

BY JEFFREY A. KATZ¹

The Coexistence Conundrum: Sub V and Small Business Cases

Editor's Note: ABI's Subchapter V Task Force is in the process of analyzing the effectiveness of subchapter V and plans to release its final report this spring. For more information on the task force, visit subtaskforce.abi.org.

Subchapter V was introduced through the Small Business Reorganization Act of 2019. Its title in the Bankruptcy Code is "Small Business Debtor Reorganization," and its explicit legislative goal was to provide a pathway for small businesses to successfully reorganize. Yet, according to the Code, subchapter V is not the haven for a "small business bankruptcy."

Outside of its title, subchapter V does not even mention the phrase "small business."² Its definition of an applicable "debtor" is markedly distinct from a "small business debtor." The latter is only found in a section outside of subchapter V: 11 U.S.C. § 101(51D), which is specifically tailored for the conventional chapter 11 procedures for small businesses.³

While scholars, practitioners and judges debate whether to make subchapter V's increased debt limit permanent to accommodate more "small businesses," a critical piece of the puzzle has largely faded into the background: the pre-existing (and still enduring) small business provisions that define a "small business debtor," which is a notable oversight.

Subchapter V now allows for businesses grappling with liabilities of up to \$7.5 million.⁴ However, the traditional chapter 11 pathway for small businesses remains at just over \$3 million.⁵ A business could qualify for subchapter V (*i.e.*, a "small business debtor reorganization") and not be a "small business debtor" under the Code. This discrepancy is evident in such rules as Rule 1020(a) of the Federal Rules of Bankruptcy Procedure, which dictates that a debtor "shall state in the petition

whether the debtor is a small business debtor and, if so, whether the debtor elects to have subchapter V of chapter 11 apply."⁶ Because a debtor can now qualify for subchapter V without being a "small business debtor," the "if so" qualifier has become mere surplusage.⁷

Although subchapter V was crafted to address the concerns of small businesses, the Code retains small business provisions that are separate from subchapter V. As stakeholders evaluate the early success of subchapter V, it is imperative that the conversation include the future of the pre-existing provisions.

Small Business Bankruptcy: A Primer

When chapter 11 of the Bankruptcy Code was enacted in 1978, it did not differentiate between large and small businesses,⁸ and the system often proved disproportionately burdensome for smaller entities.⁹ In 1994, Congress introduced the Bankruptcy Reform Act to address the unique challenges that small business debtors face when navigating chapter 11,¹⁰ but it had significant limitations.¹¹ While the Bankruptcy Reform Act simplified and expedited certain procedures, it did not do enough to recognize the unique and critical lack of resources inherent to many small businesses.¹²

Against this backdrop, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).¹³ In addition to many adjustments in the domain of consumer bankruptcy, BAPCPA sought to modify chapter 11 for small business debtors.¹⁴ Many of its changes were "to weed out small business debtors who are not likely to reorganize."¹⁵ Defined as entities that engage in business with total debts not exceeding



Jeffrey A. Katz
University of Florida
College of Law
Gainesville, Fla.

Jeffrey Katz is a J.D. candidate at the University of Florida Levin College of Law and editor-in-chief of the Florida Law Review.

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2 11 U.S.C. §§ 1181-95. The Senate version of the bill that introduced subchapter V defined a debtor as "a small business debtor." S. 1091, 116th Cong. (2019). This definition did not make its way into the enacted law. See Small Business Reorganization Act of 2019, Pub. L. No. 116-54 (2019).

3 *Id.* The distinction between a subchapter V and a small business case (not filed under subchapter V) is important where § 362(n) makes the automatic stay inapplicable in certain circumstances where the debtor is in a small business case (meaning not subchapter V). See Hon. Paul W. Bonapfel, *A Guide to the Small Business Reorganization Act of 2019*, at 7 (June 2022), available at www.flsb.uscourts.gov/sites/flsb/files/documents/Guide_to_the_Small_Business_Act_of_2019_%28Hon._Paul_Bonapfel_rev_06-2022%29.pdf (unless otherwise specified, all links in this article were last visited on Nov. 17, 2023).

