Title
Chapter 11 at the School of Subchapter V: Part I

Journal
Law & Economics, 26(5)

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Publication Date
2024-10-01

UCLA School of Law

Law & Economics Research Paper No. 24-06

CHAPTER 11 AT THE SCHOOL OF SUBCHAPTER V: PART I

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44 Bankr. L. Ltr. 6 (June 2024).

Bankruptcy Law Letter

JUNE 2024 | VOLUME 44 | ISSUE 6

CHAPTER 11 AT THE SCHOOL OF SUBCHAPTER V: PART I

*By: Daniel J. Bussel and Austin J. Damiani**

The Great Pandemic of 2020 was a watershed event in our social and economic life, but it left a surprisingly light footprint on bankruptcy law.[1] The federal government's fiscal and monetary policies flooded the United States economy with liquidity,[2] and as a result few bankruptcies resulted from the massive social and economic dislocations caused by shutdown orders, disrupted supply chains, and the sudden restructuring of much employment around telecommuting. Almost incidentally, however, a quiet revolution over small business bankruptcy took place when the Coronavirus Aid, Relief and Economic Security Act (CARES Act)[3] temporarily raised the jurisdictional limit of the then brand new Subchapter V[4] from $3,024,725[5] in noncontingent liquidated debts (excluding affiliate and insider debt) to $7.5 million.[6] Before March 2020, few small business debtors (other than family farmers under chapter 12) qualified for any form of specialized relief, and even fewer desired the "relief" that was available, as the preexisting procedures imposed additional onerous requirements on small business debtors and provided few benefits. Chapter 11 was a decidedly inhospitable environment for small businesses before Subchapter V.

Subchapter V has proven to be a hit. The ABI reports that almost 7,500 Subchapter V cases have been filed since February 2020 which is more than 25% of all chapter 11 cases filed during that period.[7] Early reviews of Subchapter V are very favorable. The ABI found that the "overwhelming consensus of bankruptcy professionals, bankruptcy judges, and academics is that Subchapter V is functioning as Congress intended," and its extensive review of the available data "show that confirmation in Subchapter V cases occurs more often, more quickly, and at lower cost than in non-Subchapter V small business cases and standard Chapter 11 cases, and that creditors are receiving more money in Subchapter V."[8]

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Mat #43108514

This essay will be published in two installments of the *Bankruptcy Law Letter* (Part I this month and Part II in the July 2024 issue). It is an overview of Subchapter V and notes along the way various issues that have arisen as the bankruptcy bar and courts adapt and apply the new procedures. But it also sets Subchapter V in historical and statutory context, and suggests that experience under Subchapter V may enrich and improve chapter 11's overall performance. It highlights a fundamental tradeoff embodied in Subchapter V: Creditors of insolvent small business debtors can be forced to share reorganization value with equity in exchange for speed, efficiency, cost savings and the finality of a payment plan with liquidation or other appropriate remedies in the event of default. How well this experiment works for distressed small businesses may influence future reform of chapter 11 itself.

This Part I begins with some historical context, moves to a discussion of Subchapter V's eligibility criteria, and ends with a discussion of its nonconsensual plan confirmation provisions which substantially relax chapter 11's cramdown rules. Next month in Part II, we will address Subchapter V's heightened feasibility standards and its scope of discharge (including potentially third-party releases). Part II then concludes with a reflection on the potential influences Subchapter V may exert on chapter 11 practice more broadly.

I. HISTORICAL CONTEXT

Subchapter V now serves the role originally envisioned for the Chandler Act's chapter XI as a less formal, less expensive, quicker, and more debtor-favorable reorganization procedure for small proprietorships and family owned and operated businesses—the proverbial local hot dog stand.[9] Although the Chandler Act did not expressly limit access to chapter XI to small business debtors, Congress intended chapter X to be the normal procedure for reorganizing corporations with outstanding publicly held securities and chapter XI for small business arrangements in which the claims of trade creditors and unsecured lenders were scaled down or extended.[10] But by the eve of the adoption of the 1978 Bankruptcy Code, chapter XI, despite all of its limitations, was being used to reorganize corporations that were among the nation's largest and chapter X was virtually a dead letter. The perceived reasons for the failure of chapter X and the popularity of chapter XI became guiding principles in the drafting of chapter 11 of the 1978 Bankruptcy Code as a unitary reorganization procedure for all debtors with features borrowed, blended and altered from both chapter X and chapter XI.[11]

Subchapter V, in turn, embraces certain abandoned features of old chapter XI in dispensing with many of the creditor protections built into modern chapter 11. In Subchapter V there is unlimited plan exclusivity for the debtor,[12] no disclosure statement,[13] no absolute priority rule,[14] no creditors' committee,[15] and no one-consenting class rule.[16]

Congress, however, anticipated that, as with chapter XI, these flexible procedures designed for sole proprietorships and small family businesses, might attract a range of other debtors. Subchapter V guards against that eventuality by limiting access to debtors (and their affiliates) whose liquidated noncontingent non-insider debts exceed $7.5 million and excluding entirely: (i) single-asset real estate debtors;[17] (ii) individuals whose debts are primarily consumer debts[18]; and (iii) SEC reporting firms and their affiliates.[19]

Chapter 11, the crown jewel of the 1978 Bankruptcy Code, fell under attack by commentators shortly after it became the law. Almost 40 years ago, Douglas Baird challenged the assumption that the going concern value of a distressed business may commonly exceed its liquidation value.[20] Businesses are frequently sold as entities both inside and outside bankruptcy. Baird argued that if continued operation of the business is the best use of a company's assets, and the market is functioning properly, the successful buyer should bid a price—the discounted value of future earnings—that equals the firm's going concern value. Subsequently, other commentators prominently called for repeal of chapter 11, arguing that chapter 11 reorganizations provide less value for both equity and debt holders while principally benefitting incumbent corporate management.[21] No constituency emerged to support repeal. Instead, legislative reform efforts have largely focused on powerful creditor constituencies jockeying for advantage and imposing greater regulation of the debtor. Market forces and strategic behavior within bankruptcies have combined with these legislative changes to continuously reshape the ordinary course of bankruptcy cases. Chapter 11 as practiced today is very different than the chapter 11 as originally enacted in 1978 and practiced in the 1980s.[22]

The net effect may well have been to make matters worse in terms of promoting internal reorganizations generally[23] and for small businesses particularly.[24] Research suggests that by such measures as plan confirmation, survival, and management turnover, there has been a modest long-term decline in the efficacy of chapter 11 as a reorganization vehicle.[25] On the other hand, as chapter 11 has become more cumbersome for traditional reorganizations, parties have increasingly looked to prepackaged bankruptcies[26] or the lightly regulated and highly expedited sale alternative available under section 363[27] as a mechanism to preserve going concern value in an echo of Douglas Baird's observations in *The Uneasy Case*. Finally, while empirical research has shown a correlation between BAPCPA and shorter chapter 11 cases (and increasing numbers of prepackaged bankruptcies), the same research has shown a correlation between BAPCPA and an increase in debtor refiling rates.[28]

In the final analysis, notwithstanding chapter 11's current flaws and woes, the greatest legacy of the Chandler Act's chapter XI remains its status as a progenitor (along with equity receiverships) of modern chapter 11. In 1978, in instance after instance the rigidities of an ossified chapter X were abandoned in favor of more flexible approaches to reorganization growing out of old chapter XI. In the same way that chapter XI's informality and flexibility informed the development of modern chapter 11, the lessons we will learn from observing Subchapter V in action may inform further reform of chapter 11, ameliorating the tendency of both post-1978 amendments and judicial fascination with textualism to ossify the statute and limit the bankruptcy system's ability to flexibly adapt it to evolving economic, business, and financial conditions.

