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KEEPING THE LIGHTS ON THROUGH DARK TIMES: HOW SUBCHAPTER V BANKRUPTCY SHOULD PROTECT SMALL BUSINESSES DECIMATED BY THE PANDEMIC

Daniel LeBrun[*]

ABSTRACT

Small to mid-market, independent businesses are at the heart of our economy and play a pivotal role in job creation. While it's estimated by the House of Representatives that these companies account for over half of overall U.S. employment, they have been traditionally underserved in bankruptcy law. Historically, the resources necessary to complete a chapter 11 bankruptcy are not within reach for these small to mid-market businesses. Passed in 2019, the Small Business Reorganization Act has modified the Bankruptcy Code to provide new avenues for these small businesses in need. Impactful in its own right, it has emerged as a lifeline to small businesses decimated by the pandemic. This Note will focus on the fundamental changes to the Bankruptcy Code brought by the SBRA and what improvements can still be made.

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I. INTRODUCTION

On August 23, 2019, President Donald J. Trump signed the Small Business Reorganization Act ("SBRA") into law. With the stroke of a pen, Subchapter V[1] had been added to Chapter 11 of the U.S. Bankruptcy Code ("Bankruptcy Code").[2] The SBRA became effective in February 2020, coincidently just ahead of the COVID-19 pandemic.[3] Since then, it has emerged as a lifeline to small business owners faced with the human and economic ravages of the pandemic.

Over 2,200 cases have been filed under Subchapter V as of this writing, over one-third of which were filed in California, Florida, and Texas.[4] Congress's stated goals in enacting the SBRA were to streamline the process and lower the costs involved in Chapter 11 to further increase the likelihood that small business debtors could remain in and successfully complete their bankruptcy.[5] Congress determined that new legislation for small businesses was necessary because:

> Small businesses—typically family-owned businesses, startups, and other entrepreneurial ventures—''form the backbone of the American economy.'' For example, it is estimated that '''companies with 50 to

[1] Small Business Reorganization Act, Pub. L. No. 116-54, 133 Stat. 1079 (2019), codified in 11 U.S.C. §§ 1181 – 1195.

[2] Title 11 of the U.S. Code.

[3] The CARES Act, enacted March 27, 2020, replaced the definition of "debtor" under 11 U.S.C. § 1182 so that the statute no longer references the term "small business debtor" defined under 11 U.S.C. § 101(51D)(A), but refers to a new definition of "debtor" under 11 U.S.C. § 1182. In effect, the CARES act expanded the eligibility for relief under the SBRA by amending the debt cap for the debtor's aggregate noncontingent liquidated secured and unsecured debts from $2.7 million to $7.5 million for all petitions filed within the one year period following its enactment. In March 2021, the COVID-19 Bankruptcy Relief Extension Act of 2021 extended the provisions of the CARES Act to March 2022. *See* 11 U.S.C. §§ 1182(1), 101(51D)(A); Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136. § 1113, 134 Stat. 281 (2020); COVID-19 Bankruptcy Relief Extension Act of 2021, Pub L. No. 117-5 135 Stat. 249 (2021).

[4] *Subchapter V Bankruptcy Statistics*, AM. BANKR. INST., https://app.powerbi.com/view?r=eyJrIjoiNzJmYWJlNDQtMGNlMy00MDA5LThmZWMtODU5YTQyMDRjYWNjIiwidCI6ImI0NDBhOWMyLThjNmYtNGNlYS1iYzI1LWYzZTI0MGJjNGI1ZCIsImMiOjF9 (last visited Aug 1, 2021) [hereinafter AM. BANKR. INST.].

[5] H.R. REP NO. 116-171, at 4 (2019).

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> 5,000 employees account for more employment than those with over 5,000.''' By their very nature, however, the longevity of these businesses is limited. According to the Small Business Administration Office of Advocacy, approximately 20 percent of small businesses survive the first year, but by the five-year mark only 50 percent are still in business and by the ten-year mark only one-third survive.[6]

Given these statistics, it was evident that small businesses struggled to remain open and something further must be done.

The timing of the SBRA's enactment appears synchronous. Small businesses that were on stable ground at the start of 2020 faltered in the face of COVID-driven shutdowns. In tandem with the Paycheck Protection Program ("PPP"), Subchapter V may have kept entire segments of our economy afloat.[7]

The SBRA introduced broad structural changes to bankruptcy law, leaving some courts divided on how to properly apply the statutory language provided by Congress when it comes to eligibility to participate as a Subchapter V debtor. Part II of this Note will discuss the history of small business reorganization in the United States and the fundamental changes that the SBRA introduced to existing bankruptcy law. On a broad scale, the SBRA effectively reduced expenses to the debtor and gave the debtor more power in plan confirmation. It also provided a number of benefits to business owners by allowing them to modify the mortgage on a debtor's principal residence and to be the sole person allowed to modify the plan post-confirmation.

Part III will address some of the issues brought to the fore by the SBRA such as: (1) whether the eligibility to be a small business

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[6] *Id.*

[7] U.S. SMALL BUS. ADMIN. OFF. OF ADVOC., 2019 SMALL BUS. PROFILE (2019), https://cdn.advocacy.sba.gov/wp-content/uploads/2019/04/23142610/2019-Small-Business-Profiles-States-Territories.pdf (finding that as of 2016, small businesses contributed to 47.3% of overall private sector employment, accounting for as high as 83.9% and 82.3% respectively in agricultural and construction employment); *see, e.g.,* MICHELLE M. HARNER, FINAL REPORT OF THE ABI COMMISSION TO STUDY THE REFORM OF CHAPTER 11, 276 (2014) https://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1096&context=books ("[I]n terms of output, the sheer number of mid-market firms . . . in aggregate, their revenues surpass those of the top 100 U.S. companies . . . and are equivalent to roughly 40 percent of the U.S. GDP").

debtor, as defined in 11 U.S.C. § 101 (51D), is meant to include businesses that cease operations before the opportunity to reorganize through bankruptcy, and (2) whether current Chapter 11 debtors with pending cases may elect to amend their petition as small business debtors to achieve retroactive effect of the SBRA. The answer to both should be a resounding yes, as these business owners should still have access to Subchapter V due to the nature of their debts.

Part III will also discuss whether the current debt limit for small business debtors is too high to fully substantiate the needs of an entity that is on the verge of bankruptcy.[8] Part IV will examine data samples of the impact of COVID-19 on small businesses and how the introduction of Subchapter V is affecting them. Section V will conclude that the SBRA, while imperfect, is still an impressive prospect for revitalizing small businesses.

II. HISTORY OF SMALL BUSINESS BANKRUPTCIES AND THE LEGISLATIVE ENACTMENT OF THE SBRA

Prior to 1994, "Mom and Pop Shops" were subject to the same procedural standards as Fortune 500 companies when filing under Chapter 11. The concept of a "small business debtor," distinct from other debtors in bankruptcy law, originated in the Bankruptcy Reform Act of 1994 ("1994 Act").[9] The 1994 Act sought to assist small businesses in reorganization by providing for an expedited process through bankruptcy.[10] The 1994 Act also created the

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[8] Pursuant to 11 U.S.C. § 101(51D), a debtor must have "aggregate noncontingent liquidated secured and unsecured debts . . . in an amount not more than $2,727,625" to qualify. 11 U.S.C. § 101(51D)(A). Under the CARES Act, the debt limit was increased to $7.5 million for one year following March 27, 2020. Coronavirus Aid, Relief, and Economic Security Act § 1113.

[9] Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 217(a), 108 Stat. 4106 (1994). The Bankruptcy Reform Act of 1994 amended 11 U.S.C. § 101 to include the following:

> [A] 'small business' means a person engaged in commercial or business activities (but does not include a person whose primary activity is the business of owning or operating real property and activities incidental thereto) whose aggregate noncontingent liquidated secured and unsecured debts as of the date of the petition do not exceed $2,000,000.

§ 217(a). 108 Stat. 4106.

