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The New Subchapter V of the Bankruptcy Code: A New Way for Small Businesses to Reorganize

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The New Subchapter V of the Bankruptcy Code: A New Way For Small Businesses To Reorganize

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Enactment of the Small Business Reorganization Act

- The Small Business Reorganization Act (SBRA) was signed into law on August 23, 2019, and went into effect on February 19, 2020
- There was broad bi-partisan support for the Act and the bill flew through both houses of congress, passing the US House of Representatives on July 23, 2019 and the US Senate on August 1, 2019.
- The law was written with input from the national bankruptcy conference, the American Bankruptcy Institute and the National Conference of Bankruptcy Judges.
- The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), which went into effect on March 27, 2020, amended the SBRA. Prior to passage of the CARES Act, a small business could have no more than $2,725,625 of noncontingent, liquidated deb to qualify for SBRA relief.
- Barely a month after the SBRA went into effect, Congress, as part of the CARES Act, increased this debt limit to $7,500,000 to expand access to the SBRA amid growing concerns about the economy as a result of COVID-19 and the economic impact of governmental measures designed to counteract the pandemic.

Why Was a New Subchapter of the Bankruptcy Code Needed to Address the Reorganization of Small Businesses?

- According to the House Report in support of the bill, the SBRA was introduced to streamline the bankruptcy process by which small businesses debtors could reorganize and rehabilitate their financial affairs.
- The House Report further noted that 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 5,000 employees account for more employment than those with over 5,000.
- Not surprisingly, while most Chapter 11 business cases are filed by small business debtors, they are often "the least likely to reorganize successfully."
- As the bill's sponsor, Representative Ben Cline (R-VA), explained at the hearing held by the Subcommittee on Antitrust, Commercial, and Administrative Law on June 25, 2019 at which [the SBRA] was considered, the legislation would allow small business debtors "to file bankruptcy in a timely, cost-effective manner, and hopefully allows them to remain in business" which "not only benefits the owners, but employees, suppliers, customers, and others who rely on that business."

Senate Statements In Support of the Bill

- Chuck Grassley (R-IA), one of the Senate sponsors of the bill, stated "Our bankruptcy system is designed to help highly complex businesses reorganize after falling on hard times, but for many small businesses going through bankruptcy, these requirements can create unnecessary burdens that stall recovery. The *Small Business Reorganization Act* takes into account the unique needs of small businesses and streamlines existing reorganization processes. A well-functioning bankruptcy system, specifically for small businesses, allows businesses to reorganize, preserve jobs, maximize the value of assets and ensure the proper allocation of resources."
- Amy Klobechar (D-MN), another Senate sponsor stated, in support of the bill: "We need to make sure that businesses on Main Street have the same opportunities as big businesses to utilize the protections offered by our bankruptcy laws. This legislation will help streamline bankruptcy procedures for small businesses, ensuring that when mom-and-pop businesses fall on hard times, they have a chance to recover and be successful."
- Richard Blumenthall (D-Conn.) stated in support of the bill: "All too often, an outdated bankruptcy system forces small businesses to close their doors when they hit hard times. When a small business owner requires relief from overwhelming debt, bankruptcy should offer a path forward to preserve jobs – not an endless, money-draining process. Our bipartisan legislation implements thoughtful, commonsense reforms to make our bankruptcy system work for small businesses instead of against them,"

This Was Not the First Attempt to Create Special Rules for Small Business Debtors

- In 2005, as part of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), small business provisions were enacted by Congress for the express purpose of "instituting a variety of time frames and enforcement mechanisms designed to weed out small business debtors who are not likely to reorganize." The other purpose of these provisions was to require the United States Trustee and the bankruptcy courts to monitor these cases more actively.
- A small business debtor was defined as a person engaged in commercial or business activity with debts of no more than $2,725,625 (excluding debts owed to insiders) and where an unsecured creditors committee has not been appointed or, if appointed, has been determined to be ineffective by the bankruptcy court.
- small business debtors were required to either file with its bankruptcy petition its most recent balance sheet, statement of operations, cash flow, and federal tax return or a sworn statement as to why those documents cannot be filed.
- The United States Trustee was required to conduct an initial interview with the small business debtor to evaluate financial viability and inquire about the debtor's business plan. The UST was also required to diligently monitor the debtor's activities to identify whether the debtor will be unable to confirm a plan.
- Small business debtors could request that the court waive the requirement that it file a disclosure statemen or ask the court to conditionally approve the disclosure without notice and a hearing. In a regular Chapter 11 case, debtors are required to file a disclosure statement and seek approval of the disclosure statement after notice and a hearing before soliciting votes on their plan.