Subchapter V allows small business debtors to keep their assets and to pay their creditors' claims out of disposable income over the period of the plan pursuant to a streamlined process.[29] The court can confirm the debtor's plan without the support of any class of creditors[30] and under expedited procedures.[31] To use Subchapter V, the debtor must file its chapter 11 plan within 90 days of its bankruptcy petition unless the court finds an extension of that deadline warranted by circumstances beyond the debtor's control.[32] The debtor's post-petition earnings are not part of the Subchapter V debtor's estate unless nonconsensual plan confirmation occurs.[33] Moreover, to confirm nonconsensually, the plan must provide that the debtor's projected disposable income during the plan period (*i.e.*, a minimum of 3 years) will be applied to payments under the plan.[34] The calculation of projected disposable income, however, is not subject to the rigid chapter 13 guidelines applicable to above-median income consumer debtors.[35] Also unlike chapter 13, the Subchapter V plan may modify a mortgage in the debtor's primary residence, provided that the loan secured by the residence was used for the debtor's business and not to acquire the residence.[36] The following sections discuss selected issues that have arisen in applying these procedural innovations.

II. ELIGIBILITY

Subchapter V was designed to facilitate and simplify the reorganization of small proprietorships and family businesses,[37] and thereby attract debtors that might not otherwise file under chapter 11 or might delay filing until reorganization was no longer feasible.[38] In particular, chapter 11's absolute priority rule was viewed as a significant barrier to successful reorganization of these types of firms, since the going concern value of such firms was tied to maintaining the pre-bankruptcy link between ownership and management by reorganizing the firm under its existing ownership.[39]

Subchapter V's rejection of the "one size fits all approach"[40] to reorganization hearkens back to the Chandler Act's bifurcated scheme, which generated filings under chapter XI by firms for which it was not designed and bred litigation over debtor eligibility.[41] In 1978, Congress reacted against these defects of the two-track system by adopting a unified reorganization procedure under chapter 11.[42] Reestablishing a bifurcated approach through Subchapter V inevitably raises litigable issues concerning debtor-eligibility for the simplified procedure designed for sole proprietorships and small family businesses. And like chapter XI, the debtor-favorable features of Subchapter V will attract other types of firms giving rise to threshold litigation as objecting creditors and the U.S. Trustee police the frontier to screen out those too large, complex, or otherwise ill-suited for the simplified procedure.[43]

Eligibility disputes revolve around the Code's definition of "small business debtor" and the uncodified requirement of "good faith" in commencing the case. Small business debtors are defined as:

1. a person engaged in commercial or business activities;

2. with aggregate noncontingent liquidated secured and unsecured debts not more than $7.5 million as of the petition date excluding debts owed to affiliates and insiders;

3. of which not less than 50% arose from the commercial or business activities of the debtor.[44]

Two types of firms that might otherwise meet these criteria are specifically excluded: single-asset real estate debtors[45] and SEC reporting firms and their affiliates.[46]

"Commercial or business activities" as used in Subchapter V is not defined or otherwise used as a term of art in federal law.[47] The U.S. Trustee has disputed a number of edge cases, but bankruptcy courts have generally refused to impose meaningful limits on access to Subchapter V beyond the specific statutory exclusions. One court has suggested "even employees flipping burgers at fast food restaurants are 'engaged in commercial or business activities' as a part of our grand American economy."[48] Nor has the absence of a profit motive necessarily proved an obstacle to clearing the "commercial or business activities" hurdle.[49]

The statutory requirement that an eligible debtor must be "engaged in" commercial activity suggests that the Subchapter V debt restructuring will be tied to ongoing business activity.[50] But bankruptcy courts have not imposed such a requirement. No nexus is required between the commercial activity at time of filing and the source of the debt.[51] This decoupling allows a modest amount of present commercial activity to permit restructuring of legacy business debt from a previous operation under Subchapter V. For example, one court suggested the debtor renting out a room in her house was a sufficiently commercial activity for the debtor to access Subchapter V to restructure business debt from a defunct business.[52]

Subchapter V thus accommodates reorganizing small businesses, but also relieves failed entrepreneurs from legacy business debt of defunct entities that will never be revived. The lesson from the case law for these entrepreneurs is to keep the entity on life support, extend wind-down, or engage in new business activities sufficient to preserve access to Subchapter V. The statute therefore advances not just a pro-reorganization policy, but entrepreneurship *per se* by mitigating the financial consequences of failed entrepreneurial efforts.[53] In this respect Subchapter V substitutes a more forgiving procedure not only for reorganizing debtors who would otherwise find themselves in chapters 11 or 13 but also provides an alternative route for both individuals and entities to access the fresh start policy for individuals historically associated with chapter 7—without the limitations imposed by chapter 7 itself.[54]

Lease obligations may materially impact debtor eligibility toward the $7.5 million cap. The status and treatment of landlords are not expressly dealt with in Subchapter V. Accordingly, the general provisions of the Code related to unexpired leases remain applicable.[55] In *In re Macedon Consulting, Inc.*, the bankruptcy court revoked the debtor's Subchapter V election after finding its prepetition lease obligations liquidated and noncontingent, pushing it over the $7.5 million cap.[56] The court declined to consider postpetition events, including the possibility of assumption or rejection, in determining the debtor's eligibility under § 1182(1)(A).[57] At least one court has pushed back, albeit in *dicta*: "[A] debtor's future payment obligations under its unexpired leases and executory contracts should rarely, if ever, be counted toward the subchapter V debt cap."[58] This would seem to follow from the statutory debtor eligibility criteria to the extent that the amount of the future rent claim remains unliquidated, *i.e.* until termination or rejection occurs. The ABI has, however, recommended that Congress clarify the issue by expressly excluding future rent claims from the debt cap calculation, arguing future rent claims under long-term leases do not meaningfully add to the complexity of Subchapter V proceedings and therefore should not affect debtor eligibility.[59] In any event, nothing in § 1182(1)(A) suggests that claims arising out of lease rejection or termination will be exempt from the § 502(b)(6) cap on landlord damages. If termination or rejection has occurred at the time of the determination of debtor eligibility, the landlord's claim for future rent should nevertheless be subject to the § 502(b)(6) cap for the purposes of determining debtor eligibility.

The question of how and when postpetition events might factor into the Subchapter V eligibility calculus also surfaced in the Alex Jones bankruptcies. Free Speech Systems, LLC, the parent company of InfoWars, filed bankruptcy and elected Subchapter V in July 2022.[60] Free Speech's eligibility was not disputed until Alex Jones personally filed a separate chapter 11 proceeding (not under Subchapter V) in December 2022 after incurring a $1.5 billion judgment for defaming the families of the victims of the Sandy Hook massacre. The defamation claimants moved to revoke Free Speech's Subchapter V election arguing that although section 1182(1)(A), defining "debtor" for Subchapter V purposes, includes the modifier "as of the date of the filing of the petition," section 1182(1)(B)(i), setting forth the exclusion based on its affiliates' status, does not.[61] Section 1182(1)(B)(i) states the term "debtor" does not include "any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts" greater than $7.5 million.[62] The defamation claimants argued that because Mr. Jones had noncontingent and liquidated debts of over $1 billion, and is an affiliate of Free Speech Systems, the statute barred Free Speech (as well as Mr. Jones personally) from access to Subchapter V.