[10] § 217(f), 108 Stat. 4106. This section amended 11 U.S.C. § 1125 to allow the court to conditionally approve the debtor's disclosure statement so that the debtor may begin soliciting approval of his or her plan, as well as allowing for "a hearing

National Bankruptcy Review Commission ("NBRC").[11] The NBRC's final report in 1997 found that a majority of Chapter 11 cases resulted in dismissal and conversion.[12] Notably, the report concluded that Chapter 11, as it stood, induced many small businesses to file for bankruptcy, even though such businesses never possessed a viable path towards confirmation.[13] The final proposals of the NBRC sought to "better serve the interests of justice and the special needs of small business debtors and their creditors"[14] and made clear their stance that "the appropriate use of Chapter 11 is one in which the debtor confirms and materially performs a plan of reorganization."[15]

Guided by the proposals made by the NBRC, Congress introduced the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCA") in 2005 as a reform measure to "improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors."[16] Section 256 of BAPCA was intended to create additional oversight of small business cases.[17] The

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on the disclosure statement [to] be combined with a hearing on confirmation of a plan." *Id.*

[11] *National Bankruptcy Review Commission*, FED. REG., https://www.federalregister.gov/agencies/national-bankruptcy-review-commission (last visited Mar. 28, 2021) ("The Commission was created to investigate and study issues relating to the Bankruptcy Code; to solicit divergent views of parties concerned with the operation of the bankruptcy system; to evaluate the advisability of proposals with respect to issues; and to prepare a report to be submitted to the President, Congress and the Chief Justice.").

[12] NAT'L BANKR. REV. COMM'N, CHAPTER 2: BUSINESS BANKR., 610, (Oct. 20, 1997) https://govinfo.library.unt.edu/nbrc/report/15smalbu.pdf ("[A] debtor entering into Chapter 11 only [had] a 6.5% chance of confirming and performing a plan.").

[13] *Id.* at 612.

[14] *Id.* at 615 ("[By] (i) establishing presumptive plan-filing and plan-confirmation deadlines specially tailored to fit small business cases; and (ii) directing bankruptcy judges to use modern case-management techniques in all small business cases to further reduce cost and delay.").

[15] *Id.* at 611.

[16] H.R. REP NO. 109-31, at 2 (2005).

[17] BAPCA was enacted on April 20, 2005 with the intent to address a number of issues, including: the prolonged escalation in consumer bankruptcy filings, the losses passed onto our economy through discharged debts, the "loopholes" that encourage abusive filings, and debtors who are able to repay a significant portion of their debts but are not mandated to. *Id.* at 6; The Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. 109-8, 119 Stat, 23, (2005).

section required the Office of the United States Trustee ("U.S. Trustee") to be actively involved and to apply various mandatory deadlines and enforcement mechanisms.[18] Congress believed this would "weed out small business debtors who are not likely to reorganize."[19] BAPCA appeared to have unduly burdened small business. Under its framework, small business debtors were obligated to issue detailed financial reports within a minimal time period, submit to inspections of assets, and regularly meet with the U.S. Trustee.[20] These reporting requirements created numerous occasions for conversion or dismissal of the debtor's petition if not fully complied with.[21] BAPCA's new requirements would pose no issue for a national conglomerate with a plethora of resources at its disposal. For a small business in distress, however, these obstacles would prove to be next to insurmountable.[22]

In 2012, the American Bankruptcy Institute ("ABI") established the Commission to Study the Reform of Chapter 11 ("Commission") to reevaluate U.S. business reorganization laws in

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[18] *Id.* at 19 ("The main reason [for greater UST involvement] is that creditors in these smaller cases do not have claims large enough to warrant the time and money to participate actively in these cases. The resulting lack of creditor oversight creates a greater need for the United States trustee to monitor these cases closely.").

[19] *Id.*

[20] *See* James B. Haines, Jr. & Philip J. Hendel, *No Easy Answers: Small Business Bankruptcy After BAPCA*, 47 B.C. L. REV. 71 (2005) (arguing that these additional reporting requirements would heavily add to a business's administrative expenses and that the requirement for managers of small businesses to devote excessive time to meetings with the U.S. Trustee is less than necessary to "improve the quality of the reorganization" as opposed to their managing the day-to-day operations of a business in financial distress).

[21] *See also* Written Statement of the Honorable Melanie L. Cyganowski (Ret.), former Chief Bankruptcy Judge E.D.N.Y., *CFA Field Hearing Before the ABI Commission to Study the Reform of Chapter 11*, http://commission.abi.org/field-hearing-cfa-november-15-2012 (Nov. 15, 2012) (arguing that the deadlines put in place by BAPCA created concern amongst lenders, leading to the lenders taking early action to reduce credit risk which then ultimately hurt debtors' abilities to secure alternative funding, to the detriment of the entire reorganization process).

[22] HARNER, *supra* note 7, at 12 (2014)

> [E]vidence suggests that chapter 11 has become too expensive (particularly for small and medium-sized enterprises) and is no longer capable of achieving certain policy objectives such as stimulating economic growth, preserving jobs and tax bases at both the state and federal level, or helping to rehabilitate viable companies that cannot afford a chapter 11 reorganization.

Id.

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response to further criticisms of BAPCA.[23] The Commission drew information over the course of 2012 to 2014 from over 150 insolvency professionals who formed advisory committees, as well as sixteen field hearings open to the public across eleven different cities.[24] The general consensus was that, for small business debtors, Chapter 11 bankruptcies were an imperfect tool in their times of need.

Specifically, business owners lose their equity in ownership and Chapter 11 bankruptcies were too costly and time consuming for a small business to manage.[25] From 2008 to 2015, only twenty seven percent (27%) of small business Chapter 11 cases reached confirmation of a plan, with a total of 18,000 applying for relief.[26] This does not even account for those small businesses who saw Chapter 11 as a lost cause and opted not to even file in the first place.[27] To be sure, debtors have numerous fiscal obligations in a traditional Chapter 11 they must contend with up front, such as U.S. Trustee fees and legal expenses. This is without accounting for the costs of possible discovery and litigation should any parties object to the debtor's proposed plan. Taking this all into account, it is not surprising to find that fewer than one-third of small businesses that have attempted to reorganize have failed to do so.[28]

[23] *Id.* at 281 ("[C]hapter 11 is not working for small and middle-market debtors, and . . . that certain of the deadlines imposed by the BAPCPA amendments were particularly challenging and counterproductive for small business debtors.").
[24] *Id.* at 13-16 (noting that common themes presented in the witnesses' statements at the field hearings: an increase in 363 sales, a decrease in stand-alone reorganizations, decrease in unsecured creditor recoveries, and an increase in the costs associated with Chapter 11s – all of which contribute to Chapter 11 no longer working effectively for small to mid-market companies).
[25] Robert J. Keach, *Testimony of American Bankruptcy Institute, Hearing On Oversight Of Bankruptcy Law & Legislative Proposals*, at 4-5 (June 19, 2019), https://docs.house.gov/meetings/JU/JU05/20190625/109657/HHRG-116-JU05-Wstate-KeachR-20190625.pdf (noting as well how Chapter 11 failed to provide for small business owners who may be "unsophisticated in finance, business plans, or restructuring issues" and lack the resources of larger corporations).
[26] *Id.* at 4.
[27] "The number of cases filed under the current small business chapter 11 has declined for eight consecutive years." *Id.* at 4 n.1; "Witnesses testified how small- and medium-sized businesses no longer use chapter 11 to try to save their businesses; rather, for the most part, these companies file bankruptcy knowing the business will not survive." *Id.* at 4.
[28] *Id.*

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Passed with bipartisan support, the SBRA introduced a number of measures for small business debtors to succeed in reorganizing or restructuring their debts under Subchapter V.[29] First, small business debtors proceeding under Subchapter V are no longer subject to the administrative expenses traditionally associated with standard Chapter 11 bankruptcies.[30] Second, a benefit of Subchapter V for small business owners is that the law allows an equity owner to maintain ownership *without* paying unsecured creditors in full *and* despite the objections advanced by unsecured creditors.[31] This approach gives less leverage to the unsecured creditors in the process so as to better reach a consensual plan between debtor and creditors.[32] Third, a small business debtor under Subchapter V has the exclusive right to file a plan,[33] and pursuant to § 1190(3), the debtor may propose a plan which modifies the mortgage on the debtor's principal residence "if the granting of the security interest was not used

[29] Introduced on June 18, 2019 by Representative Ben Cline (R-VA), with the Antitrust, Commercial, and Administrative Law Subcommittee, Chairman David N. Cicilline (D-RI), Full Committee Ranking Member Doug Collins (R-GA) and Representative Steve Cohen (D-TN), the Small Business Reorganization Act of 2019 became public law on August 23, 2019 with an effective date of February 19, 2020. H.R. REP NO. 116-171 (2019).

