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Bankruptcy 2021: Views from the Bench

Small Business Reorganization

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AN INTRODUCTION TO SUBCHAPTER V CASES

I. Introduction to the SBRA

The Small Business Reorganization Act of 2019 (as amended, the "SBRA")[1] created a new option for eligible chapter 11 filers -- a new subchapter, subchapter V. Concerned that many smaller business debtors (the majority of chapter 11 filers) were facing too much difficulty within the traditional chapter 11 framework, Congress passed the SBRA to streamline the chapter 11 process for small business debtors (entities or individuals) and to give them a better chance of achieving a confirmed plan of reorganization. The SBRA's new subchapter V provisions -- which vary in key respects from those of a traditional chapter 11 proceeding -- are designed to reduce administrative costs for small businesses, expedite and in some ways make easier the plan solicitation and confirmation path, and better enable small business debtors to retain ownership of their businesses post-confirmation, even if no creditors agree to the debtor's plan.

Subchapter V is in new Bankruptcy Code sections 1181-1195, with conforming amendments scattered in the Code. Most sections of chapters 1, 2 and 3 of the Bankruptcy Code and many sections of chapter 11 apply in subchapter V cases, but some do not as set forth in Code section 1181. The prior small business provisions remain in force and apply as the default provisions for small business debtors that do not elect to proceed under subchapter V.

Subchapter V provides eligible debtors with various powerful and cost-saving tools not otherwise available to chapter 11 debtors. Among these benefits are:

(1) the elimination of the absolute priority rule, thereby allowing equity holders to retain their ownership interests in the subchapter V debtor without paying all creditors in full (sections 1181(a) and 1191(b));

(2) no creditors' committee unless the court finds cause for one (section 1181(b));

(3) no requirement to file a disclosure statement unless ordered by the court for cause (section 1181(b));

(4) the debtor's exclusive right (which cannot be terminated) to file a plan (section 1189(a));

(5) the elimination of the requirement to pay quarterly U.S. Trustee fees (28 U.S.C. § 1930(a)(6)(A));

(6) the appointment of a new participant – the subchapter V trustee – to assist in developing a consensual plan, while leaving the debtor in possession and control of its assets and business (section 1183(b)(7));

(7) the ability to confirm a plan even if all classes reject the plan (section 1191(b));

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[1] Small Business Reorganization Act of 2019, H.R. 3311, 116th Congress (2019-20); Small Business Reorganization Act of 2019, S. 1091, 116th Congress (2019-20). Then-President Trump signed the SBRA into law on Aug. 23, 2019. *See* Pub. L. No. 116-54 (2019). Unless noted otherwise, all Code references are to title 11 of the U.S. Code as amended by the SBRA.

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(8) the ability to pay administrative expenses over time under a plan (section 1191(e));

(9) the ability to modify a claim secured only by a security interest in the debtor's principal residence, if new value received in connection with granting the security interest was used primarily in connection with the debtor's business and not primarily to acquire the property (section 1190(3)); and

(10) the modification of the disinterestedness requirements of section 327(a) for a professional that holds a prepetition claim of less than $10,000 (*i.e.*, such professional is not disqualified for employment) (section 1195).

The SBRA's timing was very fortuitous, having been enacted prior to the progression of the COVID-19 pandemic in the United States in Q1 2020. Generally, the pandemic led to a severe drop in the demand for the goods and services of many small businesses. Thus, only months after its passage, subchapter V became more prominent and more critically needed to provide aid to small businesses harmed by the pandemic and its repercussions. The SBRA was amended in late March 2020, under the pandemic-related Coronavirus Aid, Relief and Economic Security Act of 2020 (CARES Act),[2] so that subchapter V relief would be available to more debtors. Specifically, the CARES Act temporarily raised the debt ceiling to $7.5 million, up from $2,725,625, for cases filed between March 27, 2020, and March 26, 2021. The threshold was originally scheduled to return to $2,725,625 after one year, but it was extended until March 27, 2022 with the enactment of the COVID-19 Bankruptcy Relief Extension Act on March 27, 2021.[3]

In many observers' views, the SBRA appears to be working as Congress intended. Notably, approximately 23 percent of all chapter 11 filings in 2020 were subchapter V cases, according to Bloomberg Law Dockets (Feb. 22, 2021), which is impressive. And, for the first half of 2021, the number of subchapter V filings across the country surpassed the total from the first half of 2020 (*see* https://www.abi.org/sbra). Since early 2020, the jurisdictions with the most subchapter V filings are the Ninth, Eleventh and Fifth Circuits (*id.*). Notwithstanding the foregoing, as some small businesses hopefully have faced the worst of it in terms of the negative economic effects of the COVID-19 pandemic, the popularity of the subchapter V election may materially decrease in the short term. The actual overall effectiveness of the subchapter V amendments may not be better known until economic forces and circumstances have normalized more so, although certainly the subchapter V option allowed some businesses hard hit by the pandemic to survive.