The bankruptcy court, however, ruled that Mr. Jones' postpetition chapter 11 filing did not invalidate the prior Subchapter V election of Free Speech Systems because its "statement of election in its voluntary petition—and the basis for making it as of that day—remain true."[63] The *Free Speech* court was concerned that "[i]f postpetition affiliate filings lead to ineligibility and revocation, . . . debtors could float in and out of Subchapter V at any time."[64] But the existence of a concurrent chapter 11 filing does not lead to debtors "floating in and out of Subchapter V." Once the affiliate files under chapter 11, it makes eminent sense to jointly administer the pending Subchapter V with its larger affiliate in the chapter 11 case—as Congress seems to have intended. Moreover, ignoring postpetition affiliate filings will result in uncoordinated related filings proceeding under different reorganization rules and debtor manipulation of the sequence of affiliate filings to end run Subchapter V's eligibility criteria. *Free Speech Systems* invites debtors to strategically sequence bankruptcies of qualifying and nonqualifying affiliates to evade the rule requiring joint administration under chapter 11. Doing so may be particularly tempting for a substantial nonqualifying business in need of reorganization operating through numerous affiliated entities that individually otherwise qualify for Subchapter V relief.[65]

Any fixed debt cap on Subchapter V access will induce strategic behavior due to the strong incentives to qualify for Subchapter V relief. Debtors who want that relief will attempt to squeeze under the $7.5 million threshold. In 2022, Congress not only extended Subchapter V's $7.5 million debt cap for an additional two years[66] but also made a "technical" change to debtor eligibility that opens the doors of Subchapter V to some portfolio companies of private equity funds and other non-public issuers of exempt securities.[67] As originally enacted, section 1182(1)(B)(ii) excluded any debtor from Subchapter V affiliated with any issuer of any security (whether registered or exempt) under the Securities Exchange Act of 1934, but the amendments narrowed the exclusion to debtor affiliates of SEC reporting companies.[68] Query whether Congress fully appreciated the scope of this "technical amendment" expanding access to Subchapter V for affiliates of exempt issuers. Even U.S. subsidiaries of foreign publicly traded companies that are not subject to SEC reporting requirements may now be eligible, entities that seem far removed from the Subchapter V paradigm of the sole proprietorship or small family business.[69]

At least half the liquidated non-contingent non-insider debt of a Subchapter V debtor must have arisen from "the commercial or business activities of the debtor" to qualify for Subchapter V treatment.[70] Again, courts have interpreted the phrase expansively.[71] Still, there are limits.[72] *In re Blue* was a close call. Roughly 45% of the debt was clearly business, 45% was consumer, and 10% was contested, including a critical portion connected to a renovation of a vacant rental property.[73] But the court found that the renovation repaired damage from an evicted tenant, and thus the debt arose from a commercial or business activity, notwithstanding the termination of the activity and the fact that it was the debtor's consulting services that qualified her under the "presently engaged" analysis, not her defunct real estate operation.[74] Note that requiring a nexus between the business activity engaged in at the time of filing and the business activity from which the debt arose would preclude this kind of debtor from meeting the 50% threshold for Subchapter V eligibility.

Strategic manipulation of the consumer debt limit also remains a possibility. A small business owner struggling to meet the 50% business debt requirement could withhold payments on existing business debts, incur new business debts, or pay down disqualifying consumer debt before filing (perhaps with the proceeds of nondebtor affiliate loans).

The exclusion of insider debt from the $7.5 million cap[75] was no doubt designed to accommodate the reality that small family businesses are frequently funded with loans from insiders and the desire not to unduly chill such financing. But the exclusion may be of particular utility to the private equity business model, in which portfolio companies are routinely indebted to affiliates. A fund manager wishing to restructure a distressed portfolio company without losing its equity interest could strategically substitute affiliate debt for non-contingent non-insider debt to come in under the $7.5 million cap. In theory, this technique combined with the sequencing authorized by *Free Speech Systems* could allow a portfolio of affiliated distressed entities to access Subchapter V. Policing these potential devices will be left to judicial scrutiny of the debtor's "good faith."

In re McGrath offers an example of the uncodified requirement of good faith limiting access to Subchapter V.[76] A debtor with a single commercial property was earning no income from it because the mortgagee had exercised its rights to collect rents under a prepetition assignment. The court held that the debtor was not a single-asset real estate debtor because single asset real estate debtors must, by definition,[77] generate substantially all of their gross income from the property.[78] Although the debtor fell outside the statutory exclusion for single-asset real estate debtors the court nevertheless dismissed the Subchapter V case with leave to convert to chapter 7.[79] The uncodified good faith requirement closed the statutory loophole. If anything, reorganizing in Subchapter V around commercial real property generating no income makes even less sense than granting access to the income-producing single asset real estate debtors expressly excluded from this relief.[80]

Beyond the implicit good faith filing requirement for the petition commencing the case, there is an explicit requirement in both Subchapter V and chapter 11 that the plan be proposed in "good faith."[81] A bankruptcy court in *In re Who Dat?, Inc.*, rejected a plan as proposed in bad faith where the debtor had no prospect of future income: "So if chapter 11 cannot reanimate this zombie company, who benefits from this process? The answer to that question is [the debtor's] principals."[82] The court likened the debtor's scheme to fund the plan payments with new debt in lieu of income as an attempt to impermissibly orchestrate a "new value exception" in Subchapter V.[83] The new value exception as traditionally understood is irrelevant given Subchapter V's abrogation of the absolute priority rule. The Subchapter V debtor can nonconsensually retain equity on account of its prior ownership interest without making any new investment at all. But the tradeoff is that all of the debtor's disposable income must be devoted to debt repayment for three to five years. As the court intuited, nothing in the text or structure of Subchapter V suggests that the debtor may buy its way out of this requirement at a discount without obtaining the consent of all impaired creditor classes. Worse yet, the debtor in *Who Dat?* had a single asset—a trademark—that was the subject of litigation. Its Subchapter V filing was not intended to solve a financial restructuring or collective action problem, but rather an attempt to obtain strategic advantage in litigation. Dismissal for bad faith appears warranted under the circumstances.

III. CRAMDOWN, "FAIR AND EQUITABLE" & SECTION 1111(b)

At the heart of Subchapter V is the policy judgment that only the secured portion of a claim is entitled to the traditional non-consensual baseline treatment afforded by chapter 11's fair and equitable rule. The deficiency claims of secured parties and other unsecured claims may receive only a small fractional distribution, or even nothing at all, so long as all projected "disposable income" for the next three to five years is devoted to debt repayment[84] and the court finds that creditors are no worse off than they would be in a forced liquidation.[85] It is entirely conceivable under this rule that all disposable income will be devoted to servicing priority and secured claims while the debtor's pre-bankruptcy equity interests emerge unimpaired. Moreover, disposable income is defined as debtor income net of all "expenditures necessary for the continuation, preservation or operation of the business."[86] Presumably this allows a debtor entity to deduct market-rate salaries for its principals in determining disposable income. Accordingly, although individual Subchapter V debtors are limited to drawing funds for personal use from business income to the extent necessary for maintenance or support of the debtor[87] and his or her dependents,[88] if the debtor is a corporation, there is no apparent limit on the amount of the non-debtor principals' salaries so long as they are market salaries and the services are necessary for the continuation of the debtor's business. Nevertheless, judges may question the good faith of even consensual plans in which the principals' salaries seem seriously out-of-line with creditors' proposed recoveries.

