

# Small Business Bankruptcy Under The SBRA: Overview

MICHAEL J. RIELA, TANNENBAUM HELPERN SYRACUSE & HIRSCHTRITT LLP  
WITH PRACTICAL LAW BANKRUPTCY & RESTRUCTURING

Search the [Resource ID numbers in blue](#) on Westlaw for more.

**This Practice Note provides an overview of the subchapter V provisions of Chapter 11 enacted under the Small Business Reorganization Act (SBRA) for small business debtors. This Note addresses the significant provisions of the SBRA, including qualifications for being a Subchapter V debtor, duties and powers of a subchapter V debtor and a subchapter V trustee, plan requirements and deadlines, and various considerations for electing to be a Subchapter V debtor.**

Reorganization under Chapter 11 of the bankruptcy code can be expensive, risky, time-consuming, and complex for small and mid-sized companies (see Practice Note, Bankruptcy: Overview of the Chapter 11 Process ([4-380-9186](#))). A traditional Chapter 11 case may also not be a viable restructuring alternative for many smaller distressed companies because:

- The administrative burdens the Bankruptcy Code imposes on debtors.
- The absolute priority rule often requires existing equity owners to either:
  - relinquish ownership of the business; or
  - invest new money to retain their ownership stake.

The existing process under the Bankruptcy Code (established by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005) for reorganizing as a small business debtor, allows the small business debtor to proceed in Chapter 11 under slightly modified rules (see Practice Note, Small Business Chapter 11 Case: Overview ([W-000-7094](#))). However, these small business debtor requirements do not materially reduce the costs and burdens of Chapter 11 or increase the likelihood that existing equity security holders can retain

ownership of the small business under a Chapter 11 reorganization plan. Additional requirements specific to small business cases also may make it more difficult for a small business debtor to successfully reorganize under existing law.

For these reasons, many small and mid-sized companies often choose alternative restructuring processes to bankruptcy, including out-of-court workouts or sales (compositions), assignments for the benefit of creditors, receiverships, and friendly foreclosures (see Practice Note, Non-Bankruptcy Alternatives to Chapter 11 Restructurings and Asset Sales ([W-006-9306](#))). Some companies are forced to liquidate, resulting in job losses and destruction of enterprise value due to the lack of a viable alternative (see Practice Note, Chapter 7 Liquidation: Overview ([W-000-6231](#))).

To address these issues, Congress enacted the Small Business Reorganization Act (SBRA). The SBRA adds a new subchapter V to Chapter 11 of the Bankruptcy Code (Subchapter V). Subchapter V provides small businesses with aggregate liabilities of up to \$2,725,625 with an opportunity to resolve outstanding liabilities in a streamlined, cost-effective Chapter 11 bankruptcy proceeding. The SBRA is designed to foster successful restructurings of small businesses, saving jobs, and preserving enterprise value.

The SBRA was crafted in consultation with:

- The National Bankruptcy Conference.
- National Conference of Bankruptcy Judges.
- The American Bankruptcy Institute.
- Stakeholders, including:
  - commercial lenders; and
  - the US Trustee.

The SBRA was effective as of February 19, 2020.

This Note addresses the significant provisions of the SBRA, including qualifications for being a Subchapter V debtor, duties and powers of a Subchapter V debtor and a Subchapter V trustee, plan requirements and deadlines, and various considerations for electing to be a Subchapter V debtor.

## SIGNIFICANT FEATURES OF THE SBRA

The SBRA contains the following significant features and provisions for Subchapter V cases:

- The US Trustee must appoint a Subchapter V Trustee in all cases (§ 1183, Bankruptcy Code).
- The bankruptcy court may order that the debtor be removed from possession for cause, including for
  - fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after the petition date; or
  - failure to perform the debtor's obligations under a confirmed plan.
- If this occurs, the Subchapter V Trustee operates the debtor (§ 1185, Bankruptcy Code).
- No official creditors' committee is appointed in Subchapter V cases unless the bankruptcy court orders otherwise for cause (§ 1102(a)(3), Bankruptcy Code).
- The bankruptcy court must hold a status conference within 60 days after entry of the order for relief, unless the court extends that deadline. The debtor must file status report at least 14 days before the status conference (§ 1188, Bankruptcy Code).
- The debtor does not need to file a disclosure statement unless the bankruptcy court orders otherwise (§ 1181(b), Bankruptcy Code).
- The debtor has the exclusive right to file a Chapter 11 plan (§ 1189(a), Bankruptcy Code).
- The debtor must file a proposed Chapter 11 plan within 90 days after the order for relief under Chapter 11, unless the bankruptcy court extends that deadline because of circumstances for which the debtor cannot justly be held accountable (§ 1189(b), Bankruptcy Code).
- A plan may modify the rights of mortgagees holding a security interest in the debtor's principal residence, if the new value received when granting the security interest:
  - was not primarily used to acquire the property; and
  - was used primarily in connection with the small business of the debtor.
- (§ 1190(3), Bankruptcy Code).
- Acceptance of the plan by an impaired class of creditors is not required to cram down a Chapter 11 plan (§ 1191(b), Bankruptcy Code).
- Existing equity holders are more likely to retain their equity interests because the absolute priority rule does not apply in a cramdown case (§ 1191(c), Bankruptcy Code).
- In a cramdown plan, the debtor must use all of its projected disposable income (or property having a value of at least all of its projected disposable income) to make plan payments to creditors over a period of three to five years (§ 1191(c), Bankruptcy Code).
- In a cramdown plan, the property of the debtor's bankruptcy estate must include:
  - property acquired after the petition date but before the closure, dismissal, or conversion of the case; and
  - earnings for services the debtor performs after the petition date but before the closure, dismissal, or conversion of the case
- (§ 1186(a), Bankruptcy Code).

- Administrative expense claims may be paid over a three to five year period and are not required to be paid in full and in cash on the effective date (§ 1191(e), Bankruptcy Code).
- Professionals holding a prepetition claims of less than \$10,000 against the debtor may be retained as estate professionals (§ 1195, Bankruptcy Code).
- Discharge is not granted until the debtor completes all payments due within the first three years or up to five years of confirmation (§ 1192, Bankruptcy Code).
- There is no requirement to pay US Trustee quarterly fees (28 U.S.C. § 1930(6)(A)).