II. Implementation Matters

A. Eligibility to Be a Subchapter V Debtor

Only "small business debtors" may elect to be a subchapter V debtor. Code section 101(51D) defines a "small business debtor" to mean, generally, a person, corporation or partnership that is engaged in commercial or business activities (excluding a debtor whose primary activity is owning single asset real estate), which debtor has aggregate, non-contingent, liquidated

[2] Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, March 27, 2020, 134 Stat 281, 310-311.

[3] Pub L No 117-5, 135 Stat 249 (2021).

debts (secured or unsecured) of no more than $7.5 million (excluding debts owed to affiliates/insiders), provided that no less than 50% of said debts arose from the commercial or business activities. Excluded from who may be a small business debtor is any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $7.5 million (excluding debt owed to one or more affiliates or insiders).

Subchapter V is not available for (i) a single asset real estate business; (ii) an entity that is subject to reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"); or (iii) an affiliate of an issuer, as defined in section 3 of the Exchange Act.

B. Procedural/Cost Matters

After a small business debtor files and elects to proceed under subchapter V, the U.S. Trustee appoints a subchapter V trustee and schedules the § 341 meeting of creditors for a date as early as possible in accordance with applicable rules. In addition, the U.S. Trustee conducts the initial debtor interview promptly after the filing, and the bankruptcy court holds a status conference within approximately 60 days of filing. As discussed herein, under section 1189, the debtor must file a plan within 90 days, which deadline may be extended by the court only when the "need for the extension is attributable to circumstances for which the debtor should not justly be held accountable" (such as circumstances beyond the debtor's control).

Subchapter V is designed to be less expensive and less administratively burdensome than the traditional chapter 11 process. Specific cost savings include:

(i) no U.S. Trustee quarterly fees, which can be quite substantial in traditional, typically longer-track chapter 11 cases;

(ii) no creditors' committee as a general rule unless the court orders otherwise for cause (in a traditional chapter 11, the fees and expenses of the creditors' committee, including its own separate counsel and possibly other advisors, can be significant, which costs are borne by the bankruptcy estate);

(iii) no separate disclosure statement required; and

(iv) the debtor's ability to pay administrative expenses over the life of a nonconsensual plan (in the traditional chapter 11 context, the Bankruptcy Code requires that administrative claims be paid upon the effectiveness of the confirmed plan, and in some traditional chapter 11 cases, administrative solvency is a real issue).

Other changes that have increased the efficiency and speed of the cases include the following: (i) only the debtor can file a plan; (ii) a subchapter V trustee is appointed to "facilitate the development of a consensual plan of reorganization"; and (iii) the debtor may confirm a cramdown plan without the acceptance of any class of creditors.[4]

[4] A subchapter V plan is confirmed as a "consensual plan" if all requirements of section 1129(a), except paragraph (15), are met. Cramdown provisions for subchapter V cases are guided by section 1191(b), which does not require an accepting class.

III. Subchapter V Trustee

A. Potential Roles

A fundamental governance change implemented by the SBRA is that all subchapter V cases will have a trustee -- either a standing trustee or a case trustee -- regardless of debtor-in-possession (DIP) status (section 1183(a)). This is a substantial change in terms of governance and case oversight, but it is particularly important in smaller cases because there is often a lack of creditor engagement and participation and the absence of a creditors' committee to oversee small cases. In general, the role of the subchapter V trustee is to supervise and monitor the case and to participate in the development and confirmation of a plan. The debtor's creditors have no role in selecting the subchapter V trustee, unlike, for instance, chapter 7 trustees. While modeled in part after chapter 12 and chapter 13 trustees, subchapter V trustees' duties are not well-specified, but at a minimum, the subchapter V trustees are to help facilitate the development of a consensual plan of reorganization.

Other more specific functions include:

(i) being accountable for any property received by the trustee (section 704(a)(2));

(ii) if a purpose would be served, examining proofs of claims and objecting to the allowance of any claim that is improper (section 704(a)(5));

(iii) if advisable, opposing the discharge of the debtor (section 704(a)(6));

(iv) unless the court orders otherwise, furnishing such information concerning the estate and the estate's administration as is requested by a party in interest (section 704(a)(7));

(v) making a final report and filing a final account of the administration of the estate with the court and with the U.S. Trustee (section 704(a)(9));

(vi) appearing and being heard at the status conference under section 1188 and any hearing that concerns (a) the value of property subject to a lien, (b) confirmation of a plan filed under subchapter V, (c) modification of the plan after confirmation, or (d) the sale of property of the estate;

(vii) ensuring that the debtor commences making timely payments required by a confirmed plan;

(viii) if the debtor ceases to be a debtor in possession, performing the duties specified in section 704(a)(8) and paragraphs (1), (2), and (6) of section 1106(a), including operating the business of the debtor;

(ix) only if the court orders: investigating 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 a plan, and filing a statement of such investigation; and

(x) only if the court orders: after confirmation of a plan, filing such reports as are necessary or as the court orders.