The principal economic protection for unsecured creditors in Subchapter V then is the best-interests test which requires that each creditor receive more under the plan than it would receive in a chapter 7 liquidation of the debtor.[89] Since unsecured creditors of business debtors frequently receive no or *de minimus* distributions in chapter 7 liquidation, even the best-interests test may provide scant solace. Moreover, unsecured creditors' procedural rights under chapter 11 are largely gutted. There is no official committee or estate professionals representing the unsecured creditors unless the judge finds cause to appoint them;[90] neither disclosure nor solicitation of votes is necessary,[91] and the consent of impaired unsecured creditors may be irrelevant to plan confirmation, at least so long as no third-party releases are sought.[92]

Traditional chapter 11 protections for administrative expenses and home mortgages are also significantly watered down in Subchapter V. Administrative expenses need not be paid in full in cash on the plan effective date.[93] The plan may defer their payment for up to five years.[94]

Even home mortgages, which are elsewhere in the Code insulated from modification or bifurcation[95] are subject to strip-down in Subchapter V to the extent the proceeds of those mortgage loans were used for business (rather than personal) purposes.[96] Following strip-down, the home mortgage lender is left to either (i) the meager protections of Subchapter V's best-interests and net disposable income rules for its unsecured deficiency claim, or (ii) the § 1111(b)(2) election.

In short, and at every turn, so long as business debts predominate, the liability of debtors in Subchapter V is treated far more favorably than the liability of debtors in chapter 11. Finally, creditors have no ability to file their own plan under Subchapter V. The debtor retains plan exclusivity throughout the course of the proceeding.[97]

It is possible that the courts will find significant substantive "uncodified" content in the "good faith," "fair and equitable" and "unfair discrimination"[98] standards borrowed from chapter 11 and incorporated by reference in section 1191. Like chapter 11, Subchapter V sets forth its specific confirmation requirements as a nonexclusive "rule of construction" for the term of art "fair and equitable."[99] Plans that otherwise comply with the disposable income test but offend judicial sensibilities or suggest abuse might still founder on these hidden shoals.[100] But in chapter 11, these "uncodified" standards have tended to be invoked rarely, construed narrowly, and justified as historically rooted. Given these factors, it will be challenging for the bankruptcy system to develop "uncodified" constraints on Subchapter V plans beyond those expressly laid out in section 1191.

With few other creditor protections available, the incidence and strategic value of section 1111(b)(2) elections may be significantly heightened under Subchapter V since the unsecured deficiency claims of under-secured creditors can no longer block plan confirmation by invoking the absolute priority rule.[101] Ordinarily, in chapter 11, the election to waive deficiency and treat the entire debt as secured only sets the electing creditor up for an unfavorable cramdown.[102] But in Subchapter V, if unsecured deficiency claims have neither economic value nor the power to block the debtor's plan, the election to treat the entire debt as secured and hope that post-confirmation events result in future appreciation of the collateral may be the best the secured party can do for itself.[103]

The net effect of all these debtor-favorable choices in Subchapter V is to systematically redistribute any excess over the judicially determined value of the collateral away from the secured and unsecured creditors and in favor of the equity interest. Although under *Rash*,[104] retained collateral under a reorganization plan is valued at "replacement value" rather than "liquidation value," it seems unlikely that judicial valuation of asset replacement values will capture the full going concern value of an insolvent small business debtor generating a positive operating cash flow—and if a court were to so find, there would be nothing left for unsecured creditors under Subchapter V's net disposable income test.

For many sole proprietorships or family businesses, allocating going concern value primarily to equity may be reasonable given the identity between ownership and management.[105] Substantially all the going concern premium that exists may be attributable to the continuing efforts and entrepreneurial value contributed by the equity owners.[106] Unless a particular creditor has some leverage from a business perspective—perhaps because the creditor holds personal guarantees, the debtor needs additional financing, or because the creditor is also a critical supplier or customer—forced liquidation value may be all they can reasonably expect to capture. For these small business debtors, absolute priority and the elimination of the equity of insolvent debtors are theoretical constructs inconsistent with the economic reality of successfully reorganizing as a going concern. Old chapter XI rejected them,[107] and when they were introduced by the Bankruptcy Reform Act of 1978, successful bankruptcy reorganizations of small businesses became difficult and infrequent.[108] Subchapter V has now also dispensed with them.

The remaining question then is what value there is, if any, for creditors in the move from chapter 11 to Subchapter V if the ability to capture much (if any) of the collateral's going concern value is taken away. The promise of Subchapter V to creditors is that the speed, cost-effectiveness and finality that may be achieved through a Subchapter V reorganization will reduce the risk that the forced liquidation value that exists at the inception of the case will be squandered in legal expenses, delay, and false starts on failed reorganization efforts. On the other hand, from the creditor perspective, Subchapter V potentially eliminates upside—leverage to extract a portion of the going concern value of the small business enterprise as the price of consent—for this downside protection. Again, from a creditor perspective, the reasonableness of this shift depends in significant part on the ability to obtain prompt forced liquidation at low cost if confirmation standards cannot be met, or if confirmed Subchapter V plans fail.

All of which brings us to Subchapter V's strengthened feasibility requirement—the place at which Part II of this essay will pick-up next month in the July 2024 Bankruptcy Law Letter.

ENDNOTES:

[1]Unless otherwise noted, statutory references are to the United States Bankruptcy Code, 11 U.S.C.A. §§ 101 *et seq*. Chapter 11 business filings were modest during the pandemic years: 7,786 (2020); 4,366 (2021); 4,465 (2022). This represents a significant decline from a pre-pandemic rate of approximately 6,000 cases per year from 2014-2019. The last major spike in business chapter 11 filings occurred during the Great Recession, peaking at 13,683 cases in 2009. In 2023-24, the rate of commercial chapter 11 filings (and Subchapter V filings, particularly) has been increasing. During Q1 2024 there were 1,894 commercial chapter 11 filings (including Subchapter V) up 43% from 1,325 commercial chapter 11s during the same period in 2023. Subchapter V elections for small businesses increased 30% to 606 filings in Q1 2024 from the 465 filed during Q1 2023. These Q1 statistics suggest that 2024 may be the first year in which commercial chapter 11 bankruptcy filings exceed the pre-pandemic norm. The statistics cited here are drawn from figures reported by the American Bankruptcy Institute. *See* https://www.abi.org/newsroom/bankruptcy-statistics.