[30] 11 U.S.C. § 1181(b) does away with the mandatory appointment of a Creditors' Committee under § 1102 and defers it to the authority of the court to only order such for cause. Creditors' Committees are comprised of a group of unsecured creditors who hold the largest unsecured claims against the debtor in order to "assure adequate representation of creditors." 11. U.S.C. § 1102(b), (a)(2). Pursuant to 11 U.S.C. § 1103, a Creditors' Committee ordinarily has rather expansive power to hire professionals on behalf of themselves at the expense of the bankruptcy estate, *i.e.,* the debtor. In a similar fashion, § 1181(b) also nixes the requirement for post-petition disclosure statements pursuant to § 1125, which often require extraordinary legal fees on behalf of the estate to produce. Furthermore, the SBRA amended the language of 28 U.S.C. § 1930(a)(6) to specifically exclude Subchapter V cases, meaning that quarterly fees for the U.S. Trustee, which can run up to $250,000 per quarter, are no longer required. Finally, debtors can amortize certain administrative expenses over the life of a plan, rather than having to pay these costs in full at the time of plan confirmation. *See* 11 U.S.C. § 1191(e).

[31] Pursuant to 11 U.S.C. § 1191(b), the requirements of § 1129(a)(8), (10), (15) are inapplicable to Subchapter V small business debtors seeking a cramdown, thereby allowing a court to confirm a Subchapter V plan absent the acceptance of the plan by an impaired class.

[32] This is only applicable to unsecured creditors, the requirements for a cramdown of secured claims remain the same as in a traditional Chapter 11 case. *See* 11 U.S.C. § 1191(c)(1).

[33] 11 U.S.C. § 1189(a).

primarily to acquire the real property; and used primarily in connection with the small business of the debtor."[34]

The Chapter 11 bankruptcy process is also problematic to small businesses with limited staff and manpower. Confronted with bankruptcy, their management and employees would need to take time away from running the daily operations of their businesses to instead focus on the reorganization process.[35]

Similar to a traditional Chapter 11 case, a debtor under the SBRA will serve as a debtor in possession unless the court orders otherwise pursuant to objection and a hearing.[36] Although the SBRA does not create a panacea for the difficulties of operating a business in bankruptcy, the expanded leverage given to debtors under Subchapter V and the expected decreases in administrative costs will surely result in managers expending less time and fewer resources on the reorganization process. An additional benefit includes the debtor's ability to retain pre-petition counsel so long as the claim held is for less than $10,000 and "arose prior to commencement of the case," which is expected to allow the debtor's counsel to prepare pre-petition for a successful prosecution of the bankruptcy case without fear of having a conflict with the estate once the bankruptcy petition is filed.[37] Of similar benefit, the provisions of § 362(n) are inapplicable to a small business debtor who elects to proceed under

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[34] § 1190(3); *see also In re* Ventura, 615 B.R. 1, 25 (Bankr. E.D.N.Y. 2020) (proposing a number of factors to be considered in determining whether a mortgage is subject to modification).

[35] U.S. SMALL BUS. ADMIN. OFF. OF ADVOC., *supra* note 7 (finding that companies with less than 20 employees account for 89% of all businesses in the country).

[36] 11 U.S.C. §§ 1184-85; *see also* Lisa Vandesteeg, *Bankruptcy Court Decision Could Change Threshold for Removal of DIP in Subchapter V Chapter 11 Bankruptcies,* LEVENFELD PEARLSTEIN, LLC (Jan. 14, 2021) https://www.lplegal.com/content/bankruptcy-court-decision-change-threshold-removal-dip-subchapter-v-chapter-11-bankruptcies.

[37] 11 U.S.C. § 1195. Traditionally, under 11 U.S.C § 327, an attorney for the debtor with unpaid pre-petition fees serves as a person who holds or represents an "interest adverse to the estate," thus disqualifying him or her from serving as counsel for the debtor until the obligation is paid in full. § 1195 negates this and allows for the case to proceed so long as the claim is for less than $10,000. *See also In re Ozcelebi*, No. 20-70295, 2021 WL 3160861, at *1 (Bankr. S.D. Tex. July 20, 2021) (allowing debtor's counsel to reduce pre-petition claim amount to $9,999 to satisfy § 1195).

Subchapter V, giving repeat bankruptcy filers the protections of the automatic stay.[38]

In traditional Chapter 11 bankruptcies, there is an "absolute priority" rule[39] which essentially denies business owners the opportunity to maintain their interest in their own company if senior unsecured creditors are not paid in full or do not vote to accept the Chapter 11 plan.[40] Thus, if a small business owner does not pay senior creditors in full in the hopes of maintaining an equity interest, the creditors are deemed to be "impaired" under the plan. If these creditors accept the debtor's proposed plan, then there is no issue. The issue lies in the fact that, predictably, most creditors would prefer to be paid in full and will "reject" a plan that allows an owner to retain its interest—and future profits—while such creditors are left with little or no return.

At this point in seeking confirmation of the plan, the debtor's only option is to seek a "cramdown" pursuant to 11 U.S.C. § 1129(b)(1). In a cramdown, the court imposes the reorganization plan on creditors over their objections if the court deems the plan acceptable. For the court to accept a cramdown, the plan must be in accord with the provisions of § 1129(a), and may "not discriminate unfairly, and is *fair and equitable*, with respect to each class of claims or interests that is impaired under, and has not accepted, the

[38] 11 U.S.C. § 362(n)(1)-(2).

> Except as provided in paragraph (2), subsection (a) does not apply in a case in which the debtor—(A) is a debtor in a small business case pending at the time the petition is filed…Paragraph (1) does not apply—(B)to the filing of a petition if—(i)the debtor proves by a preponderance of the evidence that the filing of the petition resulted from circumstances beyond the control of the debtor not foreseeable at the time the case then pending was filed…

[39] Codified in 11 U.S.C. § 1129(b)(2)(B), the purpose of the absolute priority rule is to ensure that senior class creditors are paid in full before any junior class creditors receive any distribution from the estate unless senior class creditors consent. *See* H.R. Rep. No. 103–835, at 33 (1994) (explaining that the Code is "designed to enforce a distribution of the debtor's assets in an orderly manner ... in accordance with established principles rather than on the basis of the inside influence or economic leverage of a particular creditor").

[40] *Id.* § 1129(b)(2)(B)(i) ("[T]he condition that a plan be fair and equitable [for unsecured creditors] . . .the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value…equal to the amount of such claim, as of the effective date of the plan ….").

plan."[41] However, a traditional Chapter 11 plan cannot be seen by the court as "fair and equitable" when an owner retains an equity interest without paying unsecured creditors in full.[42] Thus, even one large unsecured creditor can be an obstruction in the way of confirming a restructuring plan or owners maintaining their equity.[43]

The SBRA has effectively changed the meaning of "fair and equitable" as applied to small business debtors proceeding under Subchapter V.[44] Codified in 11 U.S.C. § 1191(c), the new requirements for a cramdown plan to be "fair and equitable" are now based on the *projected disposable income* of the debtor in the three to five year period following confirmation.[45] The statute indicates that:

> (c) Rule of Construction.—For purposes of this section, the condition that a plan be fair and equitable with respect to each class of claims or interests includes the following requirements:
>
> > (1) With respect to a class of secured claims, the plan meets the requirements of section 1129(b)(2)(A) of this title.
> >
> > (2) As of the effective date of the plan—

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[41] *Id.* § 1129(b)(1) (emphasis added).

[42] Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 202 (1988) ("[T]he absolute priority rule 'provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan.'" (quoting *In re* Ahlers, 794 F.2d 388, 401 (8th Cir. 1986), *rev'd sub nom*. Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988))).

