The New Frontier of SUBCHAPTER V

By Mark E. Hall, Esq., and Michael R. Herz, Esq.,
Fox Rothschild LLP, Morristown, New Jersey

In August 2019, Congress passed the Small Business Reorganization Act (the "SBRA"), which became effective on February 19, 2020. The primary objective of the SBRA was to make reorganization under chapter 11 of the Bankruptcy Code more feasible and affordable for small businesses. Previously, the time and costs of a chapter 11 reorganization, including fees payable to debtors' professionals, the United States Trustee, and professionals for the unsecured creditors' committee (if formed), were too significant for many small businesses that desired to restructure under chapter 11. Further, prior to the enactment of the SBRA, small business owners were less likely to maintain control of their business without a considerable cash infusion as part of a plan of reorganization. Therefore, notwithstanding a preference to restructure, the prohibitively high administrative costs of the chapter 11 process and the resultant loss of equity without a

KEY POINTS

1. SBRA allows small business owners to more cheaply reorganize while retaining equity in their business.
2. CARES Act nearly triples debt limitation for subchapter V chapter 11 cases.
3. Selection of subchapter V trustee based on unique characteristics of each case.
4. Substantial majority of courts allow pending chapter 11 debtors to amend petitions to proceed under subchapter V.

substantial lifeline, forced many small businesses to liquidate, as it was the only viable option to address its debt.

To facilitate the objective of providing a workable restructuring process for small businesses, the SBRA created subchapter V of the Bankruptcy Code, which, as originally enacted, provided small businesses with non-contingent, liquidated debts in an amount not greater than $2,725,625 the opportunity to restructure through a new streamlined and cost effective chapter 11 process. Although titled the "Small Business" Reorganization Act, subchapter V is also available to individuals, as long as they meet the eligibility requirement, including that at least 50% of the individual's debt arises from the debtor's commercial or business activities. *See* 11 U.S.C. *§ 101(51D)(A)*. Notable features of the subchapter V process include reducing administrative costs through eliminating the appointment of an unsecured creditors' committee (unless otherwise ordered by the court for cause), exempting the requirement to pay United States Trustee fees, and requiring that the debtor file a plan of reorganization within 90 days of the petition date. Arguably the most significant benefit of a subchapter V restructuring is that small business owners can more easily retain their ownership interest in the reorganized company as long as the debtor's plan does not discriminate unfairly and is "fair and equitable" with respect to each class of claims and interests. *See* 11 U.S.C. *§ 1191(b)*. In other words, the SBRA eliminated the absolute priority rule in subchapter V cases. This differs from a typical chapter 11 reorganization which generally results in the cancellation of equity, absent post-petition "new value," usually in the form of a significant cash infusion. Plans under subchapter V are to be for at least three years but no longer than five years. Like in chapter 13, a subchapter V debtor will receive a discharge from all of its pre-confirmation debts upon completing all payments under the plan. *See* 11 U.S.C. *§ 1192*.

Most pertinently, however, subchapter V includes the creation of a new pool of trustees, who like in chapter 7 cases, are appointed by the United States Trustee to a case, and whose objectives include facilitating "the development of consensual plan of reorganization." *See* 11 U.S.C. *§* 1183(b)(7). Otherwise, the duties of a subchapter V trustee are similar in many respect to the duties of a chapter 13 or chapter 12 trustee, including supervising and monitoring the case. More specifically, the subchapter V trustee is charged with reviewing and objecting to proofs of claim; opposing the debtor's discharge (if advisable); preparing a final report and account; investigating the debtor's financial affairs, including assessing the desirability for continuance of the debtor's business and any other matter relevant to the case or to the formulation of a plan; distributing property in accordance with a confirmed plan and ensuring that the debtor makes timely payments in compliance with the plan; and, only in the event the debtor ceases to be a debtor in possession, operating the business and performing other duties assigned to trustees. *See* 11 U.S.C. *§* 1183(b)(1) – (6).