[2]The Federal Reserve held the 13-week Treasury bill rate at less than 1% from March 2020 to May 2022. From May 2022 to April 2023 the 13-week T-bill rate steadily increased to 5% and it has fluctuated between 5 and 5.5% since. *See Daily Treasury Rates*, U.S. Dep't of the Treasury, https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_bill_rates&field_tdr_date_value=2023. Meanwhile the federal government ran record budget deficits. The Federal Reserve Bank of St. Louis reports the federal budget deficit at $3.13 trillion (FY 2020); $2.78 trillion (FY 2021); $1.38 trillion (FY 2022) and $1.69 trillion (FY 2023). *See* U.S Office of Mgmt. & Budget, *Federal Surplus or Deficit* at FRED, Fed. Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/FYFSD. The 2020 deficit figure of $3.13 trillion represented 15% of GDP. Only at the height of World War II did the federal government incur deficits of this relative magnitude. For comparison, the federal budget deficit was $1.4 trillion (FY 2009) at the height of the Great Recession. By 2014, the annual deficit had reduced to $485 billion. By 2019, tax reductions and spending increases doubled the deficit to $984 billion. It then tripled again the next year as the pandemic took hold.

[3]Coronavirus Aid, Relief, and Economic Security Act, Pub. L. 116-136 § 1113(a)(1) (2020) (amending definition of "small business debtor" in 11 U.S.C.A. § 1182(1)). The one-year sunset of the $7.5 million limit in the original CARES Act was extended by subsequent legislation through June 21, 2024. The American Bankruptcy Institute is urging Congress to further extend the $7.5 million jurisdictional limit (exclusive of insider and affiliate claims) for Subchapter V. Am. Bankr. Inst., Final Report of the American Bankruptcy Institute Subchapter V Task Force (2024) (hereinafter "**ABI Subchapter V Report**"] available at: https://www.abiworld.org/newsroom/press-releases/. On April 17, 2024, the Bankruptcy Threshold Adjustment Extension Act was introduced to extend the $7.5 million debt cap for another two years, until June 2026. S. 4150, 118th Cong. (2nd Sess. 2024).

[4]§§ 1181-1194 (enacted as the Small Business Reorganization Act of 2019, Pub. L. 116-54 (2019)) became effective on February 19, 2020. It is referred to herein as **"Subchapter V."** It is largely based on the work of the *ABI Commission to Study the Reform of Chapter 11*, 23 Am. Bankr. Inst. L. Rev. 1, 297-326 (2015).

[5]This is an inflation adjusted figure as of April 2022. §§ 101(51D) ("small business debtor"), 104.

[6]§ 1182(1)(A). Approximately 25% of those firms filing under Subchapter V would have been excluded had Congress not temporarily increased the debt limit to $7.5 million. *See* ABI Subchapter V Report, *supra* note 3, at 2. The ABI has urged Congress to extend the current $7.5 million jurisdictional limit (without counting insider and affiliate debt). On April 17, 2024, the *Bankruptcy Threshold Adjustment Extension Act* was introduced to extend the $7.5 million debt cap for another two years, until June 2026. S. 4150, 118th Cong. (2nd Sess. 2024). Unsurprisingly, as in standard chapter 11 cases, the larger cases in Subchapter V are somewhat more likely to confirm plans than the smaller cases (42.2% v. 38.4%). ABI Subchapter V Report, *supra* note 3, at 93 (App. B: Subchapter V Statistical Summary).

[7]ABI Subchapter V Report, *supra* note 3, at 2-3. Interestingly, 42% of all Subchapter V cases were filed in four states: Florida (948); Texas (761); California (705); and New York (482). *Id.* At 89-90 (App. B: Subchapter V Statistical Summary).

[8]*Id.* At 5. *See also* Edith Hotchkiss, Benjamin Iverson & Xiang Zheng, *Can Small Businesses Survive Chapter 11* (Dft Feb. 2024) (regression-discontinuity and difference-in-differences analysis shows that many small businesses reorganize under Subchapter V that otherwise would have been liquidated, creditor recoveries are at

least as high in Subchapter V as in similar small business reorganizations, and post-bankruptcy survival rates are no lower).

[9]Elizabeth Warren & Jay L. Westbrook, The Law of Debtors and Creditors 189 (2d ed. 1991); *see also* H.R. Rep. No. 1409, at 50-51 (1937):

> The inclusion of corporations [in Chapter XI] will permit a large number of the smaller companies such as are now seeking relief under section 77B but do not require the complex machinery of that section, to resort to the simpler and less expensive, though fully adequate, relief afforded by [Chapter XI].

[10]*See generally* Note, *Requirements for Filing Petition under Chapter XI of the Chandler Act*, 49 Yale L. J. 927 (1940).

[11]H.R. Doc. No. 93-137, pt. 1, at 23 (1973).

[12]*Compare* § 1121 (debtor plan exclusivity terminable for cause and in any event limited to no more than 18 months from the order for relief) *with* § 1189(a) (only the debtor may file a Subchapter V plan).

[13]Three core disclosure elements, however, must be incorporated into the plan itself: (i) history of the debtor and its operations; (ii) liquidation analysis; and (iii) financial projections for the term of the plan. § 1190(1). Moreover, the court retains authority to order further disclosure consistent with chapter 11 for cause. § 1181(b).

[14]*Compare* § 1129(b)(2)(B) (absolute priority rule) *with* § 1191(c) (disposable income test). The Subchapter V version of "absolute priority" in effect rejects the traditional understanding of absolute priority in chapter 11, as set forth in Bank of Am. Nat. Tr. & Sav. Ass'n v. 203 N. LaSalle Street Partnership, 526 U.S. 434, 119 S. Ct. 1411, 143 L. Ed. 2d 607, 34 Bankr. Ct. Dec. (CRR) 329, 41 Collier Bankr. Cas. 2d (MB) 526, Bankr. L. Rep. (CCH) ¶ 77924 (1999), Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 204-05, 108 S. Ct. 963, 99 L. Ed. 2d 169, 17 Bankr. Ct. Dec. (CRR) 201, 18 Collier Bankr. Cas. 2d (MB) 262, Bankr. L. Rep. (CCH) ¶ 72186 (1988) and Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 60 S. Ct. 1, 84 L. Ed. 110 (1939), by authorizing nonconsensual confirmation of a plan in which an insolvent debtor's equity is left unimpaired notwithstanding the lack of a market-tested contribution of money or money's worth in new value.

[15]The court retains authority to order appointment of a committee and retention of committee professionals for cause. § 1181(b).

[16]The one-impaired-consenting-class rule of § 1129(a)(10) is not incorporated into Subchapter V. § 1191(b).

[17]§ 1182(1)(A) (excluding single asset real estate debtors).

[18]§ 1182(1)(A) (requiring that at least 50% of the debts arise from commercial or business activities).

[19]§ 1182(1)(B). *See infra* notes 67-69 and accompanying text.

[20]Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. Legal Stud. 127, 128 (1986).

[21]Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 Yale L. J. 1043, 1044-46 (1992). Replies to Bradley & Rosenzweig are found in Lynn M. LoPucki, *Strange Visions in a Strange World: A Reply to Professors Bradley and Rosenzweig*, 91 Mich. L. Rev. 79 (1992), and Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 Yale L. J. 437 (1992).

[22]Interestingly, mass-asbestos bankruptcy today is an exception still proceeding in a largely 1980s form. In 1994, Congress enacted section 524(g) which provided an elaborate template for mass-asbestos cases based on the *Johns-Manville* plan confirmed in December 1986. Although state-of-the-art at the time, the *Johns-Manville* plan and the procedures that produced it now resemble a 40-year-old fly caught in amber. *See* Daniel J. Bussel, *The Mass Tort Claimants' Bargain*, 97 Am. Bankr. L. J. 684 (2024) (suggesting a path for reform of current mass tort practice).