[43] There is a common law exception recognized in some circuits called the "new value exception" or "new value doctrine" which purports to allow an equity owner to maintain its interest when a "new value contribution" is infused into the company from an outside source; however, this exception is incredibly difficult to meet. *See, e.g*., Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351, 1360 (7th Cir. 1990).

[44] 11 U.S.C. § 1129(b)(2)(A)(i)(II) requires that "each holder of claim [that is impaired under and has not accepted the plan] receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, *as of the effective date of the plan*, of at least the value of such holder's interest in the estate's interest in such property." *Id.* (emphasis added).

[45] *Id.* § 1191(d) defines disposable income as "income that is received by the debtor and that is not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor; or . . . for the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor." *Id.* This is analogous to the requirements for a cramdown of unsecured creditors in Chapter 12 pursuant to § 1225(b).

(A) *the plan provides that all of the projected disposable income of the debtor to be received in the 3-year period*, or such longer period not to exceed 5 years as the court may fix, beginning on the date that the first payment is due under the plan will be applied to make payments under the plan; or
(B) the value of the property to be distributed under the plan in the 3-year period, or such longer period not to exceed 5 years as the court may fix, beginning on the date on which the first distribution is due under the plan is not less than the projected disposable income of the debtor.

(3)

(A)

(i) The debtor will be able to make all payments under the plan; or

(ii) there is a reasonable likelihood that the debtor will be able to make all payments under the plan; and

(B) the plan provides 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.[46]

This change allows owners to maintain their interest by distributing the projected disposable income from their business – which could potentially be miniscule – over an extended period rather than having to pay unsecured creditors in full or providing new value to confirm a plan. In other words, in the past, the owner would essentially need to pay 100% to unsecured creditors to maintain its interest, but now, the owner can pay just cents on the dollar.

The amendments to the Bankruptcy Code enacted by the SBRA confer greater leverage upon debtors. The SBRA has put the metaphorical ball in the debtor's court when it comes to getting their business back on track. Especially at a time when many small businesses are in desperate need due to the global pandemic,

[46] 11 U.S.C. §1191(c) (emphasis added).

Subchapter V has proven its effectiveness as an addition to the Bankruptcy Code.[47]

III. LEGAL ANALYSIS

Two main issues have arisen in the courts surrounding the ability of a debtor to elect to proceed under Subchapter V. The first issue is whether the benefits of Subchapter V should be extended to include businesses that already ceased their operations and are not capable of reorganizing.[48] The second is whether current debtors proceeding under Chapter 7 or 11 should be able to amend their petition to elect Subchapter V treatment.[49] Both of these issues should be resolved in the affirmative. Another issue posed, not by the courts, but by the American Bankruptcy Institute, is whether the debt cap of $2.7 million is sufficient to aid in the reorganization of all small businesses effectively, or if it will exclude those in most need.[50]

A. Argument for Extension of Subchapter V Benefits to Non-Operating Business Owners

Following the passage of the SBRA, 11 U.S.C. § 101(51D) was amended to define a "small business debtor" as:

> a person *engaged in commercial or business activities* (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single-asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of this date of the filing of the petition or the date of the order for relief in an amount not more than $2,725,625, not less

[47] *See* Keach, *supra* note 25, at 5 ("Providing a small or medium-sized debtor with the time and the tools to reorganize under the Bankruptcy Code allows individuals to retain businesses they have worked hard to build, while preserving the value of secured creditors' collateral.").
[48] *In re* Charles Christopher Wright, No. CV 20-01035-HB, 2020 WL 2193240 (Bankr. D.S.C. 2020).
[49] *In re* Body Transit, Inc., 613 B.R. 400 (Bankr. E.D. Pa. 2020).
[50] Keach, *supra* note 25, at 5.

> than 50 percent of which arose from the commercial or business activities of the debtor.[51]

The key phrase to this definition is "engaged in commercial or business activities." While the intent behind the enactment of the SBRA is to "streamline the bankruptcy process" such that small businesses could rehabilitate and continue operating, there is no statutory language that specifically states the business must be operating "currently."[52] Approximately fifty percent of small businesses fail after five years.[53] Almost seventy percent have closed their doors before their tenth anniversary.[54] For these entities, a traditional Chapter 11 would be near impossible due to many of the factors laid out in Part II above. Chapter 7 is an unlikely option for a discharge of individual debt due to the much lower annual income cap allowable for debtors, and is not an ideal choice for an individual who does not want to be the subject of an investigation by the Chapter 7 trustee.[55] Chapter 13 poses a much similar issue for individual debtors.[56] That issue is whether the individual owners of these failed businesses, burdened with lingering personal obligations from business expenses, should be able to seek the same benefits of Subchapter V to restructure their debts as would a debtor currently engaged in business. As of August 2021, four cases have addressed this issue directly, *In re Wright,*[57] *In re Bonert*,[58] *In re Blanchard*,[59] and *In re Thurmon*.[60]

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[51] 11 U.S.C § 101(51D) (emphasis added).

[52] H.R. REP NO. 116-171, at 1 (2019).

[53] *See Business Employment Dynamics, Entrepreneurship and the U.S. Economy*, BUREAU OF LAB. STAT., http://www.bls.gov/bdm/entrepreneurship/bdm_chart3.htm (last modified April 28, 2016).

[54] *Id.*

[55] Chapter 7 debtors must comply with a "Means Test" which varies based on income level, but generally is between $40,000 to $100,000 for an individual debtor. 11 U.S.C. § 707(b)(2). Put simply, income level higher than the local average can create a presupposition of abuse and the court may dismiss or convert the Chapter 7 case to Chapter 11 or 13 depending on the debts accumulated. *Id.*

[56] 11 U.S.C. § 109(e) limits Chapter 13 eligibility to "individual[s] with regular income that [owe] . . . . noncontingent, liquidate, unsecured debts of less than $419,275." *Id.* Moreover, Chapter 7 and Chapter 13 do not allow a debtor to modify a mortgage on a principal residence, making Subchapter V enticing to any individual debtor with an underwater mortgage.

[57] No. CV 20-01035-HB, 2020 WL 2193240 (Bankr. D.S.C. Apr. 27, 2020).

[58] 619 B.R. 248, 251 (Bankr. C.D. Cal. 2020).

In *In re Wright*, the debtor was the owner of a pair of businesses, each of which had filed for Chapter 11 relief previously and was dismissed.[61] Both businesses had sold their assets in the sum of $700,000 to pay creditors, but a number of liabilities secured by liens against the debtor's residence remained.[62] Both businesses ceased operating as of 2018 and the individual debtor sought bankruptcy relief for his continuing personal obligations on debts related to the business entities.[63] Conflict arose when the U.S. Trustee filed a Motion to Strike, arguing that the debtor "does not meet the requisite definition of 'small business debtor' pursuant to 11 U.S.C. § 101(51D)."[64] To interpret 11 U.S.C. § 101(51D), the court looked to the context of Subchapter V within the Code and to Congress's intent in enacting the SBRA.[65] Applying this rationale, the court ultimately concluded that Wright may proceed under Subchapter V, holding that so long as the debtor meets the other requirements of 11 U.S.C. § 101(51D), there are no limiting considerations in the statute concerning whether the debtor's engagement in business activities must be current.[66]

In *In re Bonert*, the debtor couple initially filed a voluntary Chapter 11 petition in late 2019 stating that they were *not* "small business debtors" within the current meaning of § 101 (51D).[67] Following the enactment of the SBRA, the debtors sought to amend their petition to redesignate themselves as small business debtors and to proceed under Subchapter V.[68] The unsecured creditors committee raised the only objection, arguing prejudice in redesignation, judicial estoppel, and that the debtors exceeded the debt limit under § 101

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[59] No. 19-12440, 2020 WL 4032411 (Bankr. E.D. La. July 16, 2020).
[60] No. 20-41400-CAN11, 2020 WL 7249555, at *1 (Bankr. W.D. Mo. Dec. 8, 2020).
[61] *In re* Wright, 2020 WL 2193240, at *1.
[62] *Id.* at *2.
[63] *Id.* at *1-2.
[64] *Id.* at *1.
[65] *Id.* at *3 ("[A]lthough . . . the history of the SBRA indicates it was intended to improve the ability of small businesses to reorganize and ultimately remain in business, nothing therein . . . limits the application to debtors *currently* engaged in business or commercial activities.").
[66] *Id*.
[67] *In re* Bonert, 619 B.R. 248, 251 (Bankr. C.D. Cal. 2020).
[68] *Id.*