Often, subchapter V trustees may play the role of mediator, trying to facilitate a resolution between the debtor and its key creditors. Further, subchapter 7 trustees may in some cases take on a more financial/business advisory role, and the courts will likely solicit and may rely upon the trustees' views on plan confirmation including feasibility and disposable income projections. *See, e.g., In re Fall Line Tree Serv.*, 2020 Bankr. LEXIS 3386, at *5 (Bankr. E.D. Ca. Dec. 3, 2020) ("The Subchapter V Trustee has supported the accuracy of the projections.").

Unless the court so orders, the subchapter v trustees do not take control of the debtor's property or investigate the financial affairs of the debtor. Subchapter V trustees can take on more expansive roles if, for instance, the court loses confidence in in the debtor's management. However, usually, owners-managers will remain in possession of the debtor entity and its property, and the subchapter V trustee will have few of the investigatory or management roles of trustees under other chapters of the Bankruptcy Code.

The duration of the subchapter V trustee's activity in a case will vary. The trustee's services will terminate in one of three ways. First, if a consensual plan is confirmed, the trustee's services terminate upon substantial consummation of the plan. Second, in the case of nonconsensual plan confirmation, the default rule (absent the plan or confirmation order providing otherwise) is that the trustee is required to make plan payments. Thus, services in such cases will run the life of the plan. Third, trustee services terminate if there is dismissal or conversion of the case under section 1112.

Much of the success or failure of subchapter V will depend on the subchapter V trustees' assistance and services in the case. If the trustees are largely passive figures, costs could be low, but the value added by the trustees could be lower. But if the trustee plays a more substantial role mediating between debtor and creditors, or if the trustee engages in material financial analysis concerning, for example, the debtor's financial projections, costs could increase very quickly.[5] The potentially pro-active participation by a subchapter V trustee could materially discourage some debtors from making the subchapter V election.

B. Management of the Estate By the Subchapter V Trustee

Section 1185(a) directs that the court shall remove a subchapter V debtor in possession on request of a party in interest and after notice and a hearing, "for cause, including fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor, either before or after commencement of the case, or for failure to perform the obligations of the debtor under a plan confirmed under this subchapter." Generally, the grounds for removing a subchapter V debtor in possession should be similar to the grounds for removal of a chapter 11 debtor in possession in a traditional chapter 11 case pursuant to section 1104(a)(1), with the exception that section

[5] The trustee will be compensated either as a standing trustee, replicating chapter 12 by receiving a percentage fee from payments made under a plan (28 U.S.C. § 586(e)), or as a case trustee under section 330(a)(1). This cost will be borne by the estate.

1104(a)(1) adds "or similar cause" and includes the limitation that cause does not include "the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor."

Section 1185(a) also does not include, for removing a chapter 11 debtor in possession in a subchapter V case, the second basis for removing a chapter 11 debtor in possession found in section 1104(a)(2) -- that appointment of a trustee would be in the "best interest of creditors, any equity security holder and other interests of the estate." Thus, the focus of a court's determination of cause under section 1185(a) appears basically limited to the improper conduct of the debtor in possession and does not include the interests of creditors, equity security holders or other interests of the estate. That said, if, for example, the debtor's financial books and records are incomplete or in disarray, the court and the subchapter V trustee could be worried about the prospects of a successful reorganization, which could also potentially lead to a dismissal or conversion of the case.

If a subchapter V debtor in possession is removed, the trustee's duties are expanded under section 1183(b)(5), and the subchapter V trustee becomes more like a chapter 11 trustee. The trustee, however, may not file or modify a plan.

IV. Plan Matters

A. In General

Although generally the subchapter V debtor must file a proposed plan within 90 days of the bankruptcy filing, once the plan is filed, there is no express deadline to obtain confirmation of the plan. The voting and confirmation schedule will be set by the bankruptcy court. Conceivably, if case circumstances justify or require it, a debtor could file a starting proposal plan within the 90-day timeframe (proposed in good faith) with the likelihood of substantive amendments, as potentially the debtor further negotiates the plan terms with the key creditors (with the subchapter V trustee's assistance) and as the business plans may become more solidified.

Among other requirements, in order to be confirmed over creditors' objections, the plan must not discriminate unfairly and be "fair and equitable" with all classes of claims and interests. To be considered fair and equitable, the subchapter V plan must (i) provide all projected "disposable income" of the debtor for a period of 3-5 years, or (ii) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor. For subchapter V cases, section 1191(c)(2) provides for a commitment period of three years or such longer time, not to exceed five years, that the court fixes. Such periods are the same or similar to the commitment periods in non-sub V chapter 11 cases and chapter 13 cases.

