YOUNG CONAWAY

Subchapter V in Practice One Year Later

On March 27, 2021, President Biden signed the COVID-19 Bankruptcy Relief Extension Act of 2021 into law and thereby extended the $7.5 million debt limit for subchapter V eligibility for one additional year.[1] Subchapter V has been a popular option for small businesses due to its streamlined nature and reduced costs.[2] However, the lack of precedent interpreting subchapter V raises questions concerning its flexibility and practical impact. This article provides a brief overview of the benefits of proceeding under subchapter V in Delaware and the types of transactions that may be consummated through subchapter V.

The Tools of the Subchapter V Debtor

Subchapter V was designed to strike a balance between significantly reducing the costs of chapter 11 cases for small business debtors, while ensuring that cases proceed expeditiously for the benefit of creditors.[3]

In furtherance of these goals, subchapter V provides debtors with the following tools, among others:

(1) elimination of the absolute priority rule, which allows equity holders to retain their ownership interests without paying all creditors in full;[4]

(2) no mandatory appointment of a creditors committee;[5]

1 H.R. 1651 – COVID-19 Bankruptcy Relief Extension Act of 2021, https://www.congress.gov/bill/117th-congress/house-bill/1651 (last visited June 10, 2021 at 11:45 a.m.).

2 Thirteen chapter 11 debtors have elected to proceed under subchapter V in Delaware since subchapter V went into effect in February 2020. *See In re United States of Am. Rugby Football Union, Ltd.*, Case No. 20-10738 (BLS) (Bankr. D. Del. Mar. 31, 2020); *In re Apogee Healthcare Holdings LLC*, Case No. 20-10973 (JTD) (Bankr. D. Del. Apr. 20, 2020); *In re Sustainable Rest. Holdings, Inc.*, Case No. 20-11087 (JTD) (Bankr. D. Del. May 12, 2020); *In re Factom, Inc.*, Case No. 20-11602 (BLS) (Bankr. D. Del. June 18, 2020); *In re RGN-Group Holdings, LLC*, Case No. 20-11961 (BLS) (Bankr. D. Del. Aug. 17, 2020); *In re Aftermaster, Inc.*, Case No. 20-12017 (JTD) (Bankr. D. Del. Aug. 28, 2020); *In re Layer Logic, Inc.*, Case No. 20-12408 (BLS) (Bankr. D. Del. Sept. 25, 2020); *In re Knighthouse Media, Inc.*, Case No. 20-12448 (JTD) (Bankr. D. Del. Oct. 2, 2020); *In re Media Lodge, Inc.*, Case No. 20-12969 (JTD) (Bankr. D. Del. Nov. 10, 2020); *In re BC Hosp. Grp., Inc.*, Case No. 20-13103 (BLS) (Bankr. D. Del. Dec. 14, 2020); *In re Champion Prop. Holdings, LLC*, Case No. 21-10396 (JTD) (Bankr. D. Del. Feb. 10, 2021); *In re Augustus Intelligence Inc.*, Case No. 21-10744 (JTD) (Bankr. D. Del. Apr. 24, 2021); *In re Seawind Dev. Corp.*, Case No. 21-10910 (JKS) (Bankr. D. Del. June 8, 2021).

3 *In re Seven Stars on the Hudson Corp.*, 618 B.R. 333, 340 (Bankr. S.D. Fla. 2020) ("[T]o balance the special new powers available to small business debtors, Congress granted creditors a very important protection: the requirement that a Subchapter V case proceed expeditiously.").

4 11 U.S.C. §§ 1181(a), 1191(b).

5 11 U.S.C. § 1181(b).