(51D).[69] The committee argued that since the debtors did not initially designate themselves as "small business debtors" under the previous definition of § 101(51D), they cannot do so now.[70] The court reasoned that the debtors had a plausible explanation for not originally designating themselves as small business debtors as they were not engaged in business activities at the time of filing.[71] Following *In re Wright*'s precedent, the court allowed the redesignation and held that the debtors may proceed under Subchapter V.[72]

In *In re Blanchard*, a similar issue arose when a creditor contested the grounds for the debtors' election to be small business debtors.[73] The joint debtors initially filed under Chapter 11 in September 2019, then amended their petition to proceed under the SBRA in April 2020 following a motion by the U.S. Trustee to convert the claim to Chapter 7 or, in the alternative, to dismiss it.[74] The U.S. Trustee then filed an objection to the debtors' claimed status as small business debtors, objecting on the grounds that the debtors had spent eight months in Chapter 11 with no real progress towards reorganization, and the amendment to Subchapter V would "permit them to bypass deadlines applicable in their existing case and those which would now be long overdue in a subchapter V small business debtor case."[75] Subsequently, one of the creditors in the case filed for joinder to the U.S. Trustee's motion to convert.[76] The creditor argued that an "individual debtor's personal guarantee of commercial or business loans to a separate entity in which the individual debtor has a controlling interest" is insufficient to accord with the provisions of § 101(51D).[77] Rather, the creditor asserted that there must be a coexistent case filed for the separate legal entity to which the debtor is an affiliate pursuant to § 1182(1)(A).[78] The court ultimately found the creditor's construction of § 101(51D) was

[69] *Id.* at 252.
[70] *Id.* at 258.
[71] *Id.* at 255.
[72] *Id.*
[73] *In re* Blanchard, No. 19-12440, 2020 WL 4032411 (Bankr. E.D. La. July 16, 2020).
[74] *Id.*
[75] *Id.*
[76] *Id.*
[77] *Id.*
[78] *Id.*

too narrow and that "the statute neither qualifies 'engaged in' as currently nor formerly," and in the end adopted the same reasoning as the court in *In re Wright*.[79]

The courts seemed to agree on the definition of "engaged in business or commercial activities." Recently, however, the Western District of Missouri decided to take a different route. In *In re Thurmon*, the debtor couple owned seventy percent of Dowel, LLC, which operated two pharmacies in the Higginsville area of Missouri.[80] Both pharmacies were closed in April 2020 and Dowel, LLC sold off a majority of their assets; however, a large deficiency remained as to one secured creditor and other miscellaneous business debts that had not been settled.[81] As of the Thurmons' petition date, Dowel, LLC "had no employees, no customers, no vendors, and no intent to resume business activities," but under Missouri law they were still an entity in good legal standing.[82] The debtors argued that they should be eligible because (1) the statutory language is silent as to whether business engagement must be current, (2) that even if so construed, Dowel, LLC is still in good standing, and that (3) the court should follow the decisions of *In re Wright, In re Bonert,* and *In re Blanchard* which all previously agreed on this issue.[83]

The court debated the meaning of the phrase "engaged in" based on its plain meaning and as it is applied in other contexts of the Bankruptcy Code.[84] Based on its plain meaning, the court believed there must be active engagement.[85] For precedent, the court looked to the interpretation of "engaged in" as applied to family farmers in Chapter 12 bankruptcies. The court in *In re Tim Wargo & Sons, Inc.,*[86] which *Thurmon* primarily cited, determined whether the debtor fit into the meaning of "conducting" farming within §101(17)(B).[87] *Wargo* ultimately found that the debtors were not "conducting" business as they had an arrangement with a tenant farmer and were not playing a minimally active role in the farming operations taking

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[79] *Id.* at *2.
[80] *In re* Thurmon, No. 20-41400-CAN11, 2020 WL 7249555, at *1 (Bankr. W.D. Mo. Dec. 8, 2020).
[81] *Id.*
[82] *Id*. at *2.
[83] *Id.*
[84] *Id.* at *3-4.
[85] *Id.*
[86] 869 F.2d 1128 (8th Cir. 1989).
[87] *Id.* at 1130.

place.[88] Similarly, *Wargo* found that debtor must "take an active role in the operation" of the farm to qualify as a family farmer under § 101(17)(B).[89] The *Thurmon* court's comparisons to *Wargo* are simply unfounded, as there is no correlating understanding in 11 U.S.C § 101(51D) that to be a "small business debtor" the person must play an active role in the operation of his or her related business activities. The only requirement imposed by § 101(51D) is that at least fifty percent of the person's debts must have accrued due to the business's activities, not that the debtor has direct oversight of said business activities.[90]

The *Thurmon* court also leaned on *In re Easton*'s determination that a debtor must have "some significant degree of engagement in" crop production to qualify as family farmers under § 101(17)(A) and viewed this as synonymous to the requirements of § 101(51D).[91] The court placed emphasis on the above quoted language yet ignored the rest of the sentence which says that "ownership interest in" crop production would also suffice, a more analogous comparison to business debtors.[92]

As in the case of the Thurmons, business activities can include ownership in corporate entities without direct oversight of the business. Ownership does not always equal active participation. While it can often be helpful to look to other contexts within the Code to determine the meaning of disputed language, the underlying differences between a family farmer debtor and a small business debtor make this comparison inappropriate. The court even acknowledged that the Supreme Court has determined there is "no 'ongoing business' requirement for Chapter 11 reorganization" when analyzing 11 U.S.C. § 109,[93] then a sentence later, merely suggests that if Congress wanted to include debtors with non-operating

[88] *Id.*
[89] *Id.* (citing *In re* Burke, 81 B.R. 971, 976 (Bankr. S. C. Iowa 1987)).
[90] 11 U.S.C. § 101(51D).
[91] *In re* Thurmon, 2020 WL 7249555, at *4.
[92] *Id.*; 11 U.S.C. § 101(18)(A).
[93] Toibb v. Radloff, 501 U.S. 157, 166 (1991) (finding that the statutory language of § 109 was not unclear enough to look to legislative history, even if it were unclear there is no "clearly expressed legislative intent" that nonbusiness debtors could not enter Chapter 11, and that, while many of the provisions of Chapter 11 are suited for *primarily* business debtors, there is nothing barring nonbusiness debtors).

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businesses, they simply could have done so.[94] It seems much more likely that *In re Wright, In re Bonert*, and *In re Blanchard* correctly interpreted the phrase "engaged in": So long as the individual debtor is or was engaged in business activities and at least fifty percent of their debts have arisen due to such activities, then they are eligible for the benefits of Subchapter V restructuring.[95] These decisions lay the foundation for the idea that individuals who have attempted, but failed at sustaining their business, should still be able to restructure outside of the other chapters. Especially at a time where the effects of the COVID-19 pandemic have wreaked havoc on small businesses,[96] courts should use their discretionary powers to allow for individual debtors to proceed under Subchapter V. If small businesses really do "form the backbone of the American economy," then surely the owners of these businesses are worthy of fallback protection should their industrious efforts not succeed.[97]

B. Argument for Retroactivity of the SBRA

As the SBRA has been effective for just over one year, a current issue is whether pre-existing Chapter 11 bankruptcies that were filed prior to the enactment of the SBRA are eligible to be redesignated to Subchapter V.

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[94] *In re* Thurmon, 2020 WL 7249555, at *5.