"Disposable Income" is defined in section 1191(d) as income received by the debtor and that is not reasonably necessary for: (1) the maintenance or support of the debtor or its dependents; (2) post-petition domestic support obligations; or (3) expenditures necessary for the continuation, preservation, or operation of debtor's business (*e.g.*, payroll, utilities, rent, insurance, taxes, inventory). This definition is substantially the same definition used in Chapter 12 cases (section 1225(b)(2)), and mostly similar to the definition of disposable income used in Chapter 13 cases (section 1325(b)(2)). Of particular note, if the debtor's disposable income proves to be higher than estimated, there is no Code requirement that the additional profit be used to pay the creditors.

With regard to plan confirmation, the differences from a non-subchapter V case include:

- A subchapter V debtor has the exclusive right to file a plan, which generally must be filed within 90 days in a subchapter V case (considerably shorter than in non-sub V cases).
- Plan solicitation and confirmation is a one-step process in a subchapter V case, with no disclosure statement required. The plan though must provide some relevant information: a brief history of debtor's operations, liquidation analysis, and projections of debtor's ability to make payments. Particularly in subchapter V cases with many creditors and parties in interest, the legal, administrative, and practical savings from a one-step process can be significant.
- Confirmation in subchapter V does not require acceptance by creditors but does still have a voting component.
- The court may confirm a subchapter V plan that has not been accepted by creditors, provided the plan does not "discriminate unfairly" and is "fair and equitable."
- The "absolute priority rule" does not apply in subchapter V cases.
- Administrative claims are not required to be paid on the effective date of the confirmed plan, which such requirement exists in a non-sub V chapter 11 case.

These differences may certainly facilitate, in many cases, debtors successfully emerging with confirmed subchapter V plans, within only about six months or so of the bankruptcy filing (a more accelerated timeframe than in traditional chapter 11 cases). In a common situation, a creditor with a large unpaid prepetition claim may want the subchapter V plan to cover five years, instead of three years, so that creditors will get more of the debtor's disposable income. Notably, because the subchapter V debtor is the only party that can propose a plan, creditors lose the leverage in a traditional chapter 11 case where the creditor can threaten an alternative plan (if the debtor's statutory exclusive period to file a plan expires or is terminated).

On the other hand, commonly, it will be in the debtor's best interest to get a consensual plan expeditiously confirmed. In the situation of a cramdown plan, the subchapter V trustee will continue to be involved for purposes of plan distributions and his or her fees will continue to accrue. Consensual plans are further encouraged by two other features of the SBRA: (i) a debtor whose plan is confirmed consensually receives an immediate discharge instead of a discharge only at the end of plan payments (section 1181(c)); and (ii) the post-petition property of a debtor that confirms a cramdown (nonconsensual) plan remains property of the estate, whereas with a consensual plan, the debtor retains such property outside of the estate (section 1186(a)). This is not to say the property will be paid out to creditors -- there is no provision in subchapter V for adjusting the plan payments to include any excess. The effects on the case could become complicated, but at a minimum, more court supervision and involvement would likely be required through the duration of the plan.

B. Stretching Payments on Administrative Expenses

Subchapter V permits the debtor to pay administrative expenses over the life of the plan, instead of, for example, on the effective date of the confirmed plan in a non-SBRA chapter 11 case.[6] *See, e.g., In re Ellingsworth Residential Cmty. Ass'n*, 2020 Bankr. LEXIS 2897 (Bankr. M.D. Fla. Oct. 16, 2020) (confirming subchapter V plan that stretched out payment of administrative claims and priority claims over three years); *In re Fall Line Tree Serv.*, 2020 Bankr. LEXIS 3386 (Bankr. E.D. Cal. Dec. 3, 2020) (confirming subchapter V plan that stretched out payment of administrative claims for five years). This advantage of stretching out payments is limited in a subchapter V case to a plan that is approved pursuant to the cramdown provisions of new § 1191(b). *See* § 1191(e). Thus, the debtor is possibly in the unusual position of preferring a contested plan in order to take advantage of the ability to stretch out administrative claim payments over the life of the plan. The ability to stretch out some payments can be a significant advantage to debtors, but it is not available in a consensual plan.

As a result of the debtor's ability to defer payment of administrative claims in the cramdown situation, some trade creditors may be less willing to continue to offer pre-petition or otherwise favorable credit terms to a small business debtor, and may even demand payment in advance or cash on delivery. Such actions could materially harm the debtor in its post-petition operation of the business. This aspect's overall impact on the reorganization efforts of subchapter V debtors is certainly worth further review as more subchapter V cases are filed and resolved.

