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BANKRUPTCY CHAPTER 11 SUBCHAPTER V REFLECTIONS ON THE FIRST 180 DAYS

In August 2019, Congress passed The Small Business Reorganization Act (SBRA) creating a new Subchapter V under Chapter 11 allowing small business to take advantage of Chapter 11, but without the same cost. The new provisions took effect February 19, 2020. The new Subchapter V had a debt limit (both secured and unsecured) of $2,725.625.00. The CARES Act further modified Sub V by increasing the qualifying debt limit to $7,500,000.00 (until March 27, 2021 unless further extended by Congress). Among the benefits to debtors is the ability to "cram down" debts secured by a debtor's principal residence to the value of the property, an option not afforded by a Chapter 13 or a regular Chapter 11 bankruptcy case, if the loan was not used to purchase the property and the property was primarily used in connection with the debtor's small business. See 11 U.S.C. § 1190(3). Other benefits are, unlike large Chapter 11 cases, only the debtor may propose a plan of reorganization, a separate disclosure statement is not required, and the debtor need not solicit creditor acceptance of the plan.

Since enactment, Sub V has spawned a number of cases interpreting its provisions. The cases largely deal with the eligibility of a debtor in bankruptcy to elect this relief who originally filed prior to February 19, 2020 and then attempted to elect to proceed under Sub V after that date. A majority of the decisions, while placing the burden of proof on the debtor to demonstrate Sub V eligibility, have allowed the election for cases already pending prior to that date. See In re Bello, 613 B.R. 894 (Bankr. ED MI March 27, 2020); In re Body Transit, Inc., 613 B.R. 400 (Bankr. ED PA March 24, 2020); In re Twin Pines, LLC, 2020 Bankr. LEXIS 1217 (Bankr. D NM April 30, 2020); and In re Moore Props. of Person Cty., LLC, 2020 Bankr. LEXIS 550 (Bankr. MD NC February 28, 2020).

However, not all bankruptcy judges are in accord. One bankruptcy court dismissed the case of a debtor who had filed before the effective date. The court determined that, even if the debtor was eligible under Sub V, he had not complied with 11 U.S.C. § 1188(a), which

requires a status conference within 60 days of the original bankruptcy filing date, and 11 U.S.C. § 1189(b), which mandates the filing of a plan of reorganization within 90 days of that same date. See In re Seven Stars on the Hudson Corp., 2020 Bankr. LEXIS 2106 (Bankr. SD FL August 7, 2020). However, In re Trepetin, 2020 Bankr. LEXIS 1770 (Bankr. D MD July 7, 2020), the bankruptcy court allowed an extension of deadlines to hold a status conference and file a plan because the debtor did not manipulate the timing of the filing of the bankruptcy case and no creditor asserted unfair prejudice from the delay. See also In re Bonert, 2020 Bankr. LEXIS 1783 (Bankr. CD CA June 3, 2020). Another bankruptcy court adopted an even more expansive view of Sub V, allowing a debtor to proceed despite not being presently engaged in commercial activities. See In re Blanchard, 2020 Bankr. LEXIS 1909 (Bankr. ED LA, July 16, 2020). Finally, a different bankruptcy court reached into the substantive rights of parties under Sub V to find that the individual debtor could "cram down" a principal residence that the debtor also used as a bed and breakfast. See In re Ventura, 615 B.R. 1 (Bankr. ED NY April 10, 2020).

In summary, bankruptcy courts appear to be applying a liberal reading of the provisions of Sub V in a manner that favors debtors seeking protection under its provisions. Given the speed at which a Sub V case may proceed and the likelihood that a bankruptcy court will determine Sub V eligibility within the first few weeks of the case, we strongly suggest that servicers engage local counsel for guidance immediately after learning of a Sub V filing, or a motion to convert to Sub V.

We will continue to track and report on this developing case law.

If you have specific legal questions about your files, please feel free to contact our attorneys referenced below.

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