4 11 U.S.C. § 1182(1)(A).

5 11 U.S.C. § 101(51D).

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

7 A possible reason for this discrepancy is that the \$7.5 million debt limit in subchapter V is technically temporary. See text accompanying n.21-30.

8 Brian A. Blum, "The Goals and Process of Reorganizing Small Businesses in Bankruptcy," 4 *J. Sm. & Emerging Bus. L.* 181, 206 (2000).

9 *Id.*

10 Small businesses historically have not had a bankruptcy chapter that worked well for them. See Prof. Laura N. Coordes, "Bespoke Bankruptcy," 73 *Fla. L. Rev.* 359, 377-78 (2021); see also Prof. Christopher D. Hampson, "Bespoke, Tailored, and Off-the-Rack Bankruptcy: A Response to Professor Coordes's 'Bespoke Bankruptcy,'" 73 *Fla. L. Rev.* 15, 19 & n.33 (2023).

11 James B. Haines Jr., "No Easy Answers: Small Business Bankruptcies After BAPCPA," *B.C. L. Rev.* 71, 74-75 (2005).

12 *Id.*

13 Pub. L. No. 109-8, 119 Stat. 23, 59 (2005).

14 See *id.*

15 H.R. Rep. No. 109-31, at 19 (2005).

\$2.7 million, small business debtors faced new regulations.¹⁶ BAPCPA shortened the deadline for these debtors to submit a reorganization plan within 300 days of the order for relief,¹⁷ required that the initial debtor interview be taken shortly after the filing date, increased reporting obligations for small businesses, and allowed the possibility of asking for a waiver of the disclosure statement.¹⁸

While BAPCPA aimed to benefit small business debtors, its impact fell short. ABI and the National Bankruptcy Conference advocated for modifications to chapter 11 tailored to small businesses.¹⁹ In response, Congress enacted the Small Business Reorganization Act (SBRA) in 2019, aiming to create a bankruptcy pathway that would be better suited for the needs of small businesses.²⁰ Subchapter V's provisions were designed to be less costly, more efficient and more accessible.²¹ The provisions also simplified the traditionally complex requirements of chapter 11, thus offering streamlined processes and more practical restructuring opportunities for small businesses.²²

The initial eligibility criteria for subchapter V mirrored those of a small business debtor. A debtor with "aggregate noncontingent liquidated secured and unsecured debts" of less than \$2,725,625 could take advantage of the new provisions.²³ However, this limit was soon criticized for being too restrictive during the COVID-19 pandemic, which started in early 2020.²⁴ Commentators opined that it precluded many businesses from benefiting from subchapter V,²⁵ and Congress acted swiftly. Just 36 days after the SBRA's enactment, Congress temporarily increased the debt ceiling for subchapter V eligibility to \$7.5 million.²⁶ A year later, Congress renewed the debt limit for another year.²⁷

The increased threshold was not permanent. On March 27, 2022, it expired and reverted to the original limit of \$2,725,625.²⁸ Five days later, the limit was automatically adjusted to \$3,024,725 under § 104's inflation-adjustment provisions.²⁹ However, Congress seemingly did not like the default \$3 million debt limit. The bipartisan Bankruptcy Threshold Adjustment and Technical Corrections Act reintroduced the \$7.5 million debt limit for two years³⁰ and was signed into law on June 21, 2022.³¹

On paper, this divergence of debt limits might be a temporary problem, but this is unlikely. In May 2023, ABI announced that it had formed a task force to study and evaluate subchapter V.³² Part of the discussions so far have included whether to permanently raise subchapter V's debt limit,³³ and the answer seems to be a clear "yes."³⁴

Subchapter V has largely succeeded, but only because its eligibility is capricious.³⁵ If Congress had consistently raised the debt limit in 2019, 2021 and 2022, it would be illogical to assume that they will allow a reduction now, especially when widespread agreement exists against lowering it.