The SBRA also provides relief to preference defendants in all bankruptcy cases, not only Subchapter V cases, by:

- Amending section 547(b) of the Bankruptcy Code to require a plaintiff in a preference case to conduct reasonable due diligence regarding the defendant's known or reasonably knowable affirmative defenses before filing a preference action (§ 547(b), Bankruptcy Code).
- Increasing the monetary threshold in 28 U.S.C. § 1409(b) from \$13,650 to \$25,000 for actions to recover a debt against a non-insider defendant brought in the district where the defendant resides. Examples of covered actions include recovery actions relating to preference and fraudulent transfer cases.

(See Box, Additional Protections for Preference Defendants.)

## ELIGIBILITY AS A DEBTOR UNDER SUBCHAPTER V

The SBRA amends the definition of small business debtor in section 101(51D) of the Bankruptcy Code, changing the requirements for an individual or an entity to qualify as a small business debtor. The amendments to the definition apply to both Subchapter V and small business cases as defined under Section 101(51C) of the Bankruptcy Code.

The revised definition of a small business debtor requires that:

- The debtor or its affiliate must engage in commercial or business activities other than having its primary business activity be owning single asset real estate (see Engaged in Commercial Business).
- The debtor may not have more than \$2,725,625 in noncontingent, liquidated, secured, and unsecured debts (see Debt Qualification).
- Of the debtor's \$2,725,625 debt cap, at least 50% must have arisen from commercial or business activities, excluding debts owed to:
  - affiliates; or
  - insiders.
- (See Commercial Debt Threshold.)
- The debtor or its affiliate must not be a corporation subject to the reporting requirements under sections 13 or 15(d) of the Securities Exchange Act of 1934(15 U.S.C. § 78m, 78o(d); see Reporting Companies Excluded).

(§ 101(51D), Bankruptcy Code.)

Each of these components of the definition must all be met for a debtor to qualify as a small business debtor. Each condition of section 101(51D) of the Bankruptcy Code.

## ENGAGED IN COMMERCIAL BUSINESS

While the Bankruptcy Code describes a small business debtor as a person (defined as an individual, partnership, or corporation (§ 101(41), Bankruptcy Code)) engaged in commercial activities, the debtor does not need to be engaged in business or commercial dealings at the time of the bankruptcy filing.

However, a debtor does not qualify as a small business debtor if it does not have business or commercial interests that are either:

- Ongoing on the petition date.
- Closed immediately before the petition date.

The debtor may be an individual, provided the individual engages in commercial or business activities, for example, as a guarantor on a business loan.

### Real Estate Businesses

A debtor the primary activity of which is owning single asset real estate (SARE) (§ 101(51)(B), Bankruptcy Code) does not qualify as a small business debtor for either a Subchapter V case or a small business case.

New under the SBRA, a debtor the primary activity of which is the business of owning or operating real property or related activities can be a small business debtor. For example, a debtor the primary business of which is the ownership or operation of multiple parcels of real property can now qualify as a small business debtor because of its real estate activities. For more information on SARE debtors, see Practice Note, Single Asset Real Estate Cases: Implications and Strategies for Practitioners ([W-001-3574](#)).

### DEBT QUALIFICATION

A small business debtor's aggregate noncontingent, liquidated, secured and unsecured debts may not exceed \$2,725,625 (excluding debts owed to affiliates or insiders).

While the terms noncontingent and liquidated are not defined in the Bankruptcy Code, they are interpreted in practice as follows:

- **Noncontingent debt.** A debt that is owed at the time of the petition date and is not dependent on the occurrence of a future event for the liability to arise. For example, if a debtor cosigns a secured loan and the principal debtor defaults, the liability on the loan automatically arises and the debt is therefore noncontingent.
- **Liquidated debt.** A debt that has a fixed calculated and determined amount. The amount is either previously agreed to by the parties or can be precisely determined by mathematical calculation, reference to the parties' agreement, or operation of law. For example, a promissory note for a stated face amount is liquidated because its value can be determined by a simple calculation.

The debt owed to an affiliate or insider is not included in the calculation of a small business debtor's noncontingent and liquidated debt. Because an owner or principal of a small business typically finances the business and operations of the company, if an owner's debt was counted in the statutory debt cap, it likely bars many small businesses from qualifying as Subchapter V debtors.

The US Trustee and other parties in interest must determine whether a small business debtor's debt is both:

- Noncontingent and liquidated.
- Not owed to an affiliate or insider.

This time-intensive inquiry includes:

- Reviewing the debtor's financial information submitted with the petition (see Section 1116 Requirements).
- Reviewing the debtor's schedules and statements when filed (see Practice Note, Schedules and Statements of Financial Affairs: Overview ([W-000-9982](#))).
- Asking the debtor relevant questions at the initial debtor interview to obtain the necessary information (see Practice Note, US Trustee Guidelines and Requirements for Chapter 11 Debtors: Initial Debtor Interview ([W-000-5977](#))).

### COMMERCIAL DEBT THRESHOLD

At least 50% of the Subchapter V debtor's debt must arise from the commercial or business activities of the debtor.

While this requirement is new under the SBRA, it is unlikely to impact current practice because consumers had previously been excluded from the definition of small business debtor if they did not engage in commercial or business activities.

Section 101(8) of the Bankruptcy Code defines consumer debt as debt incurred by an individual primarily for a personal, family, or household purpose. Therefore, less than half of the small business debtor's debt in either a Subchapter V or a small business case may be consumer debt.

### REPORTING COMPANIES EXCLUDED

The debtor may not be a corporation (or an affiliate) that is subject to the reporting requirements under Section 13 or 15(d) of the Securities Exchange Act of 1934. This is a new requirement under the SBRA that excludes reporting corporations (§ 101(9), Bankruptcy Code) from qualifying as small business debtors in either a Subchapter V case or a small business case.

### ELECTING TO BE A SUBCHAPTER V DEBTOR

An individual or entity that qualifies as a small business debtor, as defined in section 101(51D) of the Bankruptcy Code, may now choose from among three options:

- Elect to proceed under new Subchapter V of Chapter 11 under new section 103(i) of the Bankruptcy Code.
- Elect to proceed as a small business case under the existing small business case provisions and requirements under section 101(51C) of the Bankruptcy Code, which was amended to specifically exclude a Subchapter V case from the definition of small business case.
- File a traditional (non-small business debtor) Chapter 11 case.

