

Small Business Bankruptcy: What Do You Need to Know?

Article

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After the last two years, dealing with bankruptcy issues is probably the lowest priority on any business owner's mind. Perhaps you have been able to survive the unprecedented market trends and uncertainty, and now times look to be stabilizing. Having a basic understanding of what's been called "Sub 5" or "Subchapter V" can help you navigate any surprises that may be coming ahead.

Subchapter V History and Background

On February 19, 2020, the Small Business Reorganization Act ("SBRA") became effective and provided small businesses and owners, or individuals of high net worth, with a faster and more affordable pathway to reorganize- thus creating Subchapter V of Chapter 11. This section is not when the debtor is liquidating all assets. Generally speaking, a debtor in Subchapter V proposes a plan that would lead to payments being made to creditors.

When SBRA was first enacted, there was a debt limit for debtors to qualify under this section. Subchapter V was limited to debtors with aggregate debts that did not exceed approximately \$2.7 million. The debt limit was intended to ensure debtors using Subchapter V were truly small businesses and owners.

In March 2020, the debt limit was increased to \$7.5 million as part of the CARES Act. This increase significantly broadened the number of eligible businesses. While bankruptcies broadly have been down over the past two years, Subchapter Vs have been readily and increasingly filed since their creation. Subchapter V filings in Wisconsin have increased by 42%.

Important Tips About Subchapter V

Be prepared to move quickly. Under Subchapter V, the debtor must file a proposed plan within 90 days. Creditors should pay attention to how the plan deals with different types of debts, how creditors are classified, intended payments under the plan and the length of time the plan calls for payments. Be sure to pay particular attention to what happens if the debtor defaults in the plan.

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Be ready to negotiate. Another purpose of Subchapter V was encouraging debtors to work with their creditors to propose a “consensual plan.” Within 60 days of the bankruptcy petition being filed, the court will hold a status conference. Fourteen days before that conference, the debtor must file a report detailing their efforts to reach a consensual plan. This status conference is intended as a working and active discussion with the court, the debtor and creditors to figure out if a plan will work. Do not be afraid of engaging the bankruptcy trustee to help in your negotiations.

Advocate for yourself and pay attention. There is no creditor’s committee in Subchapter V. If you are the secured creditor, i.e. you hold a mortgage or lien on the debtor’s assets, be ready to discuss the terms of your debt. If you are an unsecured creditor, plan to engage in discussions with the debtor early in the process to understand what will happen. Without a creditor’s committee, the debtor could propose a plan that will change payment terms for debts, without paying claims in full, and retain its equity interest. In fact, the plan could be approved by the court without a single creditor voting for the plan. The key take-away is that a creditor paying just a little attention could lead to a greater return on your debt.

Be aware of the debt limit for Subchapter Vs are and whether the debtor may be eligible. Any creditor could challenge the debtor’s eligibility to file.

Recent Developments

On March 27, 2022, the CARES Act \$7.5 million debt limit for Subchapter V expired returning the debt limit to just over \$3 million. Recent legislation has been introduced that could impact what happens next.

Just before the expiration, Senator Grassley introduced the Bankruptcy Threshold Adjustment and Technical Corrections Act with wide bipartisan support. The Act seeks to make the \$7.5 million debt limit permanent. On April 7, Senator Murphy introduced an amendment to make the \$7.5 million debt limit effective for 2 years. The amended Act passed in the Senate on April 8, 2022. However, the Act must still pass in the House before becoming law.

In the immediate future, creditors may see fewer Subchapter V filings because fewer businesses will be eligible. Creditors should also expect businesses may refrain from filing to see if the Subchapter V debt limit will be permanently at \$7.5 million.

If you are not familiar with Subchapter V, please consult an attorney about your rights. Being mindful and informed about this section will put you in the best position to recover outstanding debts.

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