[95] *See also In re* Two Wheels Props., LLC., No. 20-35372, 2020 WL 7786927 (Bankr. S.D. Tex. Dec. 30, 2020) The court held that a corporation dissolved by forfeiture may not reorganize under Subchapter V and must file for liquidation under Chapter 7. The differentiating factor is that it was the corporation itself filing and not an individual seeking to restructure lingering corporate debts. *Id.*

[96] *See* Steven Hamilton, *From Survival to Revival: How to Help Small Businesses Through the COVID-19 Crisis,* BROOKINGS, at 8 (Sept. 2020), https://www.brookings.edu/wp-content/uploads/2020/09/PP_Hamilton_Final.pdf (explaining that before lockdowns first began on March 16, 2020, 11% of small businesses had already closed and by the end of March closures were up over 40%); *see also* METLIFE & U.S. CHAMBER OF COM., SMALL BUSINESS CORONAVIRUS IMPACT POLL (July 29, 2020), https://www.uschamber.com/sites/default/files/metlife_uscc_sbi_coronavirus_impact_poll_july.pdf. While a majority of small businesses report that they are either staying fully or partially open, almost 60% of polled businesses are concerned that they will have to close their doors permanently. *Id.*

[97] H.R. REP NO. 116-171, at 2 (2019) (quoting DELOITTE DEV. LLC, *Mid-Market Perspectives: America's Economic Engine—Competing in Uncertain Times,* at 4 (2011)).

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The retroactivity issue arises from constitutional due process concerns and further Supreme Court precedents determined in *United States v. Security Industrial Bank*[98] and *Landgraf v. USI Film Products.*[99] In *U.S. v. Security Industrial Bank*, Justice Rehnquist led the Court in its decision to not apply a series of lien avoidance statutes retroactively to pending cases that predated the enactment of the 1978 Bankruptcy Code Act.[100] This decision was guided by Fifth Amendment Due Process concerns of taking of private property without due compensation, and the bankruptcy law principle that "[n]o bankruptcy law shall be construed to eliminate property rights which existed before the law was enacted in the absence of an explicit command from Congress."[101]

In the context of a Title VII violation prior to the passing of the Civil Rights Act of 1991, the *Landgraf* Court determined that provisions of legislative enactments do not apply retroactively to cases already pending on appeal.[102] The Court reiterated the general presumption against retroactivity of laws on the basis of "[e]lementary considerations of fairness" and that individuals have "an opportunity to know what the law is and to conform their conduct accordingly."[103] The Court also recognized that there are instances in which a court should "apply the law in effect at the time it renders its decision."[104] This applies especially when the language of the statute is unambiguous.[105] Markedly, the Court also determined that, absent legislative authorization, it is sometimes still proper to apply a law retroactively.[106]

Recently, the bankruptcy court in *In re Body Transit, Inc.*[107] applied the logic of two cases: *In re Progressive Solutions, Inc.*[108]

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[98] 459 U.S. 70 (1982).
[99] 511 U.S. 244 (1994).
[100] *Sec. Indus. Bank*, 459 U.S. at 82.
[101] *Id*. at 81.
[102] *Landgraf,* 511 U.S. at 286.
[103] *Id*. at 265.
[104] *Id.* at 273 (quoting Bradley v. School Bd. Of City of Richmond, 416 U.S. 696, 711(1994)).
[105] United States v. Schooner Peggy, 5 U.S. 103 (1801) (reversing order on appeal where the language of recent legislative enactment allowed for the Court to retroactively apply law).
[106] *Landgraf,* 511 U.S. at 273.
[107] 613 B.R. 400 (Bankr. E.D. Pa. 2020).
[108] 615 B.R. 894 (Bankr. C.D. Cal. 2020).

and *In re Moore Properties of Person County, LLC*[109] to determine the issue of retroactivity. The court in *In re Progressive Solutions, Inc.* ultimately denied the debtor's motion for Subchapter V election based on Federal Rule of Bankruptcy Procedure 1009, though strangely not before going into a rather lengthy analysis of the SBRA.[110] Through its analysis, it determined that there could be "'no legal reason' to restrict a pending Chapter 11 small business debtor from redesignating its case as a Subchapter V case."[111] This conclusion was based on the SBRA's legislative history, the rules of statutory construction iterated in *Landgraf*, and "the court's ability to reschedule the procedural matters . . . and the deadlines . . . imposed by the SBRA."[112]

The *In re Moore Properties* bankruptcy court applied a similar framework, analyzing the fact that the canons of determining applicability of laws to prior conduct of the parties are somewhat conflicting: "(1) a court is to apply the law in effect at the time it renders its decision; and (2) retroactivity is not favored in the law."[113] In the context of Subchapter V, the primary concern is not to "harmonize these canons," but rather as the *In re Moore* court saw it, to determine whether applying new law to past conduct would merely affect contractual rights of the parties, or eradicate "vested property interests."[114] The court found that the modifications to the

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[109] No. 20-80081, 2020 WL 995544 (Bankr. M.D.N.C Feb. 28, 2020).

[110] *In re Body Transit, Inc*., 613 B.R. 400, 405. The court referenced *In re Progressive Sols., Inc.,* 615 B.R. 894 (Bankr. C.D. Cal. Feb. 21, 2020) which denied debtor's motion to approve redesignation to Subchapter V strictly on the basis of procedural infirmity.

[111] *In re Body Transit, Inc*., 613 B.R. 400, 405 (quoting *Progressive Sols., Inc.,* 615 B.R. 894, 900).

[112] *Id*.

[113] *Id*. at 406 (citing *In re* Moore Props., No. 20-80081, 2020 WL 995544, at *3 (Bankr. M.D.N.C. Feb. 28, 2020)).

[114] *Id*.; *see also In re* Ventura, 615 B.R. 1, 16–17 (Bankr. E.D.N.Y. 2020):

> While [the creditor] speaks in terms of damage to its vested rights resulting from the progress made in the Debtor's bankruptcy case, [the creditor] is focused on the wrong question. The correct question to ask is whether designation of the Debtor as a subchapter V debtor will impair [creditor's] rights as they existed prior to the effective date of the SBRA. Clearly, the amendment to the definition of "small business debtor" does not amount to a taking of property. The SBRA merely amends the definition of small business debtor to ensure that certain debtors can avail

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bankruptcy law imposed by the SBRA, primarily in the requirements for confirmation of a reorganization plan, do not rise to the level of an "impermissible retroactive taking . . . sufficiently advanced that the substantive alterations in the requirements for plan confirmation arise to a taking of vested property rights."[115]

A number of courts have joined in this construction of Subchapter V as applying to pending cases, including the courts in *In re Ventura,*[116] *In re Twin Pines, LLC*[117] and *In re Bonert*.[118] Other jurisdictions have been less amenable in providing for the redesignation of debtors to Subchapter V, such as the courts in *In re Double H Transportation LLC*[119] and *In re Seven Stars on the Hudson Corp.*[120] For the reasons explained below, the decisions in *In re Ventura, In re Twin Pines,* and *In re Bonert* are the proper manner for determining the eligibility of debtors to redesignate their petitions.

To start, the Federal Rules of Bankruptcy Procedure allow for redesignation. Rule 1009 allows for a "voluntary petition, list, schedule, or statement [to be] amended by the debtor as a matter of

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> themselves of a less costly and time-consuming path to reorganization that befits the family – owned businesses and other "Main Street" businesses that are currently in such dire need of relief.

Id. (citing *In re Moore Props.*, 2020 WL 995544, at *4 n.10).

[115] *In re* Moore Props*.,* 2020 WL 995544, at *5; *see also In re* Slidebelts, No. 2019-25064-A-11, 2020 WL 3816290 (Bankr. E.D. Cal. July 6, 2020) (holding that "reliance by a party in interest," in this case a lack of payment to court approved counsel for the creditor's committee, may give rise to such an impermissible taking).

[116] 615 B.R. 1 (Bankr. E.D.N.Y. 2020) ("[A]s matters of first impression, procedural and timing issues did not bar debtor from amending her petition to take advantage of the benefits of the SBRA.").

[117] No. 19-10295-j11, 2020 WL 5576957 (Bankr. D.N.M. Apr. 30, 2020) (allowing a Chapter 11 petition filed 387 days prior to the enactment of the SBRA to be re-designated to Subchapter V).

[118] No. 2:19-BK-20836-ER, 2020 WL 3635869, at *2 (Bankr. C.D. Cal. 2020) (finding the debtor's "re-designation to Subchapter V to be appropriate on the specific facts of this case.").

[119] 614 B.R. 553, 554 (Bankr. W.D. Tex. 2020) ("Nothing in the SBRA enabling statute indicates that the SBRA was intended to have retroactive effect—i.e., that the SBRA should apply to pending bankruptcy cases.")