The Coexistence Conundrum

While subchapter V has been largely lauded as a success, its coexistence with the small business provisions have been confusing. One reason for BAPCPA's failure was that its provisions were "confusing, overlapping, and self-contradictory."³⁶ This critique applies when reconciling the small business provisions with subchapter V, which is bankruptcy's "coexistence conundrum."³⁷

Examining the current bankruptcy landscape is necessary to reconcile this conundrum. The Bankruptcy Reform Act and BAPCPA marked significant developments in bankruptcy law. However, in the wake of subchapter V, these acts now appear as relics of a bygone era, tailored for a pre-subchapter V landscape. So, why has Congress not abolished them?

Retaining the small business provisions perhaps reflects a cautious approach by Congress. Paying homage to the "abuse" part of BAPCPA, qualifying small businesses often lack a substantial creditor constituency, or their creditors do not have enough at stake to be invested in the case.³⁸ This absence of an interested creditor group can lead to scenarios where oversight and intervention are insufficient. Because subchapter V is voluntary, a debtor who opts out may still need the increased reporting and supervision requirements that uphold the integrity and efficiency integral to the bankruptcy system. By not aligning the debt limit of these provisions with that of subchapter V, Congress may have thought that small businesses needing oversight do not have the same debts as subchapter V debtors.

However, if oversight is the primary concern, then the effectiveness of the small business provisions under their current structure must be scrutinized. It is necessary to ascertain whether these provisions, with the lower debt limit, effectively address the oversight needs of smaller debtors. If not, amendments may be needed to ensure that these provisions effectively serve their intended purpose.

16 *Id.*

17 *Id.*

18 *Id.*

19 See Final Report of the ABI Commission to Study the Reform of Chapter 11 (2014), available at commission.abi.org/report.

20 For a thorough overview of subchapter V's history and a discussion on its unique procedures, see Prof. Christopher D. Hampson & Jeffrey A. Katz, "The Small Business Prepack: How Subchapter V Paves the Way for Bankruptcy's Fastest Cases," 92 *Geo Wash. L. Rev.* (forthcoming 2024) (manuscript at 8-13), available at papers.ssrn.com/sol3/papers.cfm?abstract_id=4595995.

21 See SBRA, Pub. L. No. 116-54, § 4(a)(1), 133 Stat. 424.

22 See *Id.*

23 *Id.*

24 For a thorough critique of the low debt limit, see, e.g., Nicole C. Cipriano, "The Big Short: How the Big Step of the Small Business Reorganization Act Fell Short," 50 *Hofstra L. Rev.* 145 (2021).

25 See *Id.*

26 Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, § 1113(a)(1)(A), 134 Stat. 249 (2020).

27 The CARES Act was set to expire on March 27, 2021. However, the COVID-19 Bankruptcy Relief Extension Act extended the debt limit until March 27, 2022. Bankruptcy Relief Extension Act of 2021, Pub. L. No. 117-5, March 27, 2021, 135 Stat. 249.

28 See Robert J. Keach & Adam Prescott, "President Biden Signs Bankruptcy Threshold Adjustment and Technical Corrections Act into Law," XLI *ABI Journal* 8, 8-9, 39, August 2022, available at abi.org/abi-journal.

29 Adjustment of Certain Dollar Amounts in the Bankruptcy Code, 87 *Fed. Reg.* 24, 6625 (Feb. 4, 2022).

30 Bankruptcy Threshold Adjustment and Technical Corrections Act, S. 3823, 117th Cong. (2022). The bill passed the house on June 7, 2022, with 94.9 percent of votes in favor of the bill. *Id.*

31 "Bill Signed: S. 1097, S. 2520, and S. 3823," White House Press Release (June 21, 2022), available at whitehouse.gov/briefing-room/legislation/2022/06/21/press-release-bill-signed-s-1097-s-2520-and-s-3823.