C. Accelerated Confirmation Schedule

Subchapter V accelerates the timeframe for a small business debtor to file a plan from 180 days - as provided under section 1121(e) - to 90 days under new section 1189. The debtor can obtain an extension of this 90 day deadline, provided it can show that the need for the extension is attributable to circumstances for which the debtor "should not justly be held accountable." It remains to be seen how stringent the courts will hold debtors to the 90 day requirement, but under the statute, the grounds for an extension are limited to circumstances beyond the debtor's control. Moreover, while the debtor is generally required to file a plan within 90 days, there is no confirmation deadline, and thus, in some cases, debtors may be able to refine their plan after its submission.

If plan modifications stretch on, or vary from the original plan in a particularly extreme manner, creditors may be able to persuasively argue that the debtor's management does not have a sufficient handle on the debtor's actual or likely financial circumstances, or that the actual goal of the debtor's bankruptcy process is speculation rather than reorganization. Making arguments of abuse of process or bad faith on the part of the debtor could give a creditor more leverage in plan negotiations.

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[6] *See* section 1129(a)(9)(A) (requiring claims specified in sections 507(a)(2) or 507(a)(3) (*i.e.*, post-petition administrative expense claims) to be paid on the effective date of the plan). Section 1191(e) now provides that notwithstanding section 1129(a)(9)(A), a plan under subchapter V may provide for the payment of post-petition administrative expense claims "through the plan."

D. Specific Plan Confirmation Issues

1. Disclosures to / Negotiations with Key Creditors

The subchapter V debtor does not need to solicit plan acceptances with a separate disclosure statement. Unless the court orders otherwise, the debtor is not required to prepare and obtain approval of a disclosures statement at all. Instead, the plan itself must include a brief history of the business operations of the debtor, a liquidation analysis, and projections with respect to the debtor's ability to make payments under the proposed plan.

Although a disclosure statement will typically not be required in a subchapter V case, to foster more creditor support and facilitate plan confirmation, the debtor may want to provide in the plan more detailed information about, among other things, (i) the debtor's prepetition financial and/or operational difficulties and the debtor's strategies to address such difficulties post-confirmation, and (ii) any prior marketing efforts, asset and business valuations that may shed light on the best exit strategy.

In many subchapter V cases, the strategy for a successful plan confirmation may include: (a) the debtor starting negotiations with key creditors early on; and (b) having an open dialogue with, and gaining the support of the subchapter V trustee, whose approval is not required but whose judgment is likely to be given a significant amount of deference by the bankruptcy court. In particular, the subchapter V trustee may be able to mediate differences between the debtor and the key creditors.

Generally, there is a considerable amount of flexibility and court discretion with respect to what can go into consensual and nonconsensual subchapter V plans, and a particular subchapter V case may have a number of negotiation points that can potentially lead to a consensual plan. Notwithstanding the foregoing, as discussed further herein, a subchapter V plan may be confirmed even if it is not accepted by any classes of claims. In some circumstances the debtor may want to propose two alternatives in its plan - one alternative that the debtor hopes will be accepted as a consensual plan under section 1191(a) and an alternative cramdown scenario plan that can be confirmed under section 1191(b) in the event the first alternative is not accepted by creditors.

2. Absolute Priority Rule is Inapplicable

Arguably, the most important benefit of subchapter V is the elimination of the absolute priority rule, which typically precludes owners from retaining equity interests in a company unless other creditors are paid in full. Typically, section 1129(b)(2)(B)(ii) mandates that a dissenting class of unsecured creditors must be paid in full before any junior class can receive or retain property under a plan of reorganization. So if the unsecured creditor class votes to reject a non-subchapter V chapter 11 plan, equity holders cannot retain or receive anything unless the dissenting class is paid in full. The equity holders would have their equity interests in the company cancelled. Bankruptcy courts recognize a new value exception to the absolute priority rule in traditional chapter 11 cases, but there are strict limitations on the exception. Equity holders' new value contribution to retain their ownership interest must be money or money's worth; contributing future labor, management, or expertise is generally insufficient to qualify as new value.

Under the SBRA, the court may confirm a plan over the objection of unsecured creditors, as long as all of the debtor's projected disposable income will be used for plan payments to creditors for a time period of three to five years. This is a major change from conventional chapter 11 cases, and it helps owners retain their equity interest in the reorganized business. Unlike most larger enterprises, small-sized and medium-sized businesses are not usually managed by outside professionals but instead are operated by the owners themselves. Business owners are often reluctant to work to salvage their business if it means relinquishing their ownership interests.

3. Home Mortgage Modifications

A subchapter V debtor is allowed to modify the rights of certain holders of claims secured only by a security interest in the debtor's principal residence when the proceeds of the relevant mortgage were used primarily in connection with the debtor's business. This can be a very important provision for homeowners who have taken out a second mortgage to support their business.

