtor must also show that it will (or a reasonable likelihood that it will) be able to make all payments called for under the plan *and* that "the plan provides appropriate remedies, which may include the liquidation of nonexempt assets, to protect the holders of claims or interests in the event that the payments are not made."[63]

Other than providing for the permissive liquidation of nonexempt assets, the final requirement that a subchapter V plan provide "appropriate remedies" to creditors and interest holders in the event of nonpayment is not specific as to what may otherwise constitute "appropriate remedies." Concerning secured creditors, however, this standard can be met very simply, by allowing the secured creditor to retain its lien under the terms of the subchapter V plan.[64]

But with respect to unsecured creditors and interest holders, alternatives to liquidating

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62 "An undersecured creditor with a large deficiency claim often controls the vote of the unsecured class. If no other impaired class of creditors accepts the plan, cramdown confirmation is not possible in a standard or non-subchapter V case because of the absence of an accepting impaired class of claims, which §1129(a)(10) requires." Bonapfel at 139-40.

63 11 U.S.C.A. §1191(c)(3).

64 See Michael Jones, *The New Requirement of Protecting Creditors from Default Under subchapter V,* ABI Journal (March 2021).

estate assets may take many different forms and will likely be the product of negotiated resolutions with creditors active in the subchapter V case, or may otherwise be proposed by the subchapter V Trustee.[65] Thus, "appropriate remedies" are likely to vary from case to case where a debtor's plan does not propose liquidating assets to satisfy creditor claims in the event of a subchapter V plan default.

One commentator suggested the following remedies:

(a) prohibiting the debtor from selling certain assets post-confirmation;

(b) requiring the debtor to grant security interests to unsecured creditors in certain estate assets;

(c) requiring the debtor to arrange third-party guaranties to creditors, providing them with an alternate (presumably healthy) party capable of curing plan defaults; and

(d) requiring debtor to procure a payment bond as insurance against plan defaults.[66]

5:19. How can Subchapter V be used to kill a personal guaranty?

A fundamental issue for smaller (and even larger non-public) debtors is that lenders, landlords, and others who extend significant credit to them often require personal guarantees from their owners. In that very common scenario, chapter 11 for the business alone cannot achieve the goal of really curing the owners' problems because the bankruptcy of a debtor offers no relief for a guarantor.

A potential solution? An individual subchapter V case for the owner-guarantor, pursuant to which guarantee claims against the individual debtor are paid less than 100% from the individual debtor's net disposable income. There are significant advantages to a private business owner who qualifies to pursue a personal subchapter V case, *particularly prior to a subchapter V for the company*. Timing and planning are key, and there are traps for the unwary.[67]

5:20. What is the role of a Subchapter V trustee?

In every subchapter V case, a trustee is appointed under Bankruptcy Code §1183. The subchapter V trustee has specific statutory duties that, generally speaking, charge her with

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65 See, e.g., Bonapfel (discussing the breadth of subchapter V trustee roles in fostering development of a plan).

66 See Michael Jones, *The New Requirement of Protecting Creditors from Default Under subchapter V*, ABI Journal (March 2021).

67 For a more thorough discussion of this approach by attorneys who have used it, *see* Friedland, Jouglaf, *Debtors Can Have Their Cake and Eat It, Too*, ABI Journal (Apr. 2021).

monitoring and oversight functions, the right to appear and be heard on specific matters, facilitate a consensual plan, and act as disbursing agent under a plan confirmed through cramdown. As we note in Section 1, this role is similar to a chapter 12 or 13 trustee.

Subchapter V trustees are selected and appointed by the office of the U.S. Trustee. At its outset, the U.S. Trustee's office "recruited, vetted and trained approximately 250 selectees from more than 3,000 applicants... [with] strong business acumen, and include lawyers, CPAs, MBAs, restructuring consultants and financial advisors with diverse backgrounds in such areas as business, law, accounting, turnaround management and mediation."[68]

Thus, the trustee's role (at least through plan confirmation) can be thought of as akin to a mediator,[69] a disinterested person who (where necessary) can understand the debtor's business and financial matters to work with all parties in the case to reach agreement regarding the terms of the debtor's plan.[70] Once a consensual plan is confirmed, the trustee's role is terminated upon substantial consummation of the plan.[71]

Although the subchapter V trustee's role is not, in the first instance, adversarial,[72] a subchapter V trustee may be ordered to investigate the "acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of the plan."[73] There is no standard scope or rule for such an investigation as each case is unique.[74]

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68 Clifford J. White III, *Small Business Reorganization Act: Implementation and Trends*, ABI Journal (January 2021). In the view of the U.S. Trustee, the subchapter V trustee's "primary pre-confirmation task" is facilitating a consensual plan of reorganization plan. *See id.*

69 The U.S. Trustee's Handbook for Small Business Chapter 11 subchapter V trustees reiterates this view, stating that plan facilitation is one of the trustee's principal duties, and encouraging subchapter V Trustees to engage in a "dialogue with the debtor and creditors over the plan to be proposed in the case," and proactively *communicating* with the debtor, its counsel, and creditors in promoting and facilitating plan negotiations, rather than acting in an adversarial capacity. *See* Office of the U.S. Trustee, Handbook for Small Business Chapter 11 Subchapter V, p. 3-6, 3-9 (Feb. 2020).