(3) no mandatory requirement to file a disclosure statement;[6]

(4) appointment of a subchapter V trustee to assist in developing a consensual plan, while leaving the debtor in possession of its assets and in control of its business;[7]

(5) the exclusive right (which cannot be terminated) to file a plan;[8]

(6) the ability to confirm a plan even if all classes reject the plan;[9]

(7) the ability to pay administrative expenses over time under a plan;[10]

(8) modification of the disinterestedness requirements of section 327(a) for a professional that holds a prepetition claim of less than $10,000;[11] and

(9) elimination of the requirement to pay quarterly United States Trustee fees.[12]

In Delaware, there is also more predictability regarding a debtor's judicial assignment if subchapter V is elected. While there are eight judges on the bench, only four judges are assigned subchapter V cases: (i) the Honorable Brendan Linehan Shannon; (ii) the Honorable John T. Dorsey; (iii) the Honorable J. Kate Stickles; and (iv) the Honorable Craig T. Goldblatt.[13]

There are certain unique requirements that the Bankruptcy Code imposes on a subchapter V debtor. Specifically, a subchapter V debtor is required to attend a status conference within 60 days of the petition date, file a status report 14 days before that conference, and file a plan within 90 days of the petition date.[14]

The Qualifications for a Subchapter V Debtor

A debtor may elect to proceed under subchapter V if it is engaged in commercial or business activities and its aggregate, noncontingent, liquidated secured and unsecured debts (excluding debts owed to insiders or affiliates)

6 11 U.S.C. § 1181.
7 11 U.S.C. § 1183.
8 11 U.S.C. § 1189.
9 11 U.S.C. § 1191(b).
10 11 U.S.C. § 1191(e).
11 11 U.S.C. § 1195.
12 28 U.S.C. § 1930(a)(6)(A).
13 *Amended Order Assigning Certain Judges to Cases Under the Small Business Reorganization Act*, dated April 26, 2021.
14 11 U.S.C. §§ 1188, 1189.

are less than $7.5 million, subject to certain exceptions.[15] Subchapter V does not apply to any debtor that is a corporation subject to certain reporting requirements of the Securities Exchange Act or to any debtor that is an affiliate of an issuer as defined in the Securities Exchange Act.[16] Companies considering subchapter V should evaluate their corporate structure to confirm that they are not affiliated with any publicly traded companies.[17]

The election to proceed under subchapter V should be made in the petition.[18] However, in certain circumstances, courts have permitted debtors to amend their petitions to apply subchapter V to a pending case.[19] The United States Trustee or a party in interest may object to the debtor's election no later than thirty days after the conclusion of the 341 meeting or within 30 days following any amendment to the election, whichever is later.[20]

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15 Section 1182 of the Bankruptcy Code governs subchapter V eligibility and provides as follows: "(1) Debtor.—The term 'debtor'— (A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than $7,500,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor; and (B) does not include-- (i) any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $7,500,000 (excluding debt owed to 1 or more affiliates or insiders); (ii) any debtor that is a corporation subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)); or (iii) any debtor that is an affiliate of an issuer, as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)."

16 *Id.* The Securities Exchange Act defines "issuer" as "any person who issues or proposes to issue any security." 15 U.S.C. §§ 78c(a)(8). The Bankruptcy Code defines "affiliate" as an "entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor," with certain exceptions. 11 U.S.C. § 101(2)(A).

17 *See In re Serendipity Labs, Inc.*, 620 B.R. 679, 683 (Bankr. N.D. Ga. 2020) (finding a debtor ineligible for subchapter V because a publicly traded company that filed reports with the SEC owned more than 27% of the debtor's voting securities and was therefore an affiliate of the debtor).

18 Interim Fed. R. Bankr. P. 1020.

19 *See e.g., In re Ventura,* 615 B.R. 1 (Bankr. E.D.N.Y. 2020) (holding a debtor may amend her petition in a pending case to designate herself as a small business debtor and proceed under subchapter V); *In re Progressive Sols., Inc.*, 615 B.R. 894, 900-01 (Bankr. S.D. Cal. 2020) (finding no legal reason why a debtor with a pending chapter 11 case could not amend its petition to proceed under new subchapter V); *In re Twin Pines, LLC*, Case No. 19-10295-j11, 2020 Bankr. LEXIS 1217, at *6 (Bankr. D. N.M. Apr. 30, 2020) (permitting debtor to elect subchapter V status 387 days after petition date); *In re Moore Props. of Person Cnty., LLC*, Case No. 20-80081, 2020 WL 995544, at *7 n.18 (Bankr. M.D. N.C. Feb. 28, 2020) (overruling objection to debtor's small business debtor designation made nine days after petition date, but observing that if "a debtor amends its election at a point in the case in which it creates cause to dismiss or convert the case under § 1112(b)(4)(J) or otherwise, a debtor's case will be in peril."); *but see In re Seven Stars on the Hudson Corp.*, 618 B.R. 333, 347 (Bankr. S.D. Fla. 2020) (refusing to permit a debtor to elect to proceed under subchapter V after the statutory deadlines for a status conference and filing a chapter 11 plan under subchapter V had passed).