[23]Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11*, 79 Am. Bankr. L. J. 603 (2005); Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt*?, 47 B.C. L. Rev. 129 (2005).

[24]*ABI Commission to Study the Reform of Chapter 11*, 23 Am. Bankr. Inst. L. Rev. 1, 297-302 (2015).

[25]Lynn M. LoPucki, *Changes in Chapter 11 Success Levels Since 1980*, 87 Temple L. Rev. 989 (2015). *But see* Mark Roe & Michael Simkovic, *Bankruptcy's Turn to Market Value*, 92 U. Chi. L. Rev. ___ (forthcoming 2025) (suggesting that bankruptcy courts embrace of market valuation procedures has eased the burden in time and administrative cost of resolving valuation disputes in bankruptcy) *available at*: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4687683.

[26]Prepackaged bankruptcies are negotiated, and consent from any impaired class is obtained, prebankruptcy. Usually only financial debt is

restructured in these cases. Post-petition implementation of the prepackaged financial restructuring is commonly achieved within 30-45 days of the commencement of bankruptcy.

[27]With the cooperation of both the debtor in possession and the affected lienholders, in lieu of reorganization or liquidation under a plan, free and clear going-concern sales of substantially all the debtor's assets are often negotiated pre-bankruptcy and consummated within 60-90 days of the bankruptcy filing under § 363. Critiques and suggestions for reform of the flourishing modern 363 practice can be found in many places including: *ABI Commission to Study the Reform of Chapter 11*, 23 Am. Bankr. Inst. L. Rev. 1, 147-160 (2015); Daniel J. Bussel & Kenneth N. Klee, *Recalibrating Consent in Bankruptcy*, 83 Am. Bankr. L. J. 663, 730-732 (2009).

[28]Foteini Teloni, *Chapter 11 Duration, Preplanned Cases, and Refiling Rates: An Empirical Analysis in the Post-BAPCPA Era*, 23 Am. Bankr. Inst. L. Rev. 571 (2015).

[29]§§ 1181-1195.

[30]Chapter 11's § 1129(a)(10) does not apply in Subchapter V. § 1191(b).

[31]§§ 1181, 1191 & 1102(a)(3).

[32]§ 1189(b).

[33]§ 1186. Of course, regardless of whether they are formally property of the estate, in practice, debtors will ordinarily fund even consensual plans with post-petition earnings.

[34]§ 1191(c)(2).

[35]§ 1191(d).

[36]§ 1190(3). This provision may generate significant litigation because many small business debtors mortgage their homes in part to raise money for their businesses, and many small businesses are operated out of the debtor's home raising difficult factual questions about the proper allocation of home mortgage obligations between business and personal use.

[37]H.R. Rep. No. 116-171, at 1 (2019) ("[Subchapter V] streamline[s] the bankruptcy process by which small business[] debtors reorganize and rehabilitate their financial affairs.").

[38]*ABI Commission to Study the Reform of Chapter 11*, 23 Am. Bankr. Inst. L. Rev. 1, 323-25 (2015).

[39]*Id.* The ABI recommendations for small business debtors heavily influenced the Small Business Reorganization Act of 2019. H.R. Rep. No. 116-171, at 4 (2019).

[40]*ABI Commission to Study the Reform of Chapter 11,* 23 Am. Bankr. Inst. L. Rev. 1, 306 (2015).

[41]*Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 93-137, pt. 1, at 23 (1973) ("each of [Chapters X, XI and XII] has detailed and overlapping rules regarding its availability which frequently produce pointless and wasteful litigation as to which chapter should be utilized"); See also *id.* (quipping "the patient will probably die while the doctors argue over which operating table he should be on.").

[42]Chapter 11 is available to "persons" which includes both individuals and corporations subject to certain specified exclusions. §§ 101(41) ("person"), 109 & 301.

[43]Creditor apathy in small business bankruptcies was a basis for abandoning creditor committees in BAPCPA's initial attempt to reform small business reorganization and Subchapter V also dispenses with creditors' committees. H.R. Rep. No. 109-31, pt. 1, at 19 (2005); § 1181(b). This leaves the U.S. Trustee as the primary institutional watchdog to prevent debtor abuse in accessing Subchapter V relief. Any party in interest, including the U.S. Trustee, can object to the debtor's designation as a small business debtor. Fed. R. Bankr. P. 1020(b). *See, e.g.*, In re Heart Heating and Cooling, LLC, 2024 WL 1228370 (Bankr. D. Colo. Mar. 21, 2024) (granting U.S. Trustee's motion to deny Subchapter V election and ordering case to proceed under Chapter 11 after rejecting debtor's numerous amendments to debt schedules to attempt to stay under the cap).

[44]§ 1182(1)(A).

[45]*Id.*

[46]§ 1182(1)(B).

[47]In re Ikalowych, 629 B.R. 261, 276, 70 Bankr. Ct. Dec. (CRR) 44 (Bankr. D. Colo. 2021).

[48]*Id.* At 286-87 (qualifying wage earners under Subchapter V's engagement prong while noting most would fail the 50% business debt requirement without entrepreneurial activity); *but see* In re Rickerson, 636 B.R. 416, 426, 128 A.F.T.R.2d 2021-6937 (Bankr. W.D. Pa. 2021) (debtor's ordinary employment insufficient basis to meet "engaged in commercial or business activities" requirement).

[49]In re Ellingsworth Residential Community Association, Inc., 2021 WL 3908525, at *3 (M.D. Fla. Aug. 19, 2021) (holding a profit motive is not required to be engaged in commercial or business activities in affirming homeowners association's Subchapter V eligibility). *See also* In

re RS Air, LLC, 638 B.R. 403, 405 (B.A.P. 9th Cir. 2022) (profit motive not required to qualify as business or commercial activity under § 1182(1)(A)).

[50]In re Hillman, 72 Bankr. Ct. Dec. (CRR) 155, 2023 WL 3804195, at *3 (Bankr. N.D. N.Y. 2023) ("the majority of bankruptcy courts . . . have found "engaged in" as having a temporal restraint . . . as of the petition date."). This reading is consistent with other uses of the phrase "engaged in" throughout Title 11. In re Thurmon, 625 B.R. 417, 421-23, 69 Bankr. Ct. Dec. (CRR) 165 (Bankr. W.D. Mo. 2020) (referencing § 101(18)(A) ("family farmer") and § 101(27A)(A) ("health care business")).

[51]In re Blue, 630 B.R. 179, 191, 70 Bankr. Ct. Dec. (CRR) 95 (Bankr. M.D. N.C. 2021) ("Nothing in the statute requires that there be a nexus between the qualifying debts and the Debtor's current business or commercial activities."); *see also,* In re Fama-Chiarizia, 655 B.R. 48, 65 (Bankr. E.D. N.Y. 2023) (marshalling authorities); *but see,* In re Ikalowych, 629 B.R. 261, 287, 70 Bankr. Ct. Dec. (CRR) 44 (Bankr. D. Colo. 2021) (requiring debt to be tied to the business activity the debtor is engaged in at time of filing).