The small business debtor must make its election on the bankruptcy petition.

### DEBTOR'S ELECTION UNDER BANKRUPTCY RULE 1020

Official Bankruptcy Form B101 and Official Bankruptcy Form B201 (bankruptcy petitions for individuals and non-individuals) are

amended to include a box on the petitions that allow both voluntary individual and non-individual debtors to proceed either:

- Under Subchapter V of Chapter 11.
- As a small business debtor and elect to be governed by the non-Subchapter V small business case provisions.

(Fed. R. Bankr. P. 1020(a).)

In an involuntary Chapter 11 case, the debtor must file a statement with the bankruptcy court within 14 days of entry of the order for relief that it qualifies as a small business debtor and whether it elects to have Subchapter V apply (Fed. R. Bankr. P. 1020(a)).

A debtor's Chapter 11 case becomes a small business case or a case under Subchapter V by virtue of the debtor's election unless and until the bankruptcy court enters a finding that the debtor's designation is not correct (Fed. R. Bankr. P. 1020(a); see *Objecting to Designation*).

Debtors must be cautious when designating themselves as small business debtor or electing Subchapter V on the petition because changing the designation requires a debtor to make a motion within an appropriate amount of time after filing the case (see *Withdrawal of Election*). Therefore, it is crucial that the debtor understands the qualifiers contained in the definition for a small business debtor (§ 101(51D), Bankruptcy Code).

Under Rule 1020 of the Federal Rules of Bankruptcy Procedure (Bankruptcy Rules), a small business case debtor may amend its petition to elect Subchapter V. However, the SBRA does not specify by when the debtor must elect to proceed under Subchapter V. Courts must review any cases where an existing small business debtor chooses to change their designation to a Subchapter V case after February 19, 2020, on a case-by-case basis.

#### WITHDRAWAL OF ELECTION

There is no absolute right to withdraw a small business election. A debtor that seeking to withdraw its designation as a small business debtor carries the burden to demonstrate that its original designation was incorrect (Fed. R. Bankr. P. 1009(a); see *In re Swartville, LLC*, 483 B.R. 453 (Bankr. E.D.N.C. 2012)).

To withdraw the small business debtor election, the debtor must make a motion on appropriate notice. The motion must:

- Be made before the debtor files its plan.
- Demonstrate cause to withdraw the designation.
- Be granted only if there is no prejudice to any party that relied on the small business debtor designation (see *In re Save Our Springs (SOS) Alliance, Inc.*, 393 B.R. 452 (Bankr. W.D. Tex. 2008); *In re Win Trucking, Inc.*, 236 B.R. 774 (Bankr. D. Utah 1999); but see *In re Barnes*, 310 B.R. 209, 212 (Bankr. D. Colo. 2004) (declining to follow bright-line test requiring a showing of no prejudice to withdraw a small business debtor election)).

#### AMENDMENT TO ELECTION

Bankruptcy Rule 1009 provides that any voluntary petition, list, schedule, or statement may be amended by the debtor as a matter of course at any time before the case is closed. The debtor must give notice of the amendment to the trustee and to any affected entity.

The provisions of the SBRA are silent on the ability of a debtor to amend its petition to convert a pending Chapter 11 or Chapter 7 to

a Subchapter V case. However, one court has opined on this issue, permitting a debtor that filed for Chapter 11 in 2018 to amend its petition after the SBRA effective date to become a Subchapter V debtor (see *In re Progressive Solutions, Inc.*, 2020 WL 975464 (Bankr. C.D. Cal, Feb. 21, 2020). The court reasoned that the SBRA has no stated limitations to the application of the SBRA to pending cases and the procedural steps in an SBRA case, like the initial debtor interview, section 341(a) meeting, or the Subchapter V status conference, can be reset or rescheduled (see *Id.* 2020 WL 975464 at \*4).

It remains to be seen whether other courts will follow, allowing a debtor to amend its Subchapter V election at a later time.

#### OBJECTING TO DESIGNATION

All parties in interest, including the US Trustee, may object to the debtor's small business debtor or Subchapter V designation. However, the objection must be filed no later than:

- 30 days after the conclusion of the section 341 meeting of creditors.
- 30 days after any amendment to the debtor's designation.

(Fed. R. Bankr. P. 1020(b).)

#### INAPPLICABLE BANKRUPTCY CODE PROVISIONS

Section 1181(a) of the Bankruptcy Code provides that the following sections of the Bankruptcy Code do not apply in Subchapter V cases:

- **Section 105(d).** This section requires a court to hold status conferences when necessary to further the expeditious and economical resolution of the case and permits a court to issue scheduling orders setting certain dates and deadlines (§ 105(d), Bankruptcy Code). These requirements are replaced in Subchapter V cases with section 1188(a) of the Bankruptcy Code, requiring a status conference.
- **Section 1101(1).** This section defines a debtor-in-possession as the debtor (§ 1101(1), Bankruptcy Code) and in Subchapter V cases is replaced by:
  - section 1182(1) of the Bankruptcy Code, which defines a debtor as a small business debtor (see *Eligibility as a Debtor Under Subchapter V*); and
  - section 1182(2) of the Bankruptcy Code, which defines a debtor-in-possession as the debtor; unless
  - the debtor is removed as a debtor-in-possession under section 1185(a) of the Bankruptcy Code.
- **Section 1104.** This section addresses the appointment of a Chapter 11 trustee or examiner (§ 1104, Bankruptcy Code) and is replaced with section 1183(a) of the Bankruptcy Code in Subchapter V cases, which provides for an automatic appointment of a Subchapter V Trustee. The US Trustee can appoint the Subchapter V Trustee by appointing:
  - a standing Subchapter V trustee;
  - a disinterested person to serve as the Subchapter V trustee; or
  - itself serve as the Subchapter V Trustee, as necessary.
- **Section 1105.** This section addresses the termination of a Chapter 11 trustee's appointment (§ 1105, Bankruptcy Code) and is replaced by section 1183(c) of the Bankruptcy Code in Subchapter V cases, which governs the termination of a Subchapter V Trustee's service in a Subchapter V case (see *Termination of Subchapter V Trustee*).