20 Interim Fed. R. Bankr. P. 1020.

How Subchapter V Results in Reduced Costs in Practice

In addition to eliminating costs associated with creditors' committees and United States Trustee fees, the streamlined nature of subchapter V can result in significant cost savings for small businesses.

For example, instead of drafting a subchapter V status report and chapter 11 plan from scratch, the Delaware bankruptcy court has issued simple forms for subchapter V debtors to complete.[21] Chief Judge Sontchi of the Delaware bankruptcy court also entered a general order setting the general bar date in subchapter V cases as 60 days following the petition date and setting the governmental bar date in subchapter V cases as 180 days following the petition date, so no bar date motion is needed.[22] Instead of mailing out a separate bar date notice, the bar date is listed in the notice of commencement.

It is questionable whether any solicitation is needed in subchapter V where a debtor seeks non-consensual confirmation under section 1191(b) of the Bankruptcy Code.[23] If the debtor determines to solicit votes, Interim Bankruptcy Rule 3017.2 permits the court to set a voting deadline, solicitation deadline, confirmation hearing date, and related dates at a time other than when a disclosure statement is approved, because there typically is no disclosure statement in a subchapter V case.[24] In accordance with Interim Bankruptcy Rule 3017.2, the Delaware bankruptcy court has entered solicitation procedures orders under certification of counsel without requiring a motion, thereby further reducing costs for subchapter V debtors.[25]

The short duration of subchapter V cases also reduces costs for small businesses. In Delaware, the typical length for a successful subchapter V case is less than four months and several cases have had plans confirmed in two months.[26]

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21 Local Forms, https://www.deb.uscourts.gov/content/local-forms (last visited June 10, 2021 at 11:47 a.m.).

22 *See GENERAL ORDER – Order Setting Proof of Claim Bar Dates in All Cases Under Subchapter V of Chapter 11* (Bankr. D. Del. Sept. 14, 2020).

23 *In re Pearl Res. LLC,* 622 B.R. 236, 259 (Bankr. S.D. Tex. 2020) ("[I]n a subchapter V case, a separate disclosure and solicitation of votes is not required[.]"); *but see Int'l Food Servicing Purchasing Grp., Inc.*, Case No. 20-01458 (Bankr. D.P.R. June 3, 2020) on appeal to the 1st Cir. BAP ("taking all this statutory reference into account, this court concludes that voting requirements are part of the subchapter V plan confirmation process").

24 Interim Fed. R. Bankr. P. 3017.2. *See also In re Adoption of Interim Bankruptcy Rules*, General Order (Bankr. D. Del. Dec. 20, 2019).

25 *See In re BC Hosp. Grp., Inc.*, Case No. 20-13103 (BLS) (Bankr. D. Del. 2020), *Certification of Counsel Regarding Proposed Order (I) Establishing Solicitation and Tabulation Procedures; (II) Approving the Form of Ballot and Solicitation Materials; (III) Establishing the Voting Record Date; (IV) Fixing the Date, Time, and Place for the Confirmation Hearing and the Deadline for Filing Objections Thereto; and (V) Granting Related Relief* [Docket No. 170] and related order [Docket No. 174].

