

# Problems in the Code

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## Eligibility for Subchapter V: The Meaning of “Engaged in Commercial or Business Activity”

*“Smaller businesses are the core of the U.S. economy.”<sup>1</sup>*

When facing distress, small businesses historically have found reorganization under chapter 11 to be too expensive, time-consuming and burdensome.<sup>2</sup> Instead of surviving as debtors in possession in chapter 11, small businesses were often left to liquidate under chapter 7 or in state-court proceedings — turning over control to chapter 7 trustees, receivers or creditors.<sup>3</sup> However, Congress sought a change, enacting the Small Business Reorganization Act of 2019 (SBRA),<sup>4</sup> which created a new subchapter V in chapter 11 of the Bankruptcy Code, designed to create a faster, less costly reorganization process for small-business debtors.<sup>5</sup> Among other things, the SBRA provides the following:

- Subchapter V debtors need not pay quarterly U.S. Trustee’s fees;<sup>6</sup>
- Absent a court order for cause, no unsecured creditors’ committee will be appointed;<sup>7</sup>
- Bankruptcy courts will hold mandatory status conferences within 60 days of the petition date to ensure the expeditious handling of cases;<sup>8</sup>
- Reorganization plans must be filed within 90 days of filing date (absent certain circumstances), resulting in faster confirmations;<sup>9</sup>
- Subchapter V debtors maintain complete exclusivity to file a reorganization plan and need not prepare and file, then potentially litigate, separate disclosure statements;<sup>10</sup>
- Subchapter V debtors may include cramdown in their plans without the approval of any class

of creditors, and the absolute-priority rule does not apply;<sup>11</sup> and

- Subchapter V debtors may pay administrative expenses over the life of the plan.<sup>12</sup>

More than four years later, it appears that subchapter V is working well: “Small businesses are using the subchapter with some regularity [and] are, for the most part, confirming reorganization plans at a relatively high rate in a relatively short period of time.”<sup>13</sup> As with any new legislation, issues have arisen regarding the SBRA’s text. One issue, as commentators<sup>14</sup> and the courts have discovered, concerns a debtor’s eligibility to file a subchapter V case in the first instance.

Specifically, 11 U.S.C. § 1182(1) governs a debtor’s eligibility to file a subchapter V case. To qualify, the debtor must qualify as a “small business debtor,” defined in § 101(51D) as:

a person engaged in commercial or business activities ... that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than \$3,424,000 ... not less than 50 percent of which arose from the commercial or business activities of the debtor....<sup>15</sup>

As stated, a debtor filing a subchapter V case must be “engaged in commercial or business activities,” but the Bankruptcy Code does not define this phrase. Is a debtor that is no longer operating on the petition date — but intends to liquidate or sell the business — still eligible for subchapter V? Must the debtor be operating in the normal course as of the petition date? These questions have divided bankruptcy courts; the minority view is that a debtor does not have to be actively operating on the



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1 ABI Subchapter V Task Force’s Final Report and Recommendations at 1 (2024), [subvtaskforce.abi.org](https://subvtaskforce.abi.org) (unless otherwise specified, all links in this article were last visited on April 21, 2025) (hereinafter “Task Force Final Report”).

2 *Id.*; see also Ralph Brubaker, “The Small Business Reorganization Act of 2019,” 39 No. 10 *Bankruptcy Law Letter* NL 1 (October 2019) (citing Ralph Brubaker, “The Small Business Reorganization Act of 2019,” 39 *Bankruptcy Law Letter* No. 10 (October 2019)).

3 See Task Force Final Report, *supra* n.1 at 1-2; Brubaker, *supra* n.2.

4 Small Business Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 1079 (Aug. 23, 2019) (effective Feb. 19, 2020).

5 See Hon. Paul W. Bonapfel, *A Guide to the Small Business Reorganization Act of 2019* at 2 (Rev. June 2022) (citing H.R. Rep. No. 116-171, at 1 (2019)).

6 28 U.S.C. § 1930(a)(6)(A).

7 11 U.S.C. § 1102(a)(3).

8 11 U.S.C. § 1188(a).

9 11 U.S.C. § 1189(b).

10 11 U.S.C. §§ 1191(a), 1187(c), 1189(a).

11 11 U.S.C. §§ 1181(a), 1191.

12 11 U.S.C. § 1191(e).