- **Section 1106.** This section governs the duties of a trustee and an examiner in Chapter 11 cases (§ 1106, Bankruptcy Code) and is replaced by section 1183(b) of the Bankruptcy Code in Subchapter V cases, which governs the duties of Subchapter V Trustees (see Duties of the Subchapter V Trustee).
  - **Section 1107.** This section addresses the rights, powers, and duties of a Chapter 11 debtor-in-possession (§ 1107, Bankruptcy Code) and is replaced in Subchapter V cases by section 1184 of the Bankruptcy Code that a debtor in a Subchapter V case:
    - has all the rights and powers of a Chapter 11 trustee, with the exception of the right to compensation under section 330 of the Bankruptcy Code; and
    - must perform all functions and duties of a Chapter 11 trustee, including operating the business of the debtor, with the exception of the duties specified in section 1106(a)(2)-(4) of the Bankruptcy Code.
  - (See Duties and Powers of the Subchapter V Debtor.)
  - **Section 1108.** This section authorizes a Chapter 11 trustee to operate the debtor's business (§ 1108, Bankruptcy Code) and is replaced in Subchapter V cases by:
    - section 1184 of the Bankruptcy Code, authorizing the Subchapter V debtor to operate its business; and
    - section 1183(b)(5) of the Bankruptcy Code, authorizing the Subchapter V Trustee to operate the debtor's business if the debtor is removed from possession.
  - (See Duties of the Subchapter V Trustee.)
  - **Section 1115.** This section addresses property and earnings that the debtor acquires after petition date within the scope of an individual Chapter 11 case (§ 1115, Bankruptcy Code) and is replaced by section 1186 of the Bankruptcy Code in Subchapter V cases, providing that this type of property is included in the property of the estate if the case is confirmed in a cramdown under section 1191(b) of the Bankruptcy Code.
  - **Section 1116.** This section governs the duties of a trustee or a debtor-in-possession in a small business case, which continues to apply in small business cases but not in Subchapter V small business debtor cases (§ 1116, Bankruptcy Code). Section 1187 of the Bankruptcy Code instead governs the duties and reporting obligations of debtors in Subchapter V cases (see Duties and Powers of the Subchapter V Debtor).
  - **Section 1121.** This section addresses which parties may file a plan in a Chapter 11 case (§ 1121, Bankruptcy Code) and is replaced by section 1189 of the Bankruptcy Code in Subchapter V cases, providing that:
    - only the debtor may file a plan; and
    - the debtor must file a plan within 90 days after the petition date or entry of the order for relief in involuntary cases, unless the bankruptcy court extends the 90-day period based on circumstances for which the debtor should not justly be held accountable.
  - (See Plan Deadline.)
  - **Section 1123(a)(8).** This section requires that an individual Chapter 11 debtor's earnings from personal services performed after the petition date must be used to provide payment to creditors under a plan (§ 1123(a)(8), Bankruptcy Code) and is replaced by section 1190 of the Bankruptcy Code, containing the plan content requirements in a Subchapter V case.
    - Section 1123(c). This section provides that in an individual Chapter 11 case, a plan proposed by a non-debtor may not provide for the use, sale, or lease of exempt property, unless the debtor consents (§ 1123(c), Bankruptcy Code). This section of the Bankruptcy Code is not necessary in Subchapter V cases because only the debtor may file a plan in Subchapter V cases.
    - **Section 1127.** This section addresses modification of Chapter 11 plans (§ 1127, Bankruptcy Code) and is replaced by section 1193 of the Bankruptcy Code governing modifications of Subchapter V plans.
    - **Section 1129(a)(15).** This section governs the property value that an individual Chapter 11 plan must provide to allowed unsecured creditors objecting to the plan (§ 1129(a)(15), Bankruptcy Code), Section 1191(a) and (b) provide that Section 1129(a)(15) does not need to be satisfied to confirm a Subchapter V plan.
    - Section 1129(b). This section contains the requirements to cram down a Chapter 11 plan on a dissenting class of impaired claims or interests (§ 1129(b), Bankruptcy Code) and is replaced by section 1191(b) of the Bankruptcy Code containing the requirements to cram down a Chapter 11 plan in Subchapter V cases.
    - Section 1129(c). This section provides that the bankruptcy court may confirm only one Chapter 11 plan, unless the confirmation order is revoked (§ 1129(c), Bankruptcy Code) and is replaced by section 1193 of the Bankruptcy Code governing modifications of Subchapter V plans.
    - Section 1129(e). This section governs when a bankruptcy court must confirm a Chapter 11 plan in small business case (§ 1129(e), Bankruptcy Code) and is replaced by section 1189 of the Bankruptcy Code in Subchapter V cases providing that only a Subchapter V debtor may file a plan within 90 days after the petition date or entry of the order for relief in involuntary cases, unless the bankruptcy court extends the 90-day period based on circumstances for which the debtor should not justly be held accountable. Subchapter V does not contain a direct analogue to section 1129(e).
    - **Section 1141(d)(5).** This section governs the discharge of debts under a plan of an individual Chapter 11 debtor (§ 1129(e), Bankruptcy Code) and is replaced by section 1192 of the Bankruptcy Code requiring the bankruptcy court to issue a discharge "as soon as practicable after completion by the debtor of all payments due within the first 3 years of the plan (or such longer period as fixed by court, not to exceed 5 years unless debtor waives discharge in writing)" in a Subchapter V case. The Subchapter V discharge applies to all debts detailed in section 1141(d)(1)(A) of the Bankruptcy Code, and all other debts allowed under section 503, except any debt:
      - that has the last payment due more than three years after the plan or at another time not to exceed five years; or
      - specified in section 523(a) of the Bankruptcy Code.
- Section 1181(b) of the Bankruptcy Code explicitly provides that, unless the bankruptcy court orders otherwise for cause, the following sections of the Bankruptcy Code do not apply in a Subchapter V case:
- Section 1102(a)(1), (2), and (4). This section governs official creditors' and equity committees in Chapter 11 cases (§§ 1102(a)(1), (2), and (4), Bankruptcy Code) and is amended by the SBRA, providing that a creditors' committee may not be appointed in a small business

case or Subchapter V case, unless the court orders appointment for cause.