26 *In re Sustainable Rest. Holdings, Inc.*, Case No. 20-11087 (JTD) (Bankr. D. Del. May 12, 2020) (plan confirmed after approximately two months); *In re Factom, Inc.*, Case No. 20-11602 (BLS) (Bankr. D. Del. June 18, 2020) (same); *In re Layer Logic, Inc.*, Case No. 20-12408 (BLS) (Bankr. D. Del. Sept. 25, 2020) (plan confirmed after approximately four months); *In re Knighthouse Media, Inc.*, Case No. 20-12448 (JTD) (Bankr. D. Del. Oct. 2, 2020) (same).

A subchapter V debtor will incur additional costs for the services of the subchapter V trustee, but these fees often total less than $15,000 for the duration of the case and have totaled less than $45,000 in the most complicated subchapter V cases.[27] Subchapter V trustees are generally discouraged from retaining their own professionals absent a specific justification.[28] To date, no subchapter V trustees have retained professionals in Delaware.

The subchapter V trustee often acts as a mediator and facilitates discussions between parties.[29] By acting in this role, the subchapter V trustee can further reduce costs by reducing conflict.

While not specific to subchapter V, small business debtors may also avoid the need for a claims agent if they have less than 200 creditors or parties in interest listed on their creditor matrix.[30]

The Flexibility of Subchapter V

While the language of subchapter V indicates that it was intended to apply to transactions where existing equity continues to own the company and makes income-based repayments to creditors over time, nothing in subchapter V precludes other types of transactions, including sales through chapter 11 plans or reorganization plans where exit facilities are used to pay claims.

Subchapter V sets forth the requirements for consensual and nonconsensual confirmation of a plan. A consensual plan may be confirmed under section 1191(a) of the Bankruptcy Code if it satisfies all of the requirements of

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27 *See, e.g., In re Sustainable Rest. Holdings, Inc.*, Case No. 20-11087 (JTD) (Bankr. D. Del. May 12, 2020) (Subchapter V trustee fees totaled $31,325.00 and expenses totaled $0.00); *In re Factom, Inc.*, Case No. 20-11602 (BLS) (Bankr. D. Del. June 18, 2020) (Subchapter V trustee fees totaled $9,499.50 and expenses totaled $67.50); *In re Layer Logic, Inc.*, Case No. 20-12408 (BLS) (Bankr. D. Del. Sept. 25, 2020) (Subchapter V trustee fees totaled $12,040.00 and expenses totaled $67.70); *In re Knighthouse Media, Inc.*, Case No. 20-12448 (JTD) (Bankr. D. Del. Oct. 2, 2020) (Subchapter V trustee fees totaled $6,900 and expenses totaled $67.50); *In re BC Hosp. Grp., Inc.*, Case No. 20-13103 (BLS) (Bankr. D. Del. Dec. 14, 2020) (Subchapter V trustee fees totaled $42,685.00 and expenses totaled $0.00).

28 *See In re Penland Heating & Air Conditioning, Inc.*, No. 20-01795-5-DMW, 2020 WL 3124585, at *2 (Bankr. E.D.N.C. June 11, 2020) ("[A]uthorizing a Subchapter V trustee to employ professionals, including oneself as counsel, routinely and without specific justification or purpose is contrary to the intent and purpose of the SBRA"); U.S. Dep't of Justice, *Handbook for Small Business Chapter 11 Subchapter V Trustees* 3-17–18 (2020) (Limiting the employment of professionals "is especially important in cases in which the debtor remains in possession and the debtor already has employed professionals to perform many of the duties that the trustee might seek to employ the professionals to perform. The trustee should keep the statutory purpose of SBRA in mind when carefully considering whether employment of the professional is warranted under the specific circumstances of each case.").

29 *See In re Seven Stars on the Hudson Corp.*, 618 B.R. at 346 n. 81 ("A Subchapter V trustee is specifically charged with the duty to facilitate the development of a consensual plan of reorganization. This role should include working not only with the debtor, but with creditors as well, to facilitate negotiation of a consensual plan. A substantial part of the Subchapter V trustee's pre-confirmation role, therefore, should be to serve as a de facto mediator between the debtor and its creditors.") (internal citation and quotation marks omitted).

