

Tip # 6: Small Businesses have more reorganization options in bankruptcy.

By: Kim Fineman

A reorganization through a Chapter 11 bankruptcy case can be a lifeline to a struggling business. Unfortunately, the additional demands that come with a bankruptcy filing can be particularly taxing on a small business. Congress took action to address the disproportionate impact in the Small Business Reorganization Act of 2019 (“SBRA”). Its purpose was to allow small businesses “to file bankruptcy in a timely, cost-effective manner, and hopefully [allow] them to remain in business” which “not only benefits the owners, but employees, suppliers, customers, and others who rely on that business.”

The SBRA added provisions to the Bankruptcy Code and created a new “Subchapter V” option in Chapter 11 cases. Subchapter V, which went into effect in February 2020, is only available to small businesses with secured and unsecured debts totaling less than \$2,725,625.* You must opt into the Subchapter V treatment at the time you file your bankruptcy petition.

A Subchapter V case can be quicker, cheaper, and more effective for small businesses. However, the business debtor only has 90 days to file its proposed Plan of Reorganization in a Subchapter V case—compared to 300 days in a traditional Chapter 11 case. If the debtor doesn’t meet this deadline, the case will be either converted to a Chapter 7 liquidation or dismissed. Because of this tight turnaround, a Subchapter V may not work for the needs of your particular business.

Here are a few of the key differences between the two reorganization options for small businesses:

SUBCHAPTER V	TRADITIONAL CHAPTER 11
Only the Debtor can propose a Plan, but must do so within 90 days	Debtor gets 300 days to file a Plan, and other parties can file competing plans after 120 days.
No Disclosure Statement or solicitation of votes required. Plan does not need creditor approval.	Disclosure Statement and solicitation of creditor votes on the Plan required, adding time and costs. Plan cannot be approved without some creditor approval.
Special Trustee appointed to monitor and facilitate reorganization until Plan confirmation. The Debtor remains in control.	No Trustee unless the Debtor is removed from control.
No Creditors Committee unless specifically ordered by the Court	Creditors Committee routinely appointed by the U.S. Trustee and the Committee’s professionals’ fees are paid by the bankruptcy estate.
Owners can retain their ownership interest provided the plan does not “discriminate unfairly” and is “fair and equitable.”	Absolute Priority Rule puts equity at the bottom of the distribution list—meaning all unsecured and other debts have to be paid before any distribution is made to equity—unless the owners “buy” a new position in the debtor business by making additional investments.
No U.S. Trustee fees	Quarterly fees owing to the U.S. Trustee from \$325 and up based on distributions
An individual who qualifies as a small business debtor can modify the mortgage on his or her principal residence, provided that the mortgage loan was not used to acquire the real property but was used primarily in connection with the debtor’s business.	Modification of consensual liens on principal residences—such as lowering the interest rate, extending maturity, or reducing to the secured value—not possible.
Discharge granted only after all payments under the Plan are complete, which can be 3-5 years.	Debtor receives a discharge of its debts upon Plan confirmation.

*There are requirements in addition to the debt limit to qualify for Subchapter V. In March 2020, the CARES Act, which was designed to help businesses in the midst of the Coronavirus epidemic, increased this debt limit to \$7,500,000 for one year. Unless further extended, that temporary increase in the debt limit will expire on March 27, 2021.