At the time of the SBRA's passage, many bankruptcy professionals and professional associations, including the American Bankruptcy Institute (the "ABI"), believed that the $2,725,625 debt limit was insufficient and would result in a limited number of small businesses attaining the intended relief. Soon after the SBRA went into effect in February, the country was hit by the COVID-19 pandemic. In an attempt to provide economic relief to U.S. businesses, Congress passed the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") in March 2020. The CARES Act increased the debt limit under subchapter V to $7.5 million (inclusive of secured and unsecured debt, but excluding debts owed to affiliates or insiders) for one year, after which the debt limit will revert back to the original $2,725,625, unless further extended by Congress. Although Congress could not have anticipated the COVID-19 pandemic and the potential impact on small businesses when passing the SBRA, the relief for small businesses under subchapter V, particularly with the enlarged debt cap, could not have come at a better time.

Approximately 600 subchapter V cases have been filed since the SBRA's enactment.[1] In each of those cases, a subchapter V trustee was appointed by the United States Trustee's Office covering the pertinent jurisdiction from a "pool" of trustees. The pool of subchapter V trustees, numbering in the hundreds nationwide, can be found on the United States Trustee's website, listed by jurisdiction.[2] Unlike the "panel" of chapter 7 trustees who are generally assigned by the United States Trustee's office "on a fair and equitable basis by utilizing a blind rotation system that includes all chapter 7 cases, whether asset or no-asset[,]"[3] subchapter V trustees are selected based on the unique characteristics of each case. Therefore, the selection of a subchapter V trustee is akin to the selection of a trustee in a non-SBRA

…continued on page 53


About the Authors

Mark E. Hall is a partner with Fox Rothschild LLP in Morristown, New Jersey. Mark is a subchapter V chapter 11 trustee and serves on the court-approved Bankruptcy Mediation Panel, both in the District of New Jersey. Mark is the Vice President of the NJ Lawyers Bankruptcy Foundation, a Trustee for The Association of the Federal Bar of New Jersey, and a member of the Lawyers Advisory Committee to the U.S. Bankruptcy Court for the District of NJ. Mark has been practicing for more than 20 years in the restructuring and insolvency community, with extensive experience representing, among others, trustees, debtors, creditors' committees, landlords, financial institutions, secured lenders, and former executives of debtor corporations.

Michael R. Herz is counsel with Fox Rothschild LLP in Morristown, New Jersey, and is part of the firm's Financial Restructuring, Bankruptcy Trustee, and Cannabis practice groups. Michael has a diverse bankruptcy practice, including representing creditors, creditor committees, and debtors, and he has extensive experience, in particular, in representing bankruptcy trustees in chapter 7 and 11 cases. He has also authored several pieces on trustee-related issues.

an adversary proceeding alleging that Midland had obtained funds in the amount of $11,211.65 within the preference period. Midland moved to dismiss the complaint, asserting its interest was perfected outside the preference period. The court analyzed Connecticut state law and prior decisions of bankruptcy courts in Connecticut to support its ruling that the motion to dismiss by Midland should be granted. It was undisputed that the service date was more than 90 days before the petition date. Under Connecticut law, service of the writ of execution perfected the judgment creditor's interest and foreclosed a competing creditor on a simple contract from acquiring a superior interest. The fact that the account was held jointly was irrelevant to the analysis. Under Connecticut law, upon commencing an action, a plaintiff could immediately move to attach real or personal property of a defendant up to the amount of the expected judgment. The plaintiff's pre-judgment attachment of real property would be perfected by recording a writ of attachment on the land records. A pre-judgment attachment of personal property, such as the bank account, would be perfected by service of the writ of execution on the party holding the property subject to attachment. If the judgment is ultimately entered in the plaintiff's favor, the judgment lien dates back to the date of the judgment attachment. Thus, the court held that the date of perfection of the pre-judgment attachment was the operative date for a preference claim under §547. Accordingly, the dismissal motion was granted.

