COMPANIES INCREASINGLY TURNING TO SUBCHAPTER V BANKRUPTCY AS A LEGAL, VIABLE "GET SOLVENT QUICK" SCHEME

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For almost a year, companies throughout Southwest Florida have grappled with COVID-19's impact on their bottom line. However, businesses have quietly started using a little-known subchapter of the Bankruptcy Code to reorganize faster, and on more preferable terms, than they would have in a traditional Chapter 11 bankruptcy case. Debtors and creditors alike should take note—failure to do so may result in multi-million-dollar mistakes.
Traditional Chapter 11 bankruptcy cases have been supremely effective for countless large businesses, but small and mid-sized businesses have had a more difficult time seeking this form of reorganizational relief. Between 2008 and 2015, less than 30% of Chapter 11 bankruptcy cases filed by small and mid-sized businesses ended in a successful reorganization. In response to those dismal statistics, the Small Business Reorganization Act ("***SBRA***") was passed, which expedites Chapter 11 reorganization for most businesses with less than $2,725,625.00 in debt by creating a "Subchapter V" to Chapter 11.

Subchapter V, for its part, expedites the reorganization process by reducing administrative overhead and eliminating bureaucratic red tape. In exchange, the SBRA sets hard and fast deadlines for debtors to file a plan of reorganization and exit the bankruptcy arena.

The SBRA took effect on February 19, 2020—less than a month after the U.S. Department of Health and Human Services announced COVID-19 was a public health emergency. After watching innumerable businesses permanently shut down, the Coronavirus Aid, Relief, and Economic Security ("***CARES***") Act was passed, which increased Subchapter V's debt limits to $7,500,000.00 for qualifying businesses that file for relief before March 27, 2021.

Many small and mid-sized businesses, leery of congressional inaction, have already made plans to file relief right before the CARES Act's Subchapter V expansion expires. In so doing, such businesses can take advantage of Subchapter V's generous "cramdown" provisions.

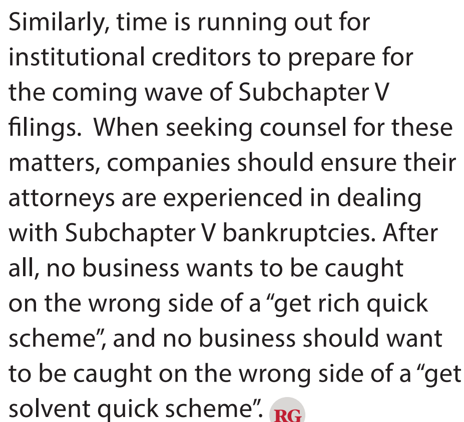
Many Chapter 11 debtors take advantage of "cramdowns", whereby a plan of reorganization is confirmed over the objections of creditors who feel they are not getting a fair deal. In ordinary Chapter 11 cases, a plan of reorganization can only be "crammed down" if, *inter alia*: (i) the plan is accepted by at least one class of claims impacted (or "impaired") by said plan; and (ii) the plan itself is "fair and equitable". Subchapter V eliminates the requirement that an impaired class approve the plan of reorganization and, as shown below, radically changes how courts interpret whether a plan is "fair and equitable".

In a traditional Chapter 11 case, the Bankruptcy Code provides stringent standards for a debtor seeking to use a cramdown against unsecured creditors (i.e. creditors without a legal or equitable interest in the debtor's property). For Subchapter V debtors, those standards are relaxed to the point a debtor can cramdown unsecured claims if the plan of reorganization shows the debtor will use all their projected disposable income to pay off creditors for 3 to 5 years (with that number fluctuating within the court's discretion). Before, a business debtor seeking a cramdown against

unsecured creditors would have to satisfy the “absolute priority rule”, which would prohibit shareholders from retaining their equity in the debtor unless the unsecured creditors were paid in full.

Traditionally, undersecured creditors (i.e. those with deficiency claims) were the final arbiters of whether a plan would succeed, as they were able to reject plans of reorganization as secured creditors, and then could strongarm the unsecured class of creditors into also rejecting the plan. With Subchapter V bankruptcy, undersecured creditors have seen their power dissipate.

Many small and mid-sized businesses interested in financial restructuring are in a great position to get the reorganization they seek, on terms they seek—but they must understand time is running out.



Similarly, time is running out for institutional creditors to prepare for the coming wave of Subchapter V filings. When seeking counsel for these matters, companies should ensure their attorneys are experienced in dealing with Subchapter V bankruptcies. After all, no business wants to be caught on the wrong side of a “get rich quick scheme”, and no business should want to be caught on the wrong side of a “get solvent quick scheme”. RG

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