Specifically, the SBRA changed the law regarding modification of mortgages on a principal residence. Modification of such a loan is not generally permitted under chapter 11 (section 1123(b)(5)). In the bankruptcy context, modification of a secured loan often means cutting the secured debt down to the actually secured amount (*i.e.*, the collateral's value); the creditor holds an unsecured deficiency claim for the remainder of the amount owed, but this would be often paid only a small, if any, recovery and be discharged. Then, as to the amount still treated as secured, the debtor would pay the reduced principal amount over an extended period of time with interest. Now, through the SBRA, under section 1190(3), a subchapter V debtor can modify a non-purchase money loan secured by a principal residence, provided that the new value received from the lender for the mortgage lien was used primarily for business purposes.

4. Discharge

The chapter 11 discharge provisions of section 1141, with the exception of section 1141(d)(5), apply with respect to consensual subchapter V plans confirmed under section 1191(a). The debtor's discharge in a consensual subchapter V plan (except as may be provided in the debtor's plan or in the order confirming the plan) becomes effective upon confirmation of the plan under section 1141(d)(1)(A).

The scope of the debtor's discharge with respect to nonconsensual subchapter V plans confirmed under section 1191(b) is determined by section 1192. The debtor's discharge in a nonconsensual plan is delayed until after completion by the debtor of all payments due within the 3-5 years of the plan, as applicable, under new section 1192.

Additionally, a corporate debtor may be able to obtain a discharge under subchapter V even if the plan is a nonconsensual liquidating plan. *Compare with* section 1141(d)(3) (prohibiting discharge of liquidating corporate debtor in typical chapter 11).

5. Defaults/Liquidation of Assets

Under section 1191(c)(3)(B), the subchapter V plan must contain some protection for the impaired creditors that have not accepted the plan in the event that the debtor does not perform as required, although the debtor has the discretion to develop whatever mechanisms will work for the circumstances of the case (section 1191(c)(3)(B) provides no parameters for the remedies under this section). While the Bankruptcy Code states that appropriate remedies "*may* include the liquidation of nonexempt assets," it does not require it. 11 U.S.C. § 1191(c)(3)(B) (emphasis added).

With regard to secured creditors, providing protection to them that satisfies the appropriate remedies standard of section 1191(c)(3)(B) may often be relatively straightforward – commonly, the secured creditor is protected by allowing it to retain its lien until its claim is fully paid. The plan may also provide that the secured creditor will be paid from any liquidation of its collateral (some or all) (with any additional funds from the sale of the asset to be used to pay other parties under the plan).

Depending on the circumstances, however, the bankruptcy court may find that section 1192(c)(3)(B) requires more, such as an involuntary liquidation provision. In such a situation, the plan may include, for instance, a process for creditors to file a notice of default and an opportunity to cure by the debtor. If the default is not timely cured, the aggrieved creditor may seek the involuntary liquidation of designated assets of the debtor, or the plan could contain a provision implementing a liquidation of certain assets. The debtor could attempt to retain some control over what assets are to be liquidated and the liquidation process (*e.g.*, a sale to affiliates at preset prices). In contrast, in a chapter 7 case, the debtor has no control in the liquidation process. Potentially, another creditor could object to the post-confirmation debtor selling or otherwise liquidating certain assets during the plan payment period if, for instance, the subject asset is important to the debtor's ongoing operation.

In lieu of a forced liquidation of certain assets, other possible plan provisions according sufficient protection to creditors could include, for instance, the granting of additional collateral to a secured creditor or collateral to an unsecured creditor, and the granting of third party guarantees executed by, for example, the debtor's interest holders. In many cases, however, a debtor's assets will already be substantially encumbered, with little or no residual equity remaining, and often, non-debtor party guarantees may have been previously provided. Thus, while the subchapter V debtor may endeavor to be creative in meeting the requirements of section 1191(c)(3)(B), there may be rather limited plan options available as a practical matter in many cases.

Finally, in some subchapter V cases, the only realistic source of a material recovery for unsecured creditors could be the potential proceeds of avoidance actions or other litigation. In such cases, the plan could empower the subchapter V trustee to pursue such claims post-confirmation in much the same manner as liquidating trustees under a traditional chapter 11 plan are routinely authorized to prosecute actions for the estate's benefit.

V. Preferential Transfers

The SBRA also included two provisions that are not limited to small business chapter 11 cases. First, through an amendment to section 547(b), a debtor in possession or trustee (as applicable) must, before commencing an action to recover a preferential transfer,[7] do due diligence to determine a party's known or reasonably knowable affirmative defenses. Second, a preference avoidance action must be commenced in the district where the defendant resides if the amount sought is less than $25,000, increased from the then limit of $13,650.

Prior to the SBRA, the Bankruptcy Code did not explicitly require a debtor or trustee to undertake any due diligence prior to commencing an action under section 547. The SBRA addresses this issue by requiring a debtor or trustee to consider a party's statutory defenses "based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses" prior to commencing a preference action. While this requirement may have been implicit prior to the SBRA, this amendment may deter debtors from trying to file nuisance preference actions in the hope of a quick settlement, and provide a potential, additional defense to parties sued under section 547, given the statutory terms ("reasonable due diligence," "reasonably knowable affirmative defenses," *etc.*) are arguably broad and amorphous. Further, this amendment may actually encourage pre-litigation negotiations among the debtor and affected creditors, wherein records and other evidence could be informally shared, to improve the chances of a settlement prior to any preference litigation.