13 Hon. Michelle M. Harner, Emily Lamasa & Kimberly Goodwin-Maigetter, “Subchapter V Cases by the Numbers,” *XL ABI Journal* 10, 12, 59-60, October 2021, [abi.org/abi-journal/subchapter-v-cases-by-the-numbers](https://abi.org/abi-journal/subchapter-v-cases-by-the-numbers); see also Paul W. Bonapfel, “Subchapter V Update,” 1-2 (March 2024); Task Force Final Report, *supra* n.1 at 1-5.

14 See, e.g., Ashley D. Champion, “Analyzing a Gatekeeper to Subchapter V Eligibility: What Does It Mean to Be ‘Engaged in Commercial or Business Activities’?,” 2021 *Ann. Surv. of Bankr. Law* 3 (October 2021).

15 11 U.S.C. § 101(51D)(A).

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petition date to file under subchapter V, while the majority view is the opposite.<sup>16</sup>

## The Minority View

The first<sup>17</sup> decisions interpreting § 101(51D)(A) held that “nothing ... in the language of the definition of a small business debtor, limits application to debtors *currently* engaged in business or commercial activities.”<sup>18</sup> These cases concluded that a debtor qualifies for subchapter V even if the debtor ceased operating pre-petition.

For example, the U.S. Trustee in *Wright* filed a motion to strike an individual chapter 11 debtor’s designation as a small business debtor and election to proceed in subchapter V.<sup>19</sup> The debtor was a former interest owner in two small businesses that had ceased operating roughly two years before the petition date.<sup>20</sup> These businesses had themselves filed for bankruptcy and been liquidated. The U.S. Trustee thus argued that the debtor was not “engaged in commercial or business activities,” as required under the SBRA, and was therefore ineligible to be a subchapter V debtor.

The bankruptcy court denied the U.S. Trustee’s motion, acknowledging that the SBRA was intended “to improve the ability of small businesses to reorganize and ultimately remain in business.”<sup>21</sup> Nonetheless, the court underscored that nothing in the statutory language “limit[ed] application [of subchapter V] to debtors *currently* engaged in business or commercial activities.”<sup>22</sup> Based on the statute’s plain language, the bankruptcy court held that a debtor is eligible for subchapter V regardless of whether it is currently engaged in business on the petition date.

## The Majority View

Similarly to the previous discussion, bankruptcy courts adopting the majority view also rely on the plain language of § 101(51D)(A). Still, these courts reach the opposite conclusion.<sup>23</sup>

For example, in *Johnson*, two individual debtors (a husband and wife) sought to convert their case from chapter 7 to subchapter V of chapter 11.<sup>24</sup> The U.S. Trustee and several

creditors objected, arguing that the debtors were ineligible because the debtors were the previous owners of a defunct business, and were not therefore currently “engaged in” any commercial or business activity on the petition date. The bankruptcy court agreed and denied the debtors’ motion to convert.

In doing so, the court rested its analysis on the plain language of the statute, holding that the phrase “engaged in” carries a “contemporary,” as opposed to a “retrospective,” meaning.<sup>25</sup> The phrase “‘engaged’ ... is commonly defined as ‘involved in activity: occupied, busy.’”<sup>26</sup> The *Johnson* court reasoned that “applying the ordinary meaning of ‘engaged’ to the [statutory] language ... a person ‘engaged in’ commercial or business activities is a person occupied with or busy in commercial or business activities — not a person who at some point in the past had such involvement.”<sup>27</sup> Congressional intent supported that rationale, the bankruptcy court explained, given that the SBRA was enacted to help small business *reorganize* and *remain* in business, as opposed to liquidate and wind down.<sup>28</sup>

## A Middle Ground

Does the majority view foreclose subchapter V for debtors that spent their final days winding down, as opposed to operating? To be sure, some distressed businesses cease operating in the normal course before filing a bankruptcy petition. Under certain circumstances, though, subchapter V might still be available.