30 Del. Bankr. L. R. 2002-1(f).

section 1129(a), other than (a)(15), which only applies to individuals.[31] A nonconsensual plan may be confirmed under section 1191(b) of the Bankruptcy Code without satisfying section 1129(a)(8) (the requirement that each class accept the plan or be unimpaired), (a)(10) (the requirement for an impaired accepting class), or (a)(15) if it "does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan."[32]

Section 1191(c) of the Bankruptcy Code sets forth the requirements for "fair and equitable" treatment under a nonconsensual plan in a subchapter V case. Among other things, the plan must provide for the application of all projected disposable income of the debtor to plan payments for a specified period of time, or the value of the property to be distributed under the plan during such period must not be less than the projected disposable income of the debtor.[33] The debtor must also demonstrate a reasonable likelihood that it will be able to make all payments under the plan.[34] The plan must provide for appropriate remedies to protect the holders of claims or interests in the event that the payments are not made.[35]

While there is limited guidance on this issue, a debtor may be able to confirm a plan that does not provide for income-based repayments to creditors if (a) the debtor will not have any future income because distributions will be made from the proceeds of a sale of all or substantially all of the debtors' assets or (b) all plan payments will be made on the effective date or with committed exit financing.[36] Likewise, a debtor should be able to demonstrate

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31 11 U.S.C. § 1191(a).

32 11 U.S.C. § 1191(b). Neither section 1129(b) nor 1191(b) of the Bankruptcy Code set forth a standard for determining "unfair discrimination" but courts typically examine the facts and circumstances of the particular case to determine whether "unfair discrimination" exists. *See In re Trib. Co.*, 972 F.3d 228, 242 (3d Cir. 2020) ("'Discriminate unfairly' is simple and direct: you can treat differently (discriminate) but not so much as to be unfair. There is, as is typical in reorganizations, a need for flexibility over precision. The test becomes one of reason circumscribed so as not to run rampant over creditors' rights."); *In re Armstrong World Indus., Inc.,* 348 B.R. 111, 121 (D. Del. 2006) ("Courts have developed several methods to determine whether a proposed plan unfairly discriminates against a dissenting class. The hallmarks of the various tests have been whether there is a reasonable basis for the discrimination, and whether the debtor can confirm and consummate a plan without the proposed discrimination.") (internal citation and quotation marks omitted).

33 11 U.S.C. § 1191(c)(2).

34 11 U.S.C. § 1191(c)(3).

35 11 U.S.C. § 1191(c)(3).

36 *See In re Sustainable Rest. Holdings, Inc.*, Case No. 20-11087 (JTD) (July 16, 2020) [Docket No. 212] (confirming subchapter V plan with no commitment to provide projected disposable income, where the debtors sold all of their income-generating assets through their plan and the proceeds from that sale would be used to make all plan distributions); *In re Layer Logic, Inc.*, Case No. 20-12408 (BLS) (Jan. 27, 2021) [Docket No. 74] (confirming subchapter V plan with no commitment to provide projected disposable income, where all plan distributions would be made from exit financing); *see also Chip Ford & Ashley Edwards, Move over, S 363: Why Buyers May Prefer Plan Sales in Subchapter V,* Am. Bankr. Inst. J., September 2020, at 16, 17–76, n.7 ("The question may arise as to whether a debtor with no projected disposable income post-confirmation (having sold its income-generating assets) can satisfy the requirements of § 1191(c)(2) in a cramdown scenario, but if projected disposable income is $0, that should render § 1191(c)(2) moot as a practical matter."); *but see In re Young*, No. 20-11844-T11, 2021 WL 1191621, at *5 (Bankr. D.N.M. Mar. 26, 2021) ("If a subchapter V debtor cannot (or chooses not to) make plan payments, creditors lose the quid pro quo for eliminating the absolute priority rule. Debtors who elect not to make plan

that it will be able to make the required payments under the plan and that creditors are protected if all plan payments are made in cash on the effective date or if the debtor establishes a trust for the benefit of creditors with sale proceeds.