- Section 1102(b). This section governs the composition of official creditors' committees (§ 1102(b), Bankruptcy Code) and is not applicable in a Subchapter V case.
- **Section 1103.** This section governs the powers and duties of official committees (§ 1103, Bankruptcy Code) and is not applicable in a Subchapter V case.
- **Section 1125.** This section governs disclosure statements and solicitation procedures (§ 1125, Bankruptcy Code) and is replaced by section 1187(c) of the Bankruptcy Code, providing that if the bankruptcy court orders that section 1125 of the Bankruptcy Code applies, section 1125(f) of the Bankruptcy Code then applies (see Disclosure Statement).

## DUTIES AND POWERS OF THE SUBCHAPTER V DEBTOR

Section 1187 of the Bankruptcy Code requires a Subchapter V debtor to comply with the requirements of sections 308 and 1116 of the Bankruptcy Code.

### SECTION 1116 REQUIREMENTS

Section 1116 of the Bankruptcy Code subjects small business debtors to additional reporting and filing requirements that are typically not imposed on large Chapter 11 debtors. These requirements apply to Subchapter V cases and include:

- Attaching various documents to the Chapter 11 petition, including the debtor's:
  - most recently prepared balance sheet;
  - latest statement of operations;
  - most recent cash flow statement; and
  - most recently filed tax return.
- (§ 1116(1)(A), Bankruptcy Code.)
- If the small business debtor cannot attach one or more of these documents, it must provide a statement under penalty of perjury explaining the absence of any of these documents (§ 1116(1)(B), Bankruptcy Code.)
- Ensuring that a member of the debtor's senior management and debtor's counsel attend all meetings in the Chapter 11 case, including those scheduled by the US Trustee. These meetings include:
  - the initial debtor interview;
  - bankruptcy court scheduling conferences; and
  - any section 341 meetings.
- (§ 1116(2), Bankruptcy Code.)
- The bankruptcy court can waive the requirement for senior management and counsel to attend these meetings on a showing of extraordinary and compelling circumstances.
- Timely file the schedules and statement of affairs (see Practice Note, Schedules and Statements of Financial Affairs: Overview ([W-000-9982](#))). Any request for an extension of time beyond 30 days from the petition date requires a showing of extraordinary and compelling circumstances (§ 1116(3), Bankruptcy Code).
- File all postpetition financial reports required under the Bankruptcy Rules or local court rules (§ 1116(4), Bankruptcy Code).

- Maintain insurance customary in the debtor's industry (§ 1116(5), Bankruptcy Code).
- Timely file tax returns and timely pay taxes (§ 1116(6)(A) and (B), Bankruptcy Code).
- Allow the US Trustee or its representative to inspect the debtor's business premises and books and records on reasonable notice (§ 1116(7), Bankruptcy Code).

### ONGOING FINANCIAL REPORTING OBLIGATIONS

In addition to the reporting requirements for the Subchapter V debtor found in section 1116 of the Bankruptcy Code (see Section 1116 Requirements), both a Subchapter V debtor and a small business debtor have increased financial reporting duties throughout their its Chapter 11 cases under section 308(b) of the Bankruptcy Code. These include that, on a periodic basis, both the Subchapter V debtor and the small business debtor, must file:

- Financial reports on profitability, defined as earnings or losses during the relevant fiscal period (§ 308(b)(1), Bankruptcy Code).
- Reasonable estimates of projected cash receipts and disbursements (§ 308(b)(1), Bankruptcy Code).
- Comparisons of actual receipts and disbursements to those projected in earlier reports (§ 308(b)(3), Bankruptcy Code).
- Proof of compliance with postpetition duties imposed by the Bankruptcy Code and the Bankruptcy Rules (§ 308(b)(4)(A), Bankruptcy Code).
- Proof of timely filing of tax returns and other required government filings (§ 308(b)(4)(B), Bankruptcy Code).
- Proof of payment of administrative expenses and taxes (§ 308(b)(4)(B), Bankruptcy Code).

These documents must be filed and completed monthly using Bankruptcy Official Form B425C, titled Small Business Monthly Operating Report (Fed. R. Bankr. P. 2015(a)(6)).

If the debtor does not comply with these postpetition financial requirements, it must file reports identifying the specific default in its obligations and how it intends to remedy its defaults (§ 308(b)(5), Bankruptcy Code).

The Bankruptcy Code also imposes a vague obligation on a Subchapter V debtor to report on "such other matters as are in the best interests of the debtor and creditors, and in the public interest in fair and efficient procedures under Chapter 11" (§ 308(b)(6), Bankruptcy Code). This essentially requires a debtor to be vigilant about reporting any relevant issues to the bankruptcy court and the US Trustee that affect the debtor's estate, its creditors, or the general public interest.

### US TRUSTEE FEES

A Chapter 11 debtor is responsible for paying a quarterly fee to the US Trustee program (28 U.S.C § 1930(a)(6)). Quarterly fees accrue throughout the course of the Chapter 11 case until the case is:

- Closed.
- Dismissed.
- Converted to another chapter.

Quarterly fees are calculated at the end of each quarter according to a graduated scale based on the total sum of the debtor's

disbursements made during the previous fiscal quarter (see Practice Note, US Trustee Guidelines and Requirements for Chapter 11 Debtors: US Trustee Quarterly Fees ([W-000-5977](#))).

The SBRA has amended 28 U.S.C. § 1930(a)(6)(A) to provide that a Subchapter V debtor is not required to pay US Trustee fees. This significant change results in material savings for Subchapter V debtors. Debtors in small business cases, however, must still pay US Trustee fees.

### POWERS OF THE SUBCHAPTER V DEBTOR

A Subchapter V debtor has the rights and powers of a Chapter 11 trustee, with the exception of the right to compensation under section 330 of the Bankruptcy Code.

The Subchapter V debtor also performs all the functions and duties of a Chapter 11 trustee, with the exception of the following:

- If the debtor has not done so, filing the list, schedule, and statement of financial affairs required by section 521(a)(1) (§ 1106(a)(2), Bankruptcy Code).
- Filing a report setting out the results of an investigation or any fraud, dishonesty, incompetence, misconduct, mismanagement, or other impropriety or irregularity in the management of the affairs of the debtor (§ 1106(a)(4), Bankruptcy Code).
- Providing information to appropriate taxing authorities for any year for which the debtor has not filed a tax return required by law (§ 1106(a)(6), Bankruptcy Code).