The SBRA also provided relief to preference defendants in all bankruptcy cases, not only subchapter V cases, by increasing the monetary threshold in 28 U.S.C. § 1409(b) for actions to recover a debt against a non-insider defendant brought in the district where the defendant resides (*e.g.*, preference and fraudulent transfer cases). Prior to the SBRA, claims under $13,650 had to be brought in the district where the defendant resides, as opposed to where the bankruptcy case is pending, but the SBRA raised this threshold amount to $25,000. Often times, the costs to defend an out-of-state preference action may outweigh the benefits of pursuing valid defenses in small preference actions, and so a preference defendant in such situation may opt to settle with the debtor or trustee.

VI. Closing Thoughts

The ability of smaller businesses to restructure their indebtedness through an expedited, streamlined chapter 11 process benefits nearly every constituency -- business owners, vendors, suppliers, customers, employees, landlords, lenders and governmental entities. The subchapter V trustees (many of whom are attorneys, accountants, and financial professionals), as well as the bankruptcy courts handling the subchapter V cases, will play a pivotal role in the success, including the credibility, of the subchapter V option, as the subchapter V process is refined through court practice and the development of case law. Subchapter V is also predicated on the capabilities of a small business debtor to right its own ship, giving the debtor more leverage against key creditors

[7] Section 547 of the Bankruptcy Code permits a debtor, subject to certain conditions and defenses, to claw back payments made to creditors within 90 days of the filing of a bankruptcy petition or one-year for insiders.

in the subchapter v process (including in some cases a dominant unsecured creditor or judgment creditor who could otherwise block a plan).

The broader, longer term benefits of subchapter V remain to be seen, with a number of things to watch for including: (i) the extent and consequences of plan defaults (as more of the 3-5 year plan terms of confirmed subchapter V plans lapse); (ii) any increase in certain exit plan strategies such as expedited sale plans and the benefits/disadvantages thereof; and (iii) the costs of subchapter V trustees and advisors they may use. In the critical short term, however, the SBRA and the modifications thereto under the CARES Act and subsequent amendments have allowed many small businesses to make it through what was hopefully the worst of the pandemic's adverse effects on the economy.

Faculty

Hon. Rebecca B. Connelly is a U.S. Bankruptcy Judge for the Western District of Virginia in Harrisonburg, appointed in July 2012. She is a former standing chapter 13 trustee and chapter 12 trustee for the Western District of Virginia. Judge Connelly has been a member of ABI since 1994 and has served as a contributing editor and a features author for the *ABI Journal*, a member of the Consumer Bankruptcy Committee, and a speaker at ABI's Annual Spring Meeting and Winter Leadership Conference, "Eye on Bankruptcy" program and Views from the Bench. She also serves on the board of CARE and was an adjunct professor of law at Washington and Lee University School of Law. Judge Connelly was appointed to the Judicial Conference Advisory Committee on Bankruptcy Rules, for which she chairs its Consumer Subcommittee, is a member of its Cross-Border Insolvency Subcommittee and acts as its Bankruptcy Committee liaison. She received her B.A. in 1985 from the University of Maryland and her J.D. in 1988 from Washington & Lee University School of Law.

Hon. John T. Dorsey is a U.S. Bankruptcy Judge for the District of Delaware in Wilmington, sworn in on June 11, 2019. Previously, he practiced complex commercial litigation in Wilmington for 28 years. For 16 of those years, Judge Dorsey was a partner at Young Conaway Stargatt & Taylor, LLC, where he represented debtors and creditors in chapter 11 litigation matters. He also served as general counsel to Young Conaway for five years. Prior to joining Young Conaway, Judge Dorsey practiced with Richards Layton & Finger, PC, and served as the state director for then U.S. Senator Joseph R. Biden, Jr. Prior to practicing law, he served in both the U.S. Army as a Military Police Investigator and the U.S. Air Force as an ICBM launch officer. Judge Dorsey was a board member of Delaware Volunteer Legal Services for 25 years and was active as a volunteer for the Delaware Office of Child Advocate representing children in foster care. He received his B.A. from the University of New York at Binghamton and his J.D. *magna cum laude* from Wake Forest University School of Law.