A line of cases applying the majority view have reasoned that while a debtor may have ceased normal day-to-day transactions pre-petition, a debtor winding down its business may still be “engaged in commercial or business activities” and eligible for subchapter V.<sup>29</sup> How so? These courts focus on the term “activities” in the phrase “commercial or business activities.”<sup>30</sup>

For example, the *Offer Space LLC* court noted that “the term ‘activity’ is defined as ‘the quality or state of being active: behavior or actions of a particular kind.’”<sup>31</sup> This definition is broad and reasonably encompasses the “activity” of winding a business down. Congress did not use a narrower phrase, such as “business operations,”<sup>32</sup> which suggests transacting business in the ordinary course.<sup>33</sup> The court cautioned that merely engaging in the bankruptcy process fails to qualify as a “commercial or business activity,” but additional out-of-court winddown activities may satisfy the definition (*i.e.*, holding active bank accounts, exploring litigation, managing its stock and taking reasonable steps to pay creditors).<sup>34</sup>

16 See *In re RS Air LLC*, 638 B.R. 403, 409 (B.A.P. 9th Cir. 2022) (discussing majority and minority views, while adopting majority approach).

17 *Id.* at 410 (noting two of first opinions on issue were *In re Wright*, Case No. 20-01035-HB, 2020 WL 2193240 (Bankr. D.S.C. April 27, 2020); *In re Blanchard*, Case No. 19-12440, 2020 WL 4032411 (Bankr. E.D. La. July 16, 2020)).

18 *In re Wright*, 2020 WL 2193240, at \*3 (Bankr. D.S.C. April 27, 2020) (emphasis added); see also *In re Blanchard*, 2020 WL 4032411 (Bankr. E.D. La. July 16, 2020); *In re Bonert*, 619 B.R. 248, 255 (Bankr. C.D. Cal. June 3, 2020) (quoting *In re Wright*, 2020 WL 2193240, at \*3).

19 *In re Wright*, 2020 WL 2193240, at \*1.

20 *Id.* at \*1-2.

21 *Id.* at \*3.

22 *Id.* (emphasis in original).

23 See, e.g., *In re Robinson*, 2023 WL 2975630 (Bankr. S.D. Miss. 2023); *NetJets Aviation Inc. v. RS Air LLC* (*In re RS Air LLC*), 2022 WL 1288608 (B.A.P. 9th Cir. 2022); *In re Two Wheels Props. LLC*, 625 B.R. 869 (Bankr. S.D. Tex. Dec. 30, 2020); *Nat'l Loan Invs. LP v. Rickerson* (*In re Rickerson*), 636 B.R. 416 (Bankr. W.D. Pa. Dec. 14, 2021); *In re Blue*, 630 B.R. 179 (Bankr. M.D.N.C. May 7, 2021); *In re Offer Space LLC*, 629 B.R. 299 (Bankr. D. Utah April 22, 2021); *In re Ikalowych*, 629 B.R. 261 (Bankr. D. Colo. April 15, 2021); *In re Johnson*, 2021 WL 825156 (Bankr. N.D. Tex. March 1, 2021); *In re Thurmon*, 625 B.R. 417 (Bankr. W.D. Mo. Dec. 8, 2020).

24 *In re Johnson*, 2021 WL 825156 (Bankr. N.D. Tex. March 1, 2021).

25 *Id.* at \*6.

26 *Id.* (quoting “engaged,” *Merriam-Webster Dictionary* (2021)).

27 *Id.* at \*6.

28 *Id.* (citing H.R. Rep. No. 116-171, 116th Cong., 1st Sess. (2019)).

29 See, e.g., *In re Fama-Chiarizia*, 655 B.R. 48, 61 (Bankr. E.D.N.Y. Sept. 15, 2023).

30 See, e.g., *In re Offer Space LLC*, 629 B.R. 299 (Bankr. D. Utah April 22, 2021).

31 *Id.* at 305 (quoting “activity,” *Merriam-Webster Dictionary* (2021)).

32 *Id.* at 305-06.

33 *Id.*

34 *Id.*

## Conclusion and a Path Forward

The split of authority interpreting § 101(51D)(A) is problematic. Aside from creating a lack of uniformity in bankruptcy law, the split means that a debtor's eligibility for subchapter V varies by jurisdiction. If a traditional chapter 11 case is too expensive or burdensome, a debtor ineligible to file for subchapter V in its jurisdiction (although potentially eligible in another, out-of-reach jurisdiction)

must resort to liquidation in chapter 7 or state court. Congress needs to make a policy decision as to whether debtors that are no longer operating are eligible for subchapter V. Whatever that policy decision may ultimately be, it simply requires amending § 101(51D)(A) to define "engaged in commercial or business activities." Doing so will achieve uniformity in the Bankruptcy Code and preclude inconsistent results. **abi**