By Megan W. Murray

Subchapter V Might Not Be So Bad

Subchapter V Tools from a Secured Creditor's Perspective

Subchapter V cases became a fixture in bankruptcy districts nationwide following the enactment of the Small Business Reorganization Act of 2019 (SBRA), especially with the formerly higher debt limits of $7.5 million of aggregate, noncontingent, liquidated secured and unsecured debts, provided that at least 50 percent of such debts stem from commercial or business activities.[1] Subchapter V allows small businesses to reorganize at a lower cost. The SBRA amendments eliminate the need for a disclosure statement and allow plan confirmation, even if the debtor cannot meet the voting requirements for a regular chapter 11 (as long as fundamental feasibility and best-interests tests are met).

Subchapter V also simplifies reorganization by allowing debtors to repay unsecured creditors over three to five years from the debtor's disposable income, thus allowing room to pay operating expenses before paying creditors. Critically, a small business owner can also retain equity in the company, even if all creditors are not paid in full.[2]

Although the debt limit has been reduced to $3,024,725 (for now), subchapter V remains a viable tool for reorganization for small business owners. Creditors, including secured creditors, are learning how to navigate these rules to best protect their interests.

Fortunately for secured creditors, the balance of power has not changed substantially from regular chapter 11 cases. In a nonsubchapter V case, the court must confirm a chapter 11 plan if all the requirements of § 1129(a) are met, including § 1129(b)(2)(A) if a secured creditor does not vote in favor of a plan. Even if a secured creditor votes against the plan, the secured creditor is protected under the cramdown provision of § 1129(b), which gives the secured creditor the benefit of its bargain with respect to its collateral. These secured creditors are also protected in a regular chapter 11 by the feasibility requirements of § 1129(a)(11) and the best-interests test in § 1129(a)(7).

Under subchapter V, § 1191 provides that secured creditors remain entitled to the same benefits of the bargain that they had in a regular chapter 11 case under § 1129(b)(2)(A).[3] Thus, where a subchapter V debtor cannot obtain full consent for its plan, § 1191(b) allows for confirmation of a nonconsensual plan and cramdown without any votes, as long as the plan does not discriminate unfairly against any impaired, nonconsenting class and is fair and equitable regarding each class of impaired claims or interests that has rejected the plan.[4]

A secured creditor maintains its same rights to fair and equitable treatment under § 1129(b)(2)(A) by being allowed to (1) keep its liens and receive payments totaling the value of collateral; (2) receive proceeds from a sale of collateral; or (3) receive the indubitable equivalent of its secured claim. However, unsecured creditors (including secured creditors with a deficiency) are subject to a new fair-and-equitable standard pursuant to § 1191(c) that requires the debtor to commit all of its disposable income for the entire term of the plan to making plan payments (or the equivalent thereof).[5]

Fair and Equitable

Section 1129(b)(2)(A) *still applies* to secured creditors whether the debtor has filed a regular chapter 11 or a subchapter V. This section provides the following means for ensuring that secured creditors' treatment is fair and equitable:

1. If the debtor is keeping the collateral, the plan must provide that a secured creditor (a) retains its liens in the collateral securing a secured creditor's allowed claim (to the extent of its allowed claim under § 506)), and (b) receives deferred cash payments with a present value totaling at least the value of the collateral securing its allowed claims (or the allowed amount of its claims if there is sufficient collateral);
2. If the debtor is disposing of collateral free and clear of the secured creditor's liens under § 363 or some other means, the plan must provide for the secured creditor to credit-bid its secured claim under § 363(k) and for the secured creditor's lien to attach to the proceeds of such sale to the extent of the allowed amount of the secured claim; and/or
3. The plan must give the secured creditor the "indubitable equivalent" of its allowed secured claim.

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1 *See* Coronavirus Aid, Relief and Economic Security Act, § 1113(a)(2), Pub. L. No. 116-136, 134 Stat. 281 (2020); COVID-19 Bankruptcy Relief Extension Act of 2021, Pub. L. No. 117-5, 135 Stat. 249.
2 *See* 11 U.S.C. §§ 1181(a), 1191 (eliminating adequate-priority rule found in regular chapter 11 cases).
3 *See* 11 U.S.C. § 1191(c).
4 *In re Pearl Res. LLC*, 622 B.R. 236, 251-52 (Bankr. S.D. Tex. 2020).
5 *See* 11 U.S.C. § 1191(d).

It is well understood that indubitable equivalent is tied to "claims," not the collateral securing the claims.[6] While the term seems vague, and courts acknowledge its flexibility, "courts should not accept offers of indubitable equivalence lightly and should insist on a high degree of certainty."[7] The indubitable-equivalent standard requires a showing that the objecting secured creditor receive the benefit of its bargain (in terms of the value of its claim and the integrity of the collateral position, regardless of what package that comes in).[8]

Secured creditors are also assured that unlike in regular chapter 11, a subchapter V plan cannot last more than five years.[9] Thus, the term "cramdown" in a subchapter V does not change a secured creditor's rights, unless the secured creditor is undersecured, in which case the secured and unsecured portions of the claim will be bifurcated under § 506 and be paid from the debtor's disposable income over three to five years.