[52]In re Fama-Chiarizia, 655 B.R. 48, 70-71 (Bankr. E.D. N.Y. 2023). For conflicting authorities on the treatment of employment, see *supra*, note 48. More typical in the case of legacy debt from a defunct business courts have looked to winding down activities and the pursuit of litigation as of the petition date as sufficiently commercial or business in nature to treat legacy debt under Subchapter V. *See, e.g.*, In re Offer Space, LLC, 629 B.R. 299, 306, 70 Bankr. Ct. Dec. (CRR) 45 (Bankr. D. Utah 2021). Courts have rejected the notion that filing for bankruptcy could constitute a commercial or business activity for the purposes of § 1182(1)(A) eligibility. *Id*. at 307.

[53]H.R. Rep. No. 116-171, at 1 (2019).

[54]§ 1192 (Subchapter V discharge provision). Corporations receive no discharge in chapter 7, § 727(a)(1), and the individual chapter 7 discharge is limited by the elaborate set of discharge exceptions in § 523(a). Some courts, however, have construed Subchapter V to incorporate the § 523(a) exceptions in the event of a nonconsensual confirmation. These issues will be discussed more fully in Part II of this essay in the July 2024 Bankruptcy Law Letter.

[55]§ 365 (assumption, rejection and assignment), 502(b)(6) (cap on landlord rejection damage claim) & 1123(b)(2) (reorganization plan may provide for disposition of executory contracts and unexpired leases consistent with § 365).

[56]In re Macedon Consulting, Inc., 652 B.R. 480, 486 (Bankr. E.D. Va. 2023) ("Absent the end of the world, we know the future date will occur. As a result, liability under the leases must be considered noncontingent and liquidated"). Fair enough, regarding the court's decision to disregard the possibility of the end of the world. But of course the amount of any future rent claim arising upon termination or rejection and the application of the § 502(b)(6) cap may vary greatly depending upon applicable mitigation principles, market conditions and the length of remaining term at the time of rejection.

[57]*Id.* at 485.

[58]In re Zhang Medical P.C., 655 B.R. 403, 407, 73 Bankr. Ct. Dec. (CRR) 33 (Bankr. S.D. N.Y. 2023) (rejecting *Macedon Consulting* because lease obligations are contingent on the debtor's election to assume or reject the lease postpetition). *See also* In re Parking Management, Inc., 620 B.R. 544, 553 (Bankr. D. Md. 2020) (lease rejection claims are contingent on bankruptcy court approval of the rejection).

[59]ABI Subchapter V Report, *supra* note 3, at 17-20.

[60]In re Free Speech Systems, LLC, 649 B.R. 729, 731 (Bankr. S.D. Tex. 2023).

[61]*Id.* at 732.

[62]§ 1182(1)(B)(i).

[63]*In re* Free Speech, 649 B.R. at 733.

[64]*Id.* at 734.

[65]Private equity sponsors in particular may seek access to Subchapter V in various ways. *See* Heidi Sorvino & Travis Powers, *Benefits of Subchapter V Under The Bankruptcy Code To Private Equity Funds In Managing Distressed Assets,* White & Williams LLP (Dec. 3, 2022), https://www.whiteandwilliams.com/resources-alerts-benefits-subchapter-v-bankruptcy-code-managing-distressed-assets. Ultimately, the strategic importance of this issue may turn on the outcome of the Supreme Court's decision in its pending review of In re Purdue Pharma L.P., 69 F.4th 45 (2d Cir. 2023), cert. granted, 144 S. Ct. 44, 216 L. Ed. 2d 1300 (2023), and whether third-party releases become a feature of Subchapter V practice.

[66]Legislation is presently pending to further extend the $7.5 million limit to June 2026. *See* note 6, supra.

[67]*Bankruptcy Threshold Adjustment and Technical Corrections Act*, Pub. L. 117-151, 136 Stat. 1298 (2022) (revising § 1182(1)(B)(ii) to

exclude "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)"). Prior to this amendment, the CARES Act tied an entity's Subchapter V eligibility to an affiliate's status as an issuer of securities rather than to its status as SEC reporting company. *See* Bill Rochelle, *A Mistake in the CARES Act on Eligibility for the SBRA Was Fixed by Congress in June*, Rochelle's Daily Wire, ABI (August 9, 2022) https://www.abi.org/newsroom/daily-wire/ a-mistake-in-the-cares-act-on-eligibility-for-the-sbra-was-fixed-by-congress-in. *See also* Mark T. Power, Joseph Orbach and Christine Joh, *Not so Technical: A Flaw in the CARES Act's Correction to "Small Business Debtor,"* 41 Am. Bankr. Inst. J. 32, 32 (Feb. 2022). There are many issuers of securities (including funds that act as private equity sponsors) that are not SEC reporting companies because they issue those securities under various statutory or regulatory exemptions.

[68]In re Phenomenon Marketing & Entertainment, LLC, 71 Bankr. Ct. Dec. (CRR) 209, 2022 WL 3042141, at *1 (Bankr. C.D. Cal. 2022) (reinstating Subchapter V election after enactment of the *Bankruptcy Threshold Adjustment and Technical Corrections Act* for debtor whose previous election was denied due to its status as an affiliate of a privately held corporation that had issued securities).

[69]*See* George P. Angelich & Christopher K.S. Wong, *Amendment to Subchapter V of Chapter 11 Clarifies Affiliates' Eligibility for Streamlined Restructuring Process*, Arent Fox Schiff (Sep. 28, 2022), https://www.afslaw.com/perspectives/alerts/amendment-subchapter-v-chapter-11-clarifies-affiliates-eligibility-streamlined.

[70]§ 1182(1)(A).

[71]*See supra* text at notes 47-54.

[72]In re Reis, 72 Bankr. Ct. Dec. (CRR) 131, 2023 WL 3215833, at *6 (Bankr. D. Idaho 2023) (debtor's medical school student loans do not qualify as business debts because at the time the debt was incurred there was no business); In re Rickerson, 636 B.R. 416, 429, 128 A.F.T.R.2d 2021-6937 (Bankr. W.D. Pa. 2021) (declining to treat debtor's unpaid taxes as business debts); In re Bennion, 71 Bankr. Ct. Dec. (CRR) 211, 2022 WL 3021675, at *3 (Bankr. D. Idaho 2022) (lumberjack could not proceed under Subchapter V because medical debt arose from logging injury incurred while felling trees on his mother's property free of charge); In re Sullivan, 626 B.R. 326, 333 (Bankr. D. Colo. 2021) (equalization payment to buy out spouse from business arose from divorce and was not business debt for the purposes of Subchapter V eligibility).

[73]In re Blue, 630 B.R. 179, 192-93, 70 Bankr. Ct. Dec. (CRR) 95 (Bankr. M.D. N.C. 2021).

[74]*Id.* At 195.

[75]§ 1182(1)(A) excludes "debts owed to 1 or more affiliates or insiders" from the $7.5 million cap.

[76]In re McGrath, 2021 WL 2405722 (Bankr. M.D. Fla. 2021).

[77]§ 101(51B).

[78]In re McGrath, 2021 WL 2405722, at *2.

[79]*Id.* at *5.

[80]*Id.* at *4 ("[the debtors] want to spin about and use a Subchapter V plan to grab back the rents and for all intents and purposes reorganize a SARE in Subchapter V. This is a subversion of Congress' express exclusion of SAREs from Subchapter V and is not 'good faith.' ").