[120] 618 B.R. 333 (Bankr. S.D. Fl. 2020) (rejecting the arguments made by the courts in In re Ventura and Twin Pines and holding that "if a debtor elects to proceed under Subchapter V, it must comply with *all* its provisions, including the statutory timelines").

course at any time before the case is closed."[121] Therefore, the procedural issue is not whether the debtor is allowed to amend the petition, but rather if the case will be dismissed under new sections of the SBRA. The primary obstacles that a debtor faces when trying to convert to Subchapter V involve §§ 1188(a)[122] and 1189(b),[123] both of which impose statutory deadlines on the debtor in order to proceed under Subchapter V. However, both sections have caveats built into them which *should* allow a court to override these concerns – the standard of whether the debtor "should not justly be held accountable."[124] While the language used by Congress for these exceptions seems narrow, it is reasonable to apply them in the context of amendments to pre-existing petitions at the time of the SBRA's enactment. As shown by the decisions in *In re Seven Stars* and *In re Double H Transportation*, these exceptions are not seen as reasonable to all.

In *In re Double H Transportation,* the LLC in question filed a voluntary Chapter 11 petition 107 days preceding the effective date of the SBRA.[125] Nine days after the SBRA was enacted, the debtor opted to amend his petition for designation as a "small business debtor" under Subchapter V.[126] The court held that if the debtor was permitted to elect Subchapter V status, it "would create a procedural quagmire" which would ultimately lead to the case's dismissal because it would not meet the procedural elements of Subchapter V.[127] The court reasoned that the deadlines imposed by §§ 1188-89 are absolute and due to the fact that a status conference was not held

[121] Fed. R. Bankr. P. 1009(a).
[122] 11 U.S.C. § 1188(a) (requiring the court to hold a status conference within 60 days "after the entry of the order for relief under this chapter").
[123] *Id.* § 1189(b) (requiring the debtor to file a plan "not later than 90 days after the order for relief under this chapter").
[124] *See id.* § 1188(b) ("The court may extend the period of time for holding a status conference under subsection (a) if the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable"); *see also id.* § 1189(B) ("[T]he court may extend the period if the need for the extension is attributable to circumstances for which the debtor should not justly be held accountable.").
[125] *In re* Double H Transp., LLC., 614 B.R. 553, 554 (Bankr. W.D. Tex. 2020).
[126] *Id.*
[127] *Id.*

and a status report obviously not filed, the debtor was out of luck in his attempt to convert under the SBRA.[128]

In re Seven Stars involved an owner of a trampoline park who initially filed for voluntary Chapter 11 relief as a "small business debtor" 387 days before the enactment of the SBRA, and then chose to amend his petition to try and reorganize under Subchapter V.[129] In response to this amendment, the court ordered the debtor to show "cause" why the case should not be dismissed due to the apparent violations of §§ 1188-89 of the Code.[130] Just as in *In re Double H Transport.*, the court took a very literal reading of the statutory provisions of the SBRA.[131] Accordingly, the court stated that the debtor "put itself in [immediate] default of Sections 1188(a) and 1189(b) upon that election [to amend]."[132] The court interpreted the exception of "circumstances beyond the debtor's control" to be a highly stringent barrier, as determined by other courts interpreting the same language applied in § 1221(d)(1).[133] Despite hearing arguments supported by cases which already decided this issue properly, the court misses the point of the safeguards provided by §§ 1188(b) and 1189(b). For some reason, the court in *In re Seven Stars* reasoned that a debtor's decision to elect Subchapter V status after the imposed deadlines have already passed with regard to their petition, due to not having existed, is a circumstance within the debtor's control.[134] The *In re Ventura* court stated it best when it said that "to argue [that] the Debtor should have complied with the procedural requirements of a law that did not [at the time] exist is the height of absurdity."[135]

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[128] *Id.*
[129] *In re* Seven Stars on the Hudson Corp., 618 B.R. 333, 337 (Bankr. S.D. Fl. 2020).
[130] *Id.* at 339.
[131] *Id.* at 342 ("[T]he Court finds the answer to the question before it in this case in the plain text of the Bankruptcy Code and Bankruptcy Rules.").
[132] *Id.* at 339.
[133] *Id.* at 344 ("Courts interpreting this language as used in Section 1221 have held that 'it effectively requires the bankruptcy court, before granting an extension request, to find that the delay necessitating the extension was caused by "circumstances beyond the debtor's control."'" (quoting *Davis v. U.S. Bank, N.A. (In re Davis),* BAP No. CC–16–1390–KuLTa, 2017 WL 3298414, at *3 (B.A.P. 9th Cir. Aug. 2, 2017 (unpublished))).
[134] *Id.* at 346 ("Where a debtor elects into Subchapter V after expiration of the statutory deadlines, however, the debtor should justly be held accountable for those circumstances, because the debtor created them.").
[135] *In re* Ventura, 615 B.R. 1, 15 (Bankr. E.D.N.Y. 2020).

From the court's holding it seems apparent that even if the debtors in question had amended their petition the day the SBRA became effective it would not be enough, because the deadlines as applied to the instant case would already be moot. This line of reasoning does not make sense. The idea of "circumstances beyond the debtor's control" clearly should be meant to include the imposition of deadlines that are literally impossible to meet. Congress passed the SBRA with the intent of fixing the problems that Chapter 11 posed to small businesses.[136] What service is it to a business that is already treading water if it cannot make the same use of the benefits of Subchapter V as a business that is just now in need of reorganization? Surely this cannot be what Congress envisioned.

C. Argument for Raising the Debt Limit Under the SBRA to $10 Million

Debtors proceeding under Subchapter V now have access to a number of benefits not previously associated with Chapter 11. However, there is an argument to be made that the current debt cap imposed by the SBRA is far too limiting, and will exclude small to mid-market entities deserving of Subchapter V treatment from seeking it.[137] The SBRA, as enacted, applies to debtors who have "aggregate noncontingent liquidated secured and unsecured debts . . . in an amount not more than $2,725,625."[138] While this would be more than a hefty sum of debt for a consumer, in the case of a small business in distress, the debt amount allowable is minimal.[139] In its final report, the ABI's Commission to Study the Reform of Chapter 11 made (the ultimately unheeded) recommendations that the term "small or medium-sized enterprise" (SME) should include non-publicly traded companies with "[l]ess than $10 million in assets or liabilities on a consolidated basis with any debtor or non-debtor

[136] H.R. REP NO. 116-171, at 4 (2019).
[137] Keach, *supra* note 25, at 5 ("The SBRA could address many of the difficulties experienced by small business debtors, in large measure by applying the terms found in Chapter 12. However, the SBRA as currently proposed…is simply too low to provide meaningful help for small and medium-sized companies.").
[138] 11 U.S.C. § 101 (51D).
[139] Keach, *supra* note 25, at 5 (noting how businesses will often look for cash infusions secured by business assets to try to stay solvent in times of financial distress, or how a business could be one underinsured products liability case away from tipping the scales over the $2.7 million limit).

affiliates."[140] After conducting a sample study of all Chapter 11 cases filed in the United States in 2007, what the Commission found was "a natural breaking point in the data" of debtors' assets and liabilities at $10 million.[141] Though this sample looks at all Chapter 11s filed in 2007, the Commission makes clear that its recommendations are to exclude individual Chapter 11 filings as well as the filings of small *public* companies.[142] These exclusions make sense as individuals, whose debts are not related to commercial activities, clearly should not be able to take advantage of small business resources in bankruptcy[143] and publicly traded companies generally have greater access to capital raising opportunities.

Business owners often find themselves struggling in challenging situations where there are no easy answers. Struggling businesses without professional guidance often seek to double down on loans in efforts to keep their entities afloat with the idea that all it takes is an extra credit card established to keep their doors open for longer.[144] The act of doing so ultimately racks up debt that will count against them when they are in an even more dire need and must resort to bankruptcy, possibly excluding them from access to Subchapter V as an attainable fresh start. Changing the SBRA's current debt limit of $2.7 million to the ABI's recommended standard of allowing for $10 million would provide SMEs, which have been traditionally underserved by existing bankruptcy law, the opportunity to properly reorganize and stay in business.