Feasibility

Subchapter V also does not dispense with the feasibility requirements of § 1129(a)(11), which provides that plan confirmation "is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan." In other words, a subchapter V debtor might not be worried about obtaining votes, but should still be concerned about showing that plan projections are viable and based on realistic and supportable facts — not a pipe dream. The purpose of feasibility requirements in chapter 11 "is to prevent confirmation of visionary schemes [that] promise creditors and equity security holders more under a proposed plan than the debtor can possibly attain after confirmation."[10] Therefore, the feasibility requirement is arguably one of the most important factors for confirmation of any kind.[11]

The use of the word "likely" in § 1129(a)(11) — that a plan is not likely to be followed by the liquidation — requires the court to assess "whether the plan offers a reasonable 'probability of success, rather than a mere possibility.'"[12] In small subchapter V cases, especially at 2025 debt limits of $3,024,725, the costs and energy to challenge feasibility might not be worthwhile for some secured creditors. A secured creditor with relatively small debts might be required to retain an expert to analyze the debtor's past financial performance, review the monthly operating reports and opine on the accuracy of projected future expenses. The cost of doing this could eat into a secured creditor's recovery on its secured claim. Compare these efforts to a debtor whose principal can opine on these issues based on his or her own experience with the debtor's financials.

Due to costs, negotiations usually ensue between secured creditors and debtors to avoid costly valuation disputes. Regardless, a secured creditor's ability to demand a showing that the debtor can make secured claim payments throughout the plan period is a powerful tool to avoid the likelihood of confirmation followed by immediate default (costing secured creditors more time and expense).

Best-Interests Test

The "best interests of creditors test" still applies in subchapter V cases, and ensures that creditors (including secured creditors) receive at least as much under a plan as they would in a chapter 7 liquidation case. Accordingly, a subchapter V plan must provide secured creditors with at least the value of its collateral, plus a return equal to or greater than what their unsecured deficiency would recover if a debtor's assets were sold and distributed.

Secured creditors concerned about their plan treatment have the ability to challenge a subchapter V debtor's best-interests test (*i.e.*, liquidation analysis) and require a demonstration that estimated values are accurate. Like feasibility, this financial analysis can put a burden on both a secured creditor and a small business, and require the cost of appraisals or an expert. In this case, a secured creditor likely has an indication of what its collateral is worth, and should be reasonably equipped to challenge an inaccurate valuation. A secured creditor's lien position is also protected and backstopped by § 1129(b)(2)(A), as previously discussed.

Section 1111(b) Election

Secured creditors retain their ability to make § 1111(b) elections in subchapter V. The time to make an § 1111(b) election is typically before the conclusion of a disclosure statement hearing,[13] but a subchapter V case does not require a disclosure statement to be filed.[14] Thus, some jurisdictions (such as North Carolina) have local rules fixing the time in which to do so:

> In a case under subchapter V ... in which § 1125 of the Bankruptcy Code does not apply, an election of application of § 1111(b)(2) of the Bankruptcy Code by a class of secured creditors may be made at any time within the time fixed by the court for filing written acceptances or rejections of the Debtor's plan or within such later time as the court may fix prior to expiration of the period provided herein.[15]

Secured creditors evaluating whether to make an § 1111(b) election must assess the potential implications and consequences of making the election. First, making the election eliminates the electing creditor's ability to participate in the class of unsecured creditors by treating the claim as fully

6 *Pearl Res.*, 622 B.R. at 270.
7 *Id.*
8 *F.H. Partners LP v. Inv. Co. of the Sw. Inc. (In re Inv. Co. of the Sw. Inc.)*, 341 B.R. 298, 319 (B.A.P. 10th Cir. 2006); *see also Pearl Res. LLC*, 622 B.R. at 274 (noting that key to providing indubitable equivalence is "certainty of payment beyond a reasonable doubt and adequate plan protections").
9 11 U.S.C. § 1191(c)(2)(A). *See also In re Trinity Fam. Prac. & Urgent Care PLLC*, 661 B.R. 793, 821 (Bankr. W.D. Tex. 2024) (noting that court "must determine what factors to consider in deciding whether a three-year period for plan payments is 'fair and equitable,' or if it should fix some other period not exceeding five years under § 1191(c)(2)(A)").
10 *Pizza of Haw. Inc. v. Shakey's Inc. (In re Pizza of Haw. Inc.)*, 761 F.2d 1374, 1382 (9th Cir. 1985).
11 *Hamilton v. Curiel (In re Curiel)*, 651 B.R. 548, 560 (B.A.P. 9th Cir. 2023), *appeal dismissed*, 2023 WL 11887031 (9th Cir. Aug. 17, 2023), *appeal dismissed*, No. 23-60038, 2023 WL 11887032 (9th Cir. Aug. 18, 2023) (citing *In re Bashas' Inc.*, 437 B.R. 874, 915 (Bankr. D. Ariz. 2010)).
12 *Curiel*, 651 B.R. at 563.
13 *See* Fed. R. Bankr. P. 3014.
14 *See* 11 U.S.C. § 1181(b) (unless court orders one for "cause").
15 *See* Local Rule 3014-1 in the Eastern District of North Carolina.