(§ 1184, Bankruptcy Code.) These specific functions and duties remain exclusive to the Subchapter V Trustee.

### RETENTION OF PROFESSIONALS FOR THE SUBCHAPTER V DEBTOR

Section 1195 of the Bankruptcy Code relaxes the disinterestedness requirement under section 327(a) so that a professional is not disqualified for employment if the professional holds a prepetition claim of less than \$10,000. This is a departure from the typical requirement in Chapter 11 cases that a professional must waive any prepetition claims against the debtor before it can be retained in the bankruptcy case.

Because professionals may hold a prepetition claim for \$10,000 or less against the Subchapter V debtor, the debtor has greater flexibility to retain professionals that have previous experience with and knowledge of the debtor.

### REMOVAL AND REINSTATEMENT OF THE DEBTOR

Section 1185(a) of the Bankruptcy Code provides that on request of a party in interest and after notice and a hearing, the court must remove the debtor from possession if cause exists. The statute contains a non-exhaustive list of items constituting cause, including, fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor (§ 1185(a), Bankruptcy Code). A court may also find other circumstances that constitute cause to remove the debtor from possession.

A debtor may be removed even after confirmation of the Chapter 11 plan if it fails to perform its obligations under the plan.

If the court removes the debtor from possession, the Subchapter V Trustee overseeing the case becomes an operating trustee and is responsible for operating the debtor's business.

Section 1185(b) of the Bankruptcy Code provides that on request of a party in interest and after notice and a hearing, the bankruptcy court may reinstate the debtor, however, the statute does not detail the circumstances under which reinstating the debtor is warranted.

### THE SUBCHAPTER V TRUSTEE

To appoint a Subchapter V Trustee in each Subchapter V case, the US Trustee can choose one of the following:

- Appoint a standing Subchapter V Trustee or a disinterested person to serve as the Subchapter V Trustee, as it does in Chapter 12 and 13 cases.
- Form a panel of trustees and appoint a person from the panel for each Subchapter V case as it does in Chapter 7 cases.
- Serve as the Subchapter V Trustee in a case, as necessary. (§ 1183(a), Bankruptcy Code; 28 U.S.C. § 586(b).)

The particulars of the appointment of a Subchapter V Trustee depend on the preference of the US Trustee for that region. The bankruptcy court has no role in the appointment of the Subchapter V Trustee.

As of February 19, 2020, the US Trustee Office for all regions decided that Subchapter V Trustees are appointed from a panel, on a case-by-case basis.

### DUTIES OF THE SUBCHAPTER V TRUSTEE

Once appointed, the Subchapter V Trustee must perform the duties specified in section 1183(b) of the Bankruptcy Code. These include duties similar to those of both a Chapter 7 trustee and a Chapter 11 trustee.

The Subchapter V Trustee must:

- Be accountable for all property received (§§ 704(a)(2) and 1183(b)(1), Bankruptcy Code).
- For an individual debtor, ensure that the debtor performs its intentions to retain or surrender property of the estate that secures consumer debts under section 521(a)(2)(B) of the Bankruptcy Code (§§ 704(a)(3) and 1183(b)(1), Bankruptcy Code).
- If a purpose is to be served, examine proofs of claims and object to the allowance of any improper claim (§§ 704(a)(5) and 1183(b)(1), Bankruptcy Code).
- Unless the court orders otherwise, furnish information concerning the estate and the estate's administration as requested by a party in interest (§§ 704(a)(7) and 1183(b)(1), Bankruptcy Code).
- Make a final report and file a final account of the administration of the estate with the court and the US Trustee (§§ 704(a)(9) and 1183(b)(1), Bankruptcy Code).
- Appear and be heard at the court status conference under section 1188 of the Bankruptcy Code (§ 1183(b)(3), Bankruptcy Code).
- Appear and be heard at any court hearing that concerns:
  - the value of property subject to a lien;
  - confirmation of a Subchapter V plan;

- modification of the plan after confirmation; or
- the sale of property of the estate.
- (§ 1183(b)(3), Bankruptcy Code.)
- Ensure that the debtor makes timely payments required under a confirmed plan (§ 1183(b)(4), Bankruptcy Code).
- Help the development of a consensual plan of reorganization (§ 1183(b)(7), Bankruptcy Code).
- Make payments and receive funds. However, the Subchapter V Trustee must retain the funds until a plan is either confirmed or denied:
  - if a plan is confirmed, the trustee must distribute payment under the terms of the plan; and
  - if the plan is not confirmed the trustee must return the funds to the debtor after deducting certain costs.
- (§ 1194, Bankruptcy Code.)

If the court orders for cause and on request of a party in interest, the Subchapter V Trustee must:

- Investigate the debtor's acts, conduct, assets, liabilities, and financial condition, the operation of the debtor's business and the desirability of continuing the business, and any other relevant matters (§ 1106(a)(3), Bankruptcy Code).
  - As soon as practicable, file a report setting out the results of the investigation, including:
    - facts relating to fraud, dishonesty, incompetence, misconduct, mismanagement, or other impropriety or irregularity in the management of the affairs of the debtor; and
    - any causes of action available to the estate.
  - (§1106(a)(4), Bankruptcy Code.)
  - Transmit a copy or a summary of any report required by 1106(a)(4) of the Bankruptcy Code to any creditors' committee or equity committee, to any indenture trustee, and to any other entity as the court designates (§ 1106(a)(4), Bankruptcy Code).
  - After plan confirmation, file reports that are necessary or as the court orders (§ 1106(a)(7), Bankruptcy Code).
- (§ 1183(b)(2), Bankruptcy Code.)

If the debtor is removed, the Subchapter V Trustee must:

- Operate the business of the debtor, like an operating Chapter 11 trustee.
- If the debtor's business has authority to operate, file with the court and with any governmental unit charged with the responsibility for collecting or determining any tax arising out of the operations, periodic reports and summaries of the operation of the business, including a statement of receipts and disbursements, and any other information the court or the US Trustee requires (§ 704(a)(8), Bankruptcy Code).
- Perform the duties of a Chapter 7 Trustee, as specified in section 704(a)(2), (5), (7), (8), (9), (10), (11) and (12) (§ 1106(a)(1), Bankruptcy Code).
- If the debtor has not done so, file the list, schedule, and statement required under Section 521(a)(1) of the Bankruptcy Code (§ 1106(a)(2), Bankruptcy Code).