[81]Plan confirmation requires that "[t]he plan has been proposed in good faith and not by any means forbidden by law." §§ 1129(a)(3), 1191(a), (b). These provisions may impair marijuana-related small businesses from accessing Subchapter V. Courts have been reluctant to approve chapter 13 plans funded by a debtor's future earnings derived from selling marijuana, an activity which is lawful in many states but remains a serious (albeit unenforced) felony under federal law, 21 U.S.C.A. §§ 801 *et seq.*, in those jurisdictions. *See, e.g.*, In re Blumsack, 657 B.R. 505, 516-17 (B.A.P. 1st Cir. 2024). The Ninth Circuit has interpreted § 1129(a)(3) narrowly to only prohibit plans that have been proposed by illegal means rather than prohibiting plans that contemplate illegal activity by the debtor. Garvin v. Cook Investments NW, SPNWY, LLC, 922 F.3d 1031, 1035, 67 Bankr. Ct. Dec. (CRR) 34, Bankr. L. Rep. (CCH) P 83392 (9th Cir. 2019). But courts, trustees and the U.S. Trustee have been particularly squeamish about handling funds derived from illegal activities including the sale of marijuana, and although debtors commonly act as disbursing agents under chapter 11, Subchapter V requires a Subchapter V trustee even while the debtor generally acts as debtor-in-possession. §§ 1183-1185. Moreover, under Subchapter V, the Subchapter V trustee is obligated to administer post-confirmation payments being made under non-consensual Subchapter V plans. § 1194(b).

[82]In re Who Dat ?, Inc., 2024 WL 1337453 at *10, *13 (Bankr. E.D. La. 2024) (finding plan proposed in bad faith, infeasible, and finding cause to convert to chapter 7).

[83]*Id.* In a chapter 11 cramdown, the new

value exception may be used by debtors to retain equity in the reorganized debtor, but the valuation of the retained interest must be subject to some form of market test. *See* Bank of Am. Nat. Tr. & Sav. Ass'n v. 203 N. LaSalle Street Partnership, 526 U.S. 434, 119 S. Ct. 1411, 143 L. Ed. 2d 607, 34 Bankr. Ct. Dec. (CRR) 329, 41 Collier Bankr. Cas. 2d (MB) 526, Bankr. L. Rep. (CCH) ¶ 77924 (1999).

[84]§ 1191(c)(2).

[85]Subchapter V requires that the plan comply with the best-interests test set forth in § 1129(a)(7) along with most of the other requirements of § 1129(a). *See* § 1191(a) (consensual plan) & 1191(b) (nonconsensual plan).

[86]§ 1191(d)(2). Even this rule governing individual debtors in Subchapter V is far more generous than those applicable to above median-income individuals under chapters 11 and 13. Those chapters limit maintenance and support allowances to a stringent set of IRS guidelines that otherwise require above-median income debtors to curtail their consumer spending significantly in order to obtain bankruptcy relief. *See* §§ 707(b)(2)(B), 1129(a)(15) and 1325(b)(3).

[87]§ 1191(d)(1)(A).

[88]Individuals may also deduct post-petition domestic support obligations in determining net disposable income. § 1191(d)(1)(B).

[89]§ 1129(a)(7).

[90]§§ 1102(a)(3), 1181(b) & 1186(a). Subchapter V does however require appointment of a Subchapter V trustee with limited duties. § 1183.

[91]§§ 1181, 1191(b). Of course, judges remain free in Subchapter V to require additional disclosure and solicitation and no doubt will remain likely to do so in appropriate circumstances.

[92]§ 1191(b).

[93]*Compare* § 1129(a)(9)(A) (chapter 11), *with* § 1191(e) (Subchapter V).

[94]§ 1191(e). It is unclear whether a plan that provides for payment without interest would comply with this rule.

[95]§§ 1123(b)(5), 1322(b)(2).

[96]§ 1190(3)(B). Distinguishing business and personal use of home mortgage proceeds seems likely to raise difficult allocation problems in some small business cases.

[97]§ 1189(a) ("Only the debtor may file a plan under this subchapter.")

[98]There is scant authority construing the "unfair discrimination" standard under § 1129(b)(1). *See* In re Tribune Company, 972 F.3d 228, 237 (3d Cir. 2020); Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 Am. Bankr. L.J. 227, 241-42 (1998).

[99]*Compare* § 1191(c) *with* § 1129(b).

[100]Kenneth N. Klee, *Cram Down II*, 64 Am. Bankr. L.J. 229, 230-31 (1990).

[101]Courts have had mixed reactions to creditors making the § 1111(b)(2) election in Subchapter V. In re Body Transit, Inc., 619 B.R. 816, 838, 69 Bankr. Ct. Dec. (CRR) 56 (Bankr. E.D. Pa. 2020) (denying creditor's § 1111(b)(2) election and applying inconsequential value exception to $80,000 of collateral securing $917,000 debt in furtherance of Congressional intent to promote small business reorganizations in Subchapter V); *but see,* In re VP Williams Trans, LLC, 2020 WL 5806507, at *6 (Bankr. S.D. N.Y. 2020) ("If section 1111(b) was supposed to give way in a subchapter V case, or to have a different application in such a case, that was for Congress to say, and Congress did not do so.").

[102]*See, e.g.,* In re Weinstein, 227 B.R. 284, 293 n. 10, 33 Bankr. Ct. Dec. (CRR) 632, 41 Collier Bankr. Cas. 2d (MB) 123 (B.A.P. 9th Cir. 1998) ("The electing undersecured creditor thus gives up any distribution it might receive on its separate unsecured claim under a reorganization plan and foregoes its right to vote on the plan as an unsecured creditor."); *see generally* M. Jonathan Hayes & Roksana D. Moradi, *The Section 1111(b) Election: A Primer*, 31 Cal. Bankr. J. 755, 765 (2011) (noting the 1111(b) election has been "unheard of and unused for many years").

[103]*See, e.g.*, Matter of Topp's Mechanical, Inc., 71 Bankr. Ct. Dec. (CRR) 24, 2021 WL 5496560 (Bankr. D. Neb. 2021); In re VP Williams Trans, LLC, 2020 WL 5806507 (Bankr. S.D. N.Y. 2020).

[104]Associates Commercial Corp. v. Rash, 520 U.S. 953, 965, 117 S. Ct. 1879, 138 L. Ed. 2d 148, 30 Bankr. Ct. Dec. (CRR) 1254, 37 Collier Bankr. Cas. 2d (MB) 744, Bankr. L. Rep. (CCH) P 77409 (1997).

[105]*See* Note, *Requirements for Filing Petition Under Chapter XI of the Chandler Act*, 49 Yale L. J. 927, 929-39 n.16 (1940) ("in old § 12 compositions of small enterprises with their good-will embodied in individual owners, this equitable result was deemed achieved when creditors received their estimated share of a figurative liquidation, but that the same measure for distribution cannot be used where good-will may easily be made available to creditors, as in the case of larger corporations. If control or manage-

ment has value for the creditors, it should be preserved for them. However, where the continuance of a corporate business is peculiarly dependent upon incumbency of the existing management, it may be regarded as 'fair and equitable,' and 'in the best interests of creditors,' to permit stockholder participation in the reorganization.")

[106]*Cf.* In re Residential Capital, LLC, 501 B.R. 549, 610-11 (Bankr. S.D. N.Y. 2013) (finding junior noteholder liens did not extend to goodwill).

[107]*See supra* text at nn. 9-16.

[108]*ABI Commission to Study the Reform of Chapter 11*, 23 Am. Bankr. Inst. L. Rev. 1, 12-13 (2015).

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