Sample data of Subchapter V filings in Delaware between February and October of 2020 show that of the twenty-nine filings that took place, twenty percent were only eligible due to the expansion of the debt limit by the CARES Act.[145] Another twenty-

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[140] HARNER, *supra* note 5, at 279.

[141] *Id.* at 287 (finding that 91.4% of debtors' schedules reflected less than $10 million in assets and 86.7% had less than $10 million in liabilities scheduled); *id.* at 277-78 ("Moreover, at the end of these deliberations, the Commissioners determined that the $10 million or less in assets or liabilities standard corresponded with the characteristics identified above of SMEs that are not being well served by current law.").

[142] *Id.* at 288 (The Commission also sought to simplify the definition of a "small business debtor" by nixing the requirements that liabilities be "noncontingent" or "liquidated" and that a debtor could qualify based on either assets *or* liabilities).

[143] *See supra* Part III.

[144] Keach, *supra* note 25, at 5.

[145] Teadra Pugh, *ANALYSIS: Small Change to SBRA Makes a Big Bankruptcy Difference*, BLOOMBERG L. (Nov. 30, 2020, 1:06 PM)

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four percent were redesignated out of Subchapter V due to the debtor or an affiliate exceeding the statutory debt limit.[146] If these numbers are consistent in other jurisdictions, it means that almost 350 Subchapter V petitions have been allowed to proceed due to the expansion of the debt limit under the CARES Act—that would have otherwise been disqualified under the SBRA—and that roughly 412 cases have been redesignated for falling above the $7.5 million threshold.[147] These numbers bolster the argument that the raised debt limit for small business debtors, as amended by the CARES Act, should at least be extended beyond March 2022 or possibly raised even further.[148] While taking these measures would greatly reduce the number of cases filed in standard Chapter 11s, it would necessarily steer to Subchapter V those businesses that Chapter 11 had previously failed, while at the same time retain the larger companies that could generally work within a traditional Chapter 11 structure.

IV. THE FUTURE OF SMALL BUSINESSES EXISTING DURING COVID-19

The Coronavirus Aid, Relief, and Economic Security Act, passed March 27, 2020, increased the debt cap to $7,500,000 for small business debtors in order to proceed under Subchapter V, applicable only to cases filed between March 27, 2020 and March 27, 2021.[149] Partially due to the COVID-19 pandemic, commercial Chapter 11 filings in 2020 increased over twenty percent from 2019 and reached the highest number of yearly filings since 2013.[150] Of

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https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-small-change-to-sbra-makes-a-big-bankruptcy-difference.

[146] *Id.*

[147] AM. BANKR. INST., *supra* note 4 (The total number of Subchapter V cases at time of writing is 1,716).

[148] As noted, the COVID-19 Bankruptcy Relief Extension Act of 2021 extended the provisions of the CARES Act until March 27, 2022. COVID-19 Bankr. Relief Extension Act, Pub L. No. 117-5 135 Stat. 249 (2021).

[149] CARES Act, Pub. L. No. 116-136 § 1113, 134 Stat. 281 (2020).

[150] *Bankruptcy Statistics*, AM. BANKR. INST., https://www.abi.org/newsroom/bankruptcy-statistics (last visited Feb 6, 2021); *see also* Becky Yerak, *Commercial Chapter 11 Filings Rose 29% Last Year, While Personal Bankruptcies Dived*, WALL STREET J. (Jan 5, 2021, 5:45 PM) https://www.wsj.com/articles/commercial-chapter-11-filings-rose-29-last-year-while-personal-bankruptcies-dived-11609886730.

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these, a total of 1,362 proceeded as Subchapter V small business cases, which equates to roughly twenty percent of Chapter 11 filings after the SBRA's effective date.[151] Research shows that this may be only the tip of the iceberg as we head further into 2021.[152] Highly anticipated by SMEs, the Paycheck Protection Program was rolled out in April of 2020 fraught with problems, namely that it was not well targeted to those most in need and that the funds were exhausted within two weeks.[153] Overall, in the first months of the pandemic, approximately 400,000 small businesses had to close their doors and liquidate, over forty percent of remaining small businesses had less than a month's cash on hand, and almost two-thirds had laid off at least one worker.[154] What we are experiencing is unlike other recessions in regard to the ways that small businesses have been affected. Even with the protections afforded by Subchapter V, going through bankruptcy can be especially expensive for small businesses. The biggest issue posed by the COVID-19 pandemic for these business owners is *the uncertainty* – faced with potential State lockdowns in late 2020 and early 2021, they have had no hope to restructure as a going concern.[155] If the owner wants to restructure the business's debts to continue operating, they need viable sustained income, something untenable for a lot of businesses now which relied wholly on in-person traffic.

For these business owners, the light at the end of the tunnel is the prospect of a vaccinated public. As we see wider vaccine rollout

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[151] AM. BANKR. INST., *supra* note 4; *Bankruptcy Statistics*, *supra* note 150.

[152] Steven Church, *Covid Vaccine Gives Small Businesses Enough Hope to Go Bankrupt*, BLOOMBERG (Dec 29, 2020, 7:00 AM) https://www.bloomberg.com/news/articles/2020-12-29/small-businesses-skipped-2020-s-bankruptcy-wave-as-hope-waned (showing that hundreds of thousands of silent closures took place in 2020 due to small business owner's fears that they would not be able to withstand bankruptcy as a going concern if there were to be a second wave of State closures due to the pandemic).

[153] Hamilton, *supra* note 96, at 11 ("Businesses with more cash on hand were more likely to be approved. And areas that experienced greater declines in hours worked and more business closures in fact received fewer PPP loans.").

[154] *Id.* at 9. Research shows that Black business owners were disproportionately affected, with a drop in Black business owners of 41% between March & April 2020 as opposed to a 22% drop across all races. *Id.*

[155] Church, *supra* note 152. Due to banks and landlords postponing collections during the pandemic, many businesses have been postponing filing their petitions. *Id.* If they file for Subchapter V too soon, they risk dismissal of their case if they do not follow the deadlines for proposal of a plan. *Id.*

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through the summer months, there is a strong likelihood that a wave of small business bankruptcies will follow when "entrepreneurs [have] hope that cutting debt under court oversight is once again worth it."[156] However, as of mid-Summer, the pace of COVID-19 vaccination administrations has stalled as the undecided or medically-isolated citizens remain unvaccinated.[157] As of August 2021, around "one-third of eligible adults in the U.S. haven't gotten a COVID-19 vaccine" according to the CDC's study, and that does not even account for unvaccinated minors.[158] In conjunction, the current sharp increase in COVID-19 cases due to the Delta variant has put small businesses in an even more precarious position heading into the fourth quarter of 2021.[159]

V. CONCLUSION

In short, the SBRA has brought new life to bankruptcy law for small businesses and their owners. No longer are qualifying small business debtors subject to the same stringent mechanisms of standard Chapter 11s, a route historically accessible only for larger corporations with means. While it is not a perfect system and may still be excluding some businesses in need of Subchapter V's benefits, qualified small business owners are now in a stronger position to revitalize their business. As of August 2021, there have been over 2,200 new Subchapter V cases filed since the enactment of the SBRA.[160] While there is no current statistical information for plan confirmations nationwide, the rise in case filings seems to show renewed optimism in the bankruptcy system.[161] Although the optimism may be well founded, it remains to be seen on a larger scale how well Subchapter V will be suited to relieving the struggles of

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[156] *Id.*

[157] Brianna Abbott, *Covid-19 Vaccination Drive Reaches Frustration Stage–Persuading The Hesitant* (July 8, 2020, 10:36 AM) https://www.wsj.com/articles/stalled-covid-vaccination-outreach-hesitancy-11625754826.

[158] *Id.*

[159] CENTER FOR DISEASE CONTROL, COVID DATA TRACKER WEEKLY REVIEW FOR AUGUST 6, 2021, https://www.cdc.gov/coronavirus/2019-ncov/covid-data/covidview/index.html.

[160] AM. BANKR. INST., *supra* note 4.

[161] *Bankruptcy Statistics*, *supra* note 150.

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small business debtors, especially as we move further through the COVID-19 pandemic.

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