- Provide information to appropriate taxing authorities for any year for which the debtor has not filed a tax return required by law (§ 1106(a)(6), Bankruptcy Code).
- (§ 1183(b)(5), Bankruptcy Code.)

If there is a claim for a domestic support obligation regarding the debtor, the Subchapter V Trustee must perform the duties specified by Section 704(c) of the Bankruptcy Code (§ 1183(b)(6), Bankruptcy Code).

The Subchapter V Trustee does not replace the debtor unless the bankruptcy court orders otherwise. However, when the court removes the debtor from possession, the Subchapter V Trustee acts as an operating Chapter 11 trustee.

### COMPENSATION OF A SUBCHAPTER V TRUSTEE AND PROFESSIONALS

A standing Subchapter V Trustee is compensated under 28 U.S.C. § 586(e), which provides a mechanism for fixing a maximum annual compensation for standing trustees.

The SBRA does not address compensation of Subchapter V Trustees who are not standing trustees, for example, panel trustees or case-by-case trustees. A panel Subchapter V Trustee is instead compensated under section 330 of the Bankruptcy Code.

A panel Subchapter V Trustee must file a fee application and seek reimbursement for actual, necessary expenses plus reasonable compensation for actual and necessary services it renders to the estate, based on:

- The nature, extent, and value of those services.
  - Time spent on those services.
  - The cost of comparable services outside of bankruptcy.
- (§ 330(a), Bankruptcy Code.)

The debtor's estate is responsible for paying the court-approved fees and expenses of the panel Subchapter V trustee.

The Subchapter V Trustee may also seek bankruptcy court approval to retain its own professionals under section 327 of the Bankruptcy Code. To the extent the Subchapter V Trustee retains professionals, the debtor's estate is responsible for paying the court approved fees and expenses of the Subchapter V Trustee's professionals. For more information on compensation of professionals, see Practice Note, [Getting Paid as a Professional to a Chapter 11 Debtor or Trustee \(8-616-5137\)](#).

### TERMINATION OF SUBCHAPTER V TRUSTEE

If the plan is a consensual plan under section 1191(a) of the Bankruptcy Code, a Subchapter V Trustee's appointment is terminated when the consensual plan is substantially consummated (§ 1183(c), Bankruptcy Code). However, a US Trustee may reappoint a Subchapter V Trustee in the case:

- As needed.
  - If there is a proposed modification to the plan.
  - If the debtor is later removed from possession.
- (§ 1183(c)(1), Bankruptcy Code.)



Termination of the Subchapter V Trustee after substantial consummation of a consensual plan is beneficial to the debtor because the debtor's estate is no longer responsible for the Subchapter V Trustee's fees and expenses.

If a plan is a cramdown plan confirmed under section 1191(b) of the Bankruptcy Code, the Subchapter V Trustee must make payments to creditors under the plan for the duration of the plan (§ 1194(b), Bankruptcy Code).

### MANDATORY STATUS CONFERENCE

The bankruptcy court must hold a status conference:

- To further the expeditious and economical resolution of the case (§ 1188(a), Bankruptcy Code).
- Within 60 days after the entry of the order for relief, which may be extended for circumstances for which the debtor should not justly be held accountable (§ 1188(b), Bankruptcy Code).

Courts may be reluctant to permit the status conference to be held beyond 60 days after the order for relief because a plan must be filed with 90 days after the petition date (§ 1189, Bankruptcy Code; see Plan Deadline).

At least 14 days before the status conference, the debtor must file a report detailing the efforts the debtor took and intends to take to obtain a consensual plan of reorganization (§ 1188(c), Bankruptcy Code). The report must also be served on the Subchapter V Trustee and all parties in interest.

### SUBCHAPTER V PLAN REQUIREMENTS DISCLOSURE STATEMENT

Under existing small business case rules, disclosure statements are required unless the court determines otherwise (see Practice Note, Small Business Chapter 11 Case: Overview: Disclosure Statement ([W-000-7094](#))). However, Under Subchapter V, the presumption is reversed and there is no requirement to file a disclosure statement unless the bankruptcy court orders otherwise (§ 1181(b), Bankruptcy Code). This can save Subchapter V debtors significant time and money from the time consuming and expensive process of preparing a disclosure statement, submitting it to the bankruptcy court for its approval, and circulating copies to creditors and other parties in interest (see Practice Note, Chapter 11 Plan Process: Overview: Disclosure and Solicitation ([O-502-7396](#))).

### PLAN DEADLINE

Only the debtor may file a plan in a Subchapter V case (§ 1189(a), Bankruptcy Code). This differs from a small business case, where the debtor has the exclusive right to file a plan for 180 days from the petition date (§ 1121(e)(1), Bankruptcy Code) and a proposed Chapter 11 plan and disclosure statement must be filed by any party within 300 days of the petition date (§ 1121(e)(2), Bankruptcy Code). In a small business case, section 1121(d) of the Bankruptcy Code also allows a party in interest to request that the bankruptcy court reduce or terminate the debtor's exclusive period (see Practice Note, Small Business Chapter 11 Case: Overview: Plan Deadline ([W-000-7094](#))).

The requirement that the Subchapter V debtor be the only one to file a plan is advantageous for the debtor because other parties may never:

- File competing plans.
- Seek to reduce or terminate the debtor's exclusive period.

However, the Subchapter V debtor must file its plan within a 90-day time period, which is half the amount time permitted in a small business case (§ 1189(b), Bankruptcy Code). The court may also only extend the 90-day deadline under the stringent requirement that "the need for the extension is attributable to circumstances for which the debtor should not justly be held accountable." When determining whether to file a small business case or a Subchapter V case, debtors must consider the significant time difference for filing a plan.

### PLAN CONFIRMATION

A debtor may confirm a consensual plan under section 1191(a) of the Bankruptcy Code, but may also confirm a plan over the objection of the debtor's creditors. Section 1191(b) of the Bankruptcy Code provides that, if the applicable requirements of section 1129(a) of the Bankruptcy Code are met regarding the plan, other than section 1129(a)(8), (10), and (15), the bankruptcy court must confirm the plan if:

- The plan does not discriminate unfairly.
- Is fair and equitable, regarding each class of impaired claims or interests that has rejected the plan.