Section 1190 of the Bankruptcy Code requires the plan to include "projections with respect to the ability of the debtor to make payments under the proposed plan of reorganization" and to provide for the "submission of all or such portion of the future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan." However, if a debtor's plan does not require any future payments and is not contingent on any future income because all distributions will be made from sale proceeds or on the effective date, these requirements should likewise be moot.[37]

For example, in *Sustainable Restaurants Group*, the Delaware bankruptcy court confirmed a plan without an impaired accepting class pursuant to section 1191(b) of the Bankruptcy Code that provided for the sale of the equity in the reorganized debtor.[38] The proceeds of the sale were used to make distributions to creditors. The plan did not include financial projections or provide for any payments to creditors based on projected income.

Similarly, in *Layer Logic*, the Delaware bankruptcy court confirmed a nonconsensual plan pursuant to section 1191(b) of the Bankruptcy Code where the plan sponsor committed to support and fund the plan. The plan set forth a debt to equity transaction that provided for the cancellation of the current equity interests and the conversion of the debt owed to the plan sponsor to equity in the reorganized debtor. All priority and general unsecured creditors were paid in full with new value cash from the plan sponsor. The plan sponsor also agreed to provide post-confirmation financial support to the reorganized debtor until its business became cash flow positive. Like in *Sustainable*, the plan did not include financial projections or provide for any payments to creditors based on projected income.[39]

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payments should not get the benefit of subchapter V. If making reasonable plan payments while working is unpalatable to the Debtors, they should have filed a chapter 7 case.") (citations omitted).

37 *See In re Sustainable Rest. Holdings, Inc.*, Case No. 20-11087 (JTD) (July 16, 2020) [Docket No. 212] (confirming subchapter V plan with no financial projections, where all plan distributions would be made from the proceeds of the debtors' sale process); *In re Layer Logic, Inc.*, Case No. 20-12408 (BLS) (Jan. 27, 2021) [Docket No. 74] (confirming subchapter V plan with no financial projections, where distributions would all be made from exit financing).

38 *See In re Sustainable Rest. Holdings, Inc.*, Case No. 20-11087 (JTD) (July 16, 2020) [Docket No. 212].

39 Subchapter V provides that section 1141(d) of the Bankruptcy Code shall not apply to plans confirmed under section 1191(b), except as provided in section 1192. Section 1192, in turn, provides that the debtor will not be granted a discharge until all plan payments due within the first three years, or up to the first five years, are completed, and that such discharge shall exclude "any debt (1) on which the last payment is due after the first 3 years of the plan, or such other time not to exceed 5 years fixed by the court; or (2) of the kind specified in section 523(a) of this title." Despite this provision, in *Layer Logic*, the debtor was granted a discharge on the effective date because all non-insider debt was paid in full and the only claim not paid in full on the effective date was related to a Payment Protection Program loan that was protected by an escrow. *In re Layer Logic, Inc.,* Case No. 20-12408 (BLS) (Jan. 27, 2021) [Docket No. 74]. In *Sustainable*, the debtors also received a discharge of claims pursuant to section 1141(d) on the effective date. *In re Sustainable Rest. Holdings, Inc.*, Case No. 20-11087 (JTD) (July 16, 2020) [Docket No. 212].

Finally, in another subchapter V case, *BC Hospitality Group, Inc.*, the debtors sought to sell their assets or equity through a chapter 11 plan. Ultimately, the debtors did not receive a bid high enough to consummate a chapter 11 plan. Even though the debtors could not confirm a plan, the Delaware bankruptcy court approved a sale of the debtors' assets pursuant to section 363 of the Bankruptcy Code. The chapter 11 cases were subsequently dismissed.

Conclusion

Subchapter V offers substantial benefits to qualifying debtors, including reduced costs and the opportunity to consummate a value-maximizing transaction in a streamlined manner. The Delaware bankruptcy court has implemented various additional benefits for subchapter V debtors, including increased predictability in judicial appointment and standardized forms for status reports and chapter 11 plans. Companies considering subchapter V should discuss their restructuring goals with counsel to understand how filing a subchapter V case in Delaware can benefit them.