32 "ABI Announces Subchapter V Task Force to Examine Small Business Reorganizations Since Subchapter's Enactment," ABI Press Release (May 8, 2023), available at abi.org/newsroom/press-releases/abi-announces-subchapter-v-task-force-to-examine-small-business. The task force recently concluded public hearings discussing various aspects of the law. A final report based on these findings will be released in spring 2024. Learn more at subtaskforce.abi.org.

33 See ABI Press Release, *supra*.

34 See, e.g., Testimony of Michael St. James for ABI Subchapter V Task Force Hearing on June 9, 2023 ("General Experiences with Subchapter V"), available at subtaskforce.abi.org/public-hearings-schedule.

35 See, e.g., *Id.*

36 *In re Donald*, 343 B.R. 524, 529 (Bankr. E.D.N.C. 2006).

37 This article uses the phrase "coexistence conundrum" to describe the complexities and challenges arising from the concurrent presence of two or more legal provisions designed to address overlapping issues.

38 H.R. Rep. No. 109-31, at 19 (2005) (noting creditors do not play major role in small business cases because they "do not have claims large enough to warrant the time and money to participate actively").

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Student Gallery: The Coexistence Conundrum: Sub V and Small Business Cases

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Conversely, if the oversight explanation is flawed, the bankruptcy community should reconsider whether there is still a need for the small business provisions at all, especially amid the small business provisions' marginalization. While the debt limit for subchapter V has been raised, the threshold for qualifying as a "small business debtor" has not. If the elevated debt limit was deemed necessary for the success of subchapter V bankruptcies, then not raising the threshold for small business debtors could signal a tacit acceptance of the small business provisions' demise.

If the small business provisions are still relevant and necessary, the failure to adjust their debt threshold in tandem with subchapter V could indicate a lack of coherence in legislative strategy for small business bankruptcies. A full exploration is beyond the scope of this article, but it is necessary to recognize the shortcomings of maintaining dual pathways for seemingly the same purpose.

Subchapter V's protocol for a disclosure statement under § 1181(b) is a concrete example of this complexity. Should a court deem a disclosure statement necessary under § 1181(b), then § 1187(c) prescribes the application of § 1125(f),³⁹ which begins with the phrase "in a small business case." According to § 101(51C), a "small business case" is "a case filed under chapter 11 of this title in which the debtor is a small business debtor and has not elected that subchapter V of chapter 11 of this title shall apply."⁴⁰

Thus, the text states that the provision deemed relevant under subchapter V is inapplicable to subchapter V cases.

For this provision to mean anything, § 1187(c) must implicitly modify § 1125(f). This is a seemingly easy resolution to an issue that should not exist in the first place.

Absent completely abrogating the small business provisions, aligning the debt thresholds of the small business provisions with those of subchapter V could enhance its effectiveness. Increasing the debt limit would also address the inconsistency where a subchapter V debtor is not always classified as a "small business debtor" under the Bankruptcy Code.

While this inconsistency might not be confusing for bankruptcy experts, subchapter V and the bankruptcy system are intended for use by individuals, who generally are not well-versed in the Code's quirks. There is a risk that a debtor might mistakenly think that it is ineligible for a "small business reorganization" (*i.e.*, subchapter V) if its debts exceed the thresholds defining a "small business debtor," thereby hindering the accessibility and intended benefits of subchapter V.

Conclusion

As the economic landscape changes and small business debt burdens grow, legal frameworks for insolvency must evolve. The introduction of subchapter V marked a pivotal change, yet the small business provisions have seen no further development since. In deliberations about the future of subchapter V within the bankruptcy community, it is imperative to reassess these small business provisions. Absent evidence of their continued efficacy, these provisions warrant elimination. **abi**

³⁹ 11 U.S.C. § 1181.

⁴⁰ 11 U.S.C. § 101(51C).

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