70 Commentators have also suggested that a subchapter V trustee may also act as a "financial wizard," capable of working with parties on cash flow statements, interest rates, and the various financial and numerical components that comprise a reorganization plan. *See* Bonapfel, n. 107 (*citing* Donald L. Swanson, *SBRA: Frequently Asked Questions and Some Answers*, 38 AMER. BANKR. INST. J. 8 (Nov. 2019)).

71 See 11 U.S.C.A. §1183(b)(1).

72 To the extent that the subchapter V trustee receives confidential information from the debtor in that non-adversarial role, the debtor and trustee may be able to assert the common-interest privilege to prevent disclosure of that confidential and/or privileged information from creditors and other third parties. *See* Camisha L. Simmons, *Can Subchapter V Trustees Invoke the Common-Interest Doctrine?*, ABI Journal (December 2021).

73 See 11 U.S.C.A. §§1106(a)(3), 1183(b)(2).

If the trustee conducts an investigation, she is required to file and serve a statement of investigation setting forth the salient facts of the investigation and her conclusions.[75] If that report details mismanagement, fraud, dishonesty in reports or schedules, or failure to comply with court orders and rules, the court may remove the debtor (or its principals) for cause and order the trustee to take on management of a subchapter V debtor's estate.[76]

And in the case of a subchapter V plan confirmed through cramdown, the trustee takes on the role of disbursing agent under the plan, charged with collecting plan payments for distribution to creditors, unless the plan or confirmation order provide otherwise.[77]

5:21. What's the bottom line about Subchapter V?

About 16 years ago one of your humble co-authors had the pleasure of co-writing a very long article titled, "*Chapter 11: Not Perfect, But Better Than the Alternatives*"[78] It argued that traditional chapter 11 works very well. We believe it still does. But more recently, that same co-author wrote an article titled, "*Rise of the Alternatives--The Increasing Use of Strategic Alternatives to Chapter 11*,"[79] in which he argued that alternative legal paths like assignments for the benefit of creditors and friendly Article 9 sales had gained in popularity because of chapter 11's deficiencies with respect to smaller debtor companies. We believe that is also true.

Subchapter V bridges the gap. Certainly, it will not be the right solution for all problems. But subchapter V is certain to give other alternatives a real run for their money.

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74 U.S. Dep't of Justice, Handbook for Small Business Chapter 11 Subchapter V Trustees, 3-8 (2020).

75 See 11 U.S.C.A. §§1106(a)(4)(A), 1183(b)(2).

76 See 11 U.S.C.A. §1183, which describes the initial duties of trustee and the additional duties of the trustee if the court expands those duties for cause; *see also* 11 U.S.C.A. §1185, which provides for the dispossession of a subchapter V debtor "for cause, including fraud, dishonesty, incompetence, or gross mismanagement" of the debtor's affairs; *see e.g., In re Dani Transport Service, Inc.*, Case No. 20-11234, Order at 2 (C.D. Cal. Feb. 23, 2021) (subchapter V debtor-in-possession removed and trustee given expanded management rights after finding that debtor fraudulently applied for a PPP loan and diverted loan proceeds without disclosing the loan to the bankruptcy court); *In re Pittner*, 638 B.R. 255 (Bankr. D. Mass. 2022) (finding cause to remove a debtor-in-possession rather than dismissing or converting the case based on the debtor's refusal to obey a court order); *see also* Fed. R. Bankr. P. 2012(a) (stating that if a debtor is removed as debtor-in-possession then the subchapter V trustee is automatically substituted for the debtor-in-possession).

77 See 11 U.S.C.A. §1194(b).

78 Sprayregen, Friedland, and Higgins, Chapter 11: Not Perfect, But Better Than the Alternatives, JOURNAL OF BANKRUPTCY LAW AND PRACTICE, Vol. 14, No. 6 (2005) at 3.

79 Jonathan P. Friedland, Rise of the Alternatives-The Increasing Use of Strategic Alternatives to Chapter 11, BANKRUPTCY DATA'S 2019 YEARBOOK, ALMANAC & DIRECTORY, 29th Edition, at 300.