Laura Davis Jones is a named partner and managing committee member of Pachulski Stang Ziehl & Jones LLP in Wilmington, Del., and is the managing partner of the firm's Delaware office. She gained national recognition as debtor's counsel in the *Continental Airlines* bankruptcy case and has represented numerous debtors, creditors' committees, bank groups, acquirers and other significant constituencies in national chapter 11 cases and workout proceedings. Ms. Jones participates as a speaker at national bankruptcy and litigation seminars, and she has authored numerous articles. She was named "Deal Maker of the Year" by *The American Lawyer* in 2002, which also has profiled her. Ms. Jones has been named continuously by her peers as one of the *The Best Lawyers in America*" and as one of the "Best Lawyers in Delaware," and was selected as one of the top 10 lawyers in Delaware by "Delaware Super Lawyers." She is a Fellow of the American College of Bankruptcy and a *Chambers USA* "Star Individual," the highest honor a lawyer can receive. Ms. Jones has been recognized in the *K&A Restructuring Register* and the *Lawdragon 500* since their inception, has been named repeatedly to the *International Who's Who of Insolvency and Restructuring Lawyers*, and is AV-rated by Martindale-Hubbell. In 2018, she received the prestigious "Women Leadership" award at Global M&A Network's Turnaround Atlas Awards, which honors the achievement of influential women leaders in the restructuring and turnaround communities. She started her career as a judicial law clerk in the U.S. Bankruptcy Court for the District of Delaware. Ms. Jones is admitted to practice in Delaware and the District of Columbia. She received her undergraduate degree from the University of Delaware and her J.D. from Dickinson School of Law, where she was on the board of editors and business manager for the *Dickinson Law Review* and served on the Appellate Moot Court Board.

Alexa J. Kranzley is a special counsel in Sullivan & Cromwell LLP's Finance and Restructuring Group in New York. She represents companies and creditors in chapter 11 proceedings and out-of-court corporate and financial restructurings, as well as and private-equity and hedge funds in connection with distressed transactions and special-situation investments. Ms. Kranzley also has experience handling adversary proceedings, contested matters and both debtor and creditor representations in bankruptcy proceedings. Ms. Kranzley's practice is international, and she has worked in collaboration with the firm's other offices on substantive matters involving restructurings in other jurisdictions. Ms. Kranzley was honored as a member of ABI's 2018 "40 Under 40" class and nominated and inducted in 2017 into the International Insolvency Institute's NextGen Leadership Program. She is also recognized by *IFLR1000* 2018 as a "Rising Star" and was named a 2021 "Outstanding Young Restructuring Lawyer" by *Turnarounds & Workouts*. Ms. Kranzley received her B.S. in 2005 from Cornell University and her J.D. in 2008 from Brooklyn Law School.

Hon. James J. Tancredi is a U.S. Bankruptcy Judge for the District of Connecticut in Hartford, sworn in on Sept. 1, 2016. Prior to his appointment to the bench, he was a commercial litigation and business restructuring partner at Day Pitney, LLP (f/k/a Day Berry & Howard), where, as a business litigator and commercial restructuring lawyer, he co-founded the firm's regional and national bankruptcy practice. He had cultivated a diverse and challenging practice that crossed major industries, moved from regional to national scope and secured material roles in prominent restructuring and bankruptcies. During his thirty-seven year career at Day Pitney, LLP, Judge Tancredi tried dozens of cases, represented a full range of constituents, and assembled and led innumerbale teams to collaborative success in often highly contested, first-impression financial reorganizations. He was consistently ranked in *The Best Lawyers in America* and as one of the best lawyers in New York and New England, and he co-founded his firm's Bankruptcy and Reorganization Practice. Judge Tancredi is the co-author of the leading treatise on alternatives to chapter 11 (*Strategic Alternatives For and Against Distressed Businesses*), and he is a frequent lecturer at the UConn School of Law and CLE seminars. Throughout his career, he has been active in professional associations, including the ABA, ABI, CT Bar Association, HCBA and CTTMA. Judge Tancredi previously served as president of The Hartford County Bar Association (the oldest bar association in the country) and as president of the Connecticut chapter of the Turnaround Management Association. He received his B.A. *magna cum laude* in urban studies and political science from the College of the Holy Cross in Worcester, Mass., and his J.D. *magna cum laude* from the University of Connecticut School of Law.

Hon. Michael G. Williamson is a U.S. Bankruptcy Judge for the Middle District of Florida in Tampa, initially appointed as bankruptcy judge in March 2000 and as chief judge from 2015-19. He currently serves as co-author of *West's Bankruptcy Law Manual* and as an adjunct professor at Stetson University College of Law, where he teaches bankruptcy law. Judge Williamson began his bankruptcy practice serving as a chapter 7 panel trustee from 1977-79. For the next 20 years, he represented numerous chapter 11 corporate debtors, creditors' committees and trustees in bankruptcy cases pending throughout the state of Florida until his appointment to the bankruptcy bench in 2000. Judge Williamson is past chair of the Committee on Creditors' Rights, Section of Litigation of the American Bar Association, past chair of the Business Law Section of The Florida Bar and that section's Bankruptcy/UCC Committee, and a Fellow of the American College of Bankruptcy. He received his undergraduate degree from Duke University in 1973 and his J.D. from Georgetown University Law Center in 1976.