[*Author's comment:* Although this was a debtor seeking avoidance of the transfer, the trustee normally stands in the shoes of the debtor and would be confronted with the same issues. The importance of this decision is simply in highlighting the differences that exist under state law with respect to perfection of judgments, garnishments, and attachments. Because these laws vary considerably from state to state, trustees need to be familiar with the applicable law of their states and possibly nearby states.] 🏛

continued from page 39

The New Frontier of Subchapter V

chapter 11 case, who is appointed based on the unique circumstances of that particular case. In some ways, however, the pool of subchapter V trustees is similar to the panel of chapter 7 trustees in that there are only certain pre-selected individuals (known to the public in each instance) who can serve as a subchapter V trustee, whereas the United States Trustee is not limited to a pre-selected list of individuals when appointing a trustee in a non-SBRA chapter 11 case.

The similarities when appointing a subchapter V trustee and appointing a traditional chapter 11 trustee begs the question as to whether or not interested parties in a case can attempt to exert any influence on the United States Trustee's selection of the subchapter V trustee. In non-SBRA cases, it is common for a creditor(s) to offer suggestions and information to the United States Trustee to aid in the appointment of a chapter 11 trustee, in part because that party-in-interest is intimately familiar with the debtor's case. Therefore, in SBRA cases, a question that may arise for an interested party, especially for a debtor or debtor's counsel, is whether it is appropriate or worthwhile to discuss the appointment of a subchapter V trustee prior to or immediately after the filing of a subchapter V case.

One of the more significant roles of a subchapter V trustee is to facilitate "the development of consensual plan of reorganization." *See* 11 U.S.C. *§* 1183(b)(7). This aspect of the subchapter V trustee's duties is completely unique, as no other party has had a similar charge under the Bankruptcy Code. The question arises whether it is fair or reasonable for the United States Trustee to consider recommendations from the debtor or debtor's counsel prior to the appointment of a subchapter V trustee with this unique role in mind, as the likelihood of confirmation of a plan may depend in part on the working relationship between the debtor and debtor's counsel and the subchapter V trustee, especially because only a debtor can propose a plan in a subchapter V case. *See* 11 U.S.C. *§ 1189(a)*.

Given the newness of subchapter V, case law has been sparse thus far. The main issue that courts have addressed is whether chapter 11 debtors that filed for bankruptcy prior to the enactment of the SBRA can amend their petition to proceed under subchapter V, with the vast majority of courts to date finding that debtors may amend their petitions to elect to proceed as a small business debtor under subchapter V. *See In re Ventura*, 651 B.R. 1 (Bankr. E.D.N.Y. 2020); *In re Body Transit, Inc.*, 613 B.R. 400 (Bankr. E.D. Pa. 2020); 613 B.R. 894 (Bankr. E.D. Mich. 2020); *In re Progressive Solutions, Inc.*, 2020 WL 975464 (Bankr. C.D. Cal. Feb. 21, 2020); *In re Trepetin*, 2020 WL 3833015 (Bankr. D. Md. July 7, 2020). Courts have noted that allowing an existing debtor to amend its petition to proceed under subchapter V is consistent with the general right to amend a petition under Fed. R. Bank. P. 1009(a). One court, however, denied the debtor the opportunity to amend its petition to elect to proceed under subchapter V, holding that the SBRA is silent as to whether it has retroactive effect and that permitting a debtor to subsequently elect subchapter v status "would create a procedural quagmire and likely create 'cause' to dismiss or convert the [d]ebtor's case." *In re Double H Transportation, LLC*, 614 B.R. 553 (Bankr. W.D. Tex. 2020); *but see In re Trepetin*, 2020 WL 3833015 (Bankr. D. Md. July 7, 2020) (in connection with amending petition to proceed under subchapter V, court extended deadlines for the debtor to file a report and plan under section 1188 and 1189).

Although case law has been sparse thus far because the SBRA has only been in effect for 6 months, considering the uniqueness of many aspects of the new law, courts will undoubtedly analyze many questions and controversies that parties will raise under the SBRA in the months to come, something the authors will be tracking. 🏛

ENDNOTES:

[1] *See* https://bit.ly/600subchapterVcases

[2] *See* https://www.justice.gov/ust/eo/private_trustee/locator/11Vcbc.htm

[3] *See* https://www.justice.gov/ust/handbook-chapter-7-trustees