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secured, despite § 506(b). Therefore, it only controls its own secured class. As noted in *In re Body Transit Inc.*:

> An undersecured creditor that makes the § 1111(b)(2) election is entitled to have its entire claim treated in the plan as secured. The plan then must provide that the electing creditor will be paid the full amount of its claim ... and that it will retain its original lien until the full amount of the claim is paid. By making the election, the creditor no longer has an unsecured claim and thus is not part of the unsecured class.[16]

Therefore, the secured creditor receives the benefit of any post-confirmation appreciation of its collateral.[17] A secured creditor considering not making an election to control an unsecured class with its deficiency component might be overly focused on regular chapter 11 procedures rather than the specific provisions of § 1191(b). Because confirmation of a subchapter V plan does not require an affirmative vote from an unsecured class, obtaining control of such class will likely not be helpful.

Second, an undersecured creditor making the § 1111(b) election can expect to receive payments totaling "at least the full amount of the claim and must also have a present value at least equal to the collateral value at the time of confirmation."[18] However, these payments may not be possible for a subchapter V debtor whose cash flow and resources are limited. Making the § 1111(b) election could backfire, and instead of receiving a higher revenue stream over time, the debtor might be unable to comply with the plan, and the secured creditor might only receive its collateral back (eliminating any benefit of its undersecured component for which the creditor made the election in the first place).

Plan Default

Section 1191(c) requires that for a subchapter V plan to be fair and equitable, the debtor must also provide "appropriate remedies, which may include the liquidation of nonexempt assets, to protect the holders of claims or interests in the event that the payments are not made." "Appropriate remedies" is undefined, but it gives creditors leverage and flexibility to request language to protect them from further delay should the reorganized debtor struggle. For example, secured creditors could ask for additional remedies beyond the scope of their loan documents, such as: (1) retaining its lien (at a bare minimum); (2) prohibiting liquidation of collateral post-confirmation; (3) asking for springing security interests or guaranties in the event of a default; (4) requiring the debtor to procure a payment bond as insurance against plan defaults; and (5) permitting immediate rights to repossess collateral after verified notice of default.

Healthy Debtor

Secured creditors that are receiving payments on the secured portion of their claims may, after confirmation, have a stronger borrower. Subchapter V plans are frequently confirmed with minimal net disposable income, thereby eliminating potentially large unsecured debts from the debtor's balance sheet. Working with a debtor to confirm a viable subchapter V plan, whether consensually or not, might be in the best interests of secured creditors.

It is true that small business debtors (who used to be shut out of chapter 11 due to the expense and time it took to reorganize) are gaining greater access to the chapter 11 process through subchapter V. This might not be so bad for secured creditors, who remain protected by the fair and equitable standards of § 1129(b)(2)(A), the best-interests test pursuant to § 1129(a)(7) and the feasibility requirements of § 1129(a)(11), all of which establish minimum standards for plan confirmation. These creditors can also still invoke § 1111(b) and have statutory rights to negotiate stronger default provisions in the plan. The more debtors and creditors know about the subchapter V process and can work effectively together to get through reorganization, the more efficient the SBRA should become. abi

Editor's Note: *ABI's Subchapter V Task Force's Final Report and recommendations to Congress is posted at subvtaskforce.abi.org. All members are invited to submit their experiences with subchapter V at abi.org/subvstories.*

16 *In re Body Transit Inc.*, 619 B.R. 816, 831-32 (Bankr. E.D. Pa. 2020).

17 *In re Scrubs Car Wash Inc.*, 527 B.R. 453, 456 (Bankr. D. Colo. 2015) ("In effect, that creditor, by retaining its lien as security for its entire claim, holds that collateral hostage from the debtor's efforts to benefit from that post-confirmation appreciation of collateral until the entire amount of the creditor's claim is paid.").

18 *Matter of Topp's Mech. Inc.*, 2021 WL 5496560, at *3 (Bankr. D. Neb. Nov. 23, 2021). Severely undersecured creditors are precluded from making the election where the secured portion is 'inconsequential.'" *See* 11 U.S.C. § 1111(b)(1)(B)(i).