The absolute priority does not apply in a cramdown of a Subchapter V plan. Therefore, equity holders can retain their interests in the business even if the plan does not pay unsecured claims in full.

### CHOOSING BETWEEN A SMALL BUSINESS CASE OR SUBCHAPTER V

Small business debtors must choose between proceeding under Subchapter V or the existing small business case rules. However, there are several advantages and disadvantages that a debtor must consider when making this determination.

### ADVANTAGES OF SUBCHAPTER V

The basic advantages of choosing to file under Subchapter V, include:

- **Retention of ownership interest.** Satisfaction of the absolute priority rule is not a requirement for confirmation of a Subchapter V plan. Therefore, Subchapter V provides a greater opportunity for existing equity owners to retain their ownership interests without investing new money.
- **Exclusive right to file a plan.** Only the debtor may propose a Chapter 11 plan in a Subchapter V case, while other parties in interest may file a plan after the exclusive period expires or terminates in a small business case.
- **No impaired accepting class.** There is no requirement that an impaired class of creditors accept the Subchapter V plan.
- **Administrative expenses paid over time.** In a Subchapter V plan, the debtor is not required to pay postpetition administrative expenses in full, in cash, on the effective date of the plan. Instead, postpetition administrative expenses, including for postpetition goods, services, and professional fees, may be paid over a period of time through the plan.

- **No US Trustee fees.** A Subchapter V debtor is not required to pay any quarterly US Trustee fees. This results in material savings for Subchapter V debtors.
- **Disinterested professionals.** A debtor in a Subchapter V case may retain professionals that hold less than \$10,000 in prepetition claims against the debtor. This provides greater flexibility for the debtor when choosing which professionals to retain.

### DISADVANTAGES OF SUBCHAPTER V

The basic disadvantages of choosing to file under Subchapter V instead of a small business case, include:

- **Appointment of a trustee.** A trustee is automatically appointed in a Subchapter V case, adding expenses and administrative burdens on the debtor.
- **Removal of management.** A debtor's management may be removed at any time, even after confirmation of the Subchapter V plan.
- **Shortened time to file a plan.** The Subchapter V debtor only has a 90-day period to file a Chapter 11 plan, though the bankruptcy court may extend that period under certain circumstances (§ 1189, Bankruptcy Code). This time period is half the amount of time allotted to a debtor in a small business case (see Practice Note, Small Business Chapter 11 Case: Overview: Plan Deadline ([W-000-7094](#))).

### CREDITOR CONSIDERATIONS

Creditors should consider the following in a Subchapter V case:

- Cash collateral, adequate protection, and automatic stay provisions in Chapter 11 are effective and remain the same.
- The cramdown provisions regarding secured creditors remain the same, but do not apply for unsecured creditors.
- Creditors may make a section 1111(b) election by the deadline established by the court (see, Practice Note, The Section 1111(b) Election ([7-609-5507](#))).
- A Subchapter V Trustee helps facilitate discussions between creditors and the debtor.
- Subchapter V provides a potentially expedited path to confirmation of a standalone plan or sale of the debtor.

### ADDITIONAL PROTECTIONS FOR PREFERENCE DEFENDANTS

The SBRA modified certain provisions regarding preference actions, which apply in all bankruptcy cases.

#### AMENDMENT TO SECTION 547(B)

Section 547(b) of the Bankruptcy Code sets out the basic elements of a preference. A preference is a transfer of an interest of the debtor in property:

- Made to or for the benefit of a creditor (§ 547(b)(1), Bankruptcy Code).
- Made on account of a debt that existed before the time of the transfer (§ 547(b)(2), Bankruptcy Code).

- Made while the debtor was insolvent (§ 547(b)(3), Bankruptcy Code).
- Made within 90 days before the filing of the bankruptcy petition (or within one year, if made to an insider) (§ 547(b)(4), Bankruptcy Code).
- Which enabled the creditor to receive more than it would have received in a Chapter 7 liquidation (§ 547(b)(5), Bankruptcy Code).

For more information on preferential transfers, see Practice Note, Preferential Transfers: Overview and Strategies for Lenders and Other Creditors ([6-381-6416](#)).

Under the SBRA, section 547(b) has been amended to provide that a plaintiff must conduct reasonable due diligence and account for the defendant's known or reasonably knowable affirmative defenses before filing a preference action. While defendants still retain the burden of proving affirmative defenses in any preference action (§ 547(c), Bankruptcy Code), the inclusion of the due diligence requirement in section 547(b) of the Bankruptcy Code is likely to impact a defendant's affirmative defenses and raise questions regarding:

- What is the standard of reasonable due diligence.
- To what extent an affirmative defense is reasonably knowable.

The answers to these questions will be determined by the courts.

#### AMENDMENT TO MONETARY VENUE THRESHOLD

The SBRA raised the dollar threshold in 28 U.S.C. § 1409(b) from \$13,650 to \$25,000 for preference actions and fraudulent transfer cases brought in the district where the defendant resides. Under the revised provision, the trustee may file a proceeding arising in or related to a bankruptcy case only in the federal district court for the district in which the non-insider defendant resides when the debt is less than \$25,000 (28 U.S.C. § 1409(b)).

Raising the dollar threshold to \$25,000 requires the plaintiff to weigh the costs of bringing covered actions of less than \$25,000 in different jurisdictions. If the creditor's defenses appear strong, trustees may be less likely to file these modest-sized actions outside the federal judicial district in which the bankruptcy case is pending.

#### ABOUT PRACTICAL LAW

Practical Law provides legal know-how that gives lawyers a better starting point. Our expert team of attorney editors creates and maintains thousands of up-to-date, practical resources across all major practice areas. We go beyond primary law and traditional legal research to give you the resources needed to practice more efficiently, improve client service and add more value.

If you are not currently a subscriber, we invite you to take a trial of our online services at [legalsolutions.com/practical-law](https://legalsolutions.com/practical-law). For more information or to schedule training, call **1-800-733-2889** or e-mail [referenceattorneys@tr.com](mailto:referenceattorneys@tr.com).