The Small Business Provisions of BAPCPA Were Not Effective In Rehabilitating Small Business Debtors

- Small business debtors were required to file a plan within 300 days of the commencement of their case and confirm the plan within 45 days of filing the plan.
- Many small business debtors were wary of the close oversight by the UST, and the administrative obligations to comply with the UST's oversight responsibilities.
- The BAPCPA amendments did not help small business debtors build creditor support or confirm a plan. Small debtors still struggled to reorganzise.
- The short timeline to confirm a filed plan placed a significant burden on the small business debtor and made it difficult of to build creditor consensus for the plan.
- The small business provisions included in BAPCPA failed to promote the reorganization of small businesses. Bankruptcy professionals, judges and commentators began pushing Congress for a new set of rules that would reduce costs, streamline the process, allow small business owners to maintain control of their business and reorganize their debts.

What is the Purpose of the SBRA?

- Based on the House Report and statements from the bill's sponsors, it is clear that the purpose of the SBRA is to offer small businesses a better chance to reorganize under the Bankruptcy Code through a streamlined and cost-effective process.
- Traditional Chapter 11 cases were often seen as too expensive, time consuming and unpredictable for smaller business debtors.
- The SBRA seeks to simplify the reorganization process by eliminating some of the large expenses of a Chapter 11 Bankruptcy case, including funding a creditors' committees and certain United States Trustee fees, while also speeding up the process by requiring a reorganization plan to be filed within 90 days of the bankruptcy filing and eliminating the requirement to file a disclosure statement.
- Perhaps most importantly, the SBRA provides small business owners a better opportunity to retain ownership of their business through the reorganization process by eliminating the "absolute priority rule" (owners can retain their equity in a Subchapter V small business over the objection of a class of unsecured creditors, without paying those creditors in full).

How Does the SBRA Try To Achieve These Goals?

- The SBRA creates a new subchapter under Chapter 11 of the Bankruptcy Code for small businesses referred to as Subchapter V and adds new §§1181 to 1195 of the Bankruptcy Code.
- Eligible small business debtors who file for relief under Chapter 11 of the Bankruptcy Code may elect to be treated as a small business debtor under Subchapter V.
- While the debtor will retain possession of its assets and continue to operate it business, a special trustee will be appointed to oversee the bankruptcy case and to "facilitate the formulation of a consensual plan of reorganization."
- No committee of unsecured creditors will be formed unless the court orders otherwise.
- The debtor will need to file its plan of reorganization within 90 days of the commencement of the case, but there is no requirement to file a disclosure statement and no deadline to confirm the plan.
- The Subchapter V plan must provide for the distribution of the debtor's "disposable income" for a period of three to five years, *However*, the debtor's equity owners will be allowed to retain their ownership interest in and control over the debtor even if creditors do not vote to accept the plan.

Who Is Eligible To Be a Small Business Debtor Under Subchapter V?

- Section 1182(1) of the Bankruptcy Code provides:

(1)DEBTOR.—The term "debtor"

(A)subject to subparagraph (B), means 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 the date of the filing of the petition or the date of the order for relief in an amount not more than $7,500,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor; and

(B)does not include—

(i)any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $7,500,000 (excluding debt owed to 1 or more affiliates or insiders);

(ii)any debtor that is a corporation subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)); or

(iii)any debtor that is an affiliate of an issuer, as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c).

Who Is Eligible To Be a Small Business Debtor Under Subchapter V?

- Of particular interest, the CARES Act increased the cap on the aggregate amount of noncontingent liquidated secured and unsecured debt under which a debtor could qualify for Subchapter V from $2,725,625 to $7,500,000. The increased cap on debt is set to expire on March 27, 2021. The cap will return to the lower inflation adjusted amount unless extended by Congress.
- In determining eligibility of a debtor for Subchapter V, debts that are contingent (such as a claim based on a guarantee of a third-party debt) or unliquidated (such as a tort claim) are not included.
- Thus, in theory, a larger business that has reduced its liquidated non-contingent debts bellow $7.5 million, but is facing significant amounts of contingent or unliquidated litigation claims might be able to squeeze their case into Subchapter V despite potentially large contingent claims.
- Note that an individual with business debts may also elect to reorganize under Subchapter V.

How Does a Debtor Elect To Be Treated As a Small Business Debtor Under Subchapter V?

- The statute does not state when or how the debtor makes the election.
- Bankruptcy Rule 1020(a) requires a debtor to state in the petition whether it is a small business debtor.
- Interim Bankruptcy Rule 1020(a) requires that the debtor state in its bankruptcy petition whether the debtor elects application of subchapter V and provides that the case will proceed in accordance with the election unless the court determines the election is incorrect.
- The Official Bankruptcy Forms for voluntary Chapter 11 cases were revised to require the debtor to state whether it is a small business debtor and whether it elects to proceed under Subchapter V.
- Creditors may object to a debtor's election to be treated as a small business debtor.

What Is the Purpose of the Subchapter V Trustee?

- Unlike a typical Chapter 11 case, Subchapter V requires that the United States Trustee appoint a disinterested person to serve as the trustee in every Subchapter V case.
- The United States Trustee Program has selected a pool of persons who may be appointed on a case-by-case basis in subchapter V cases rather than appointing a standing trustee for all cases in each district similar to a Chapter 13 trustee.
- Distinct from trustees in Chapter 7 cases, the Subchapter V trustee does not take possession of the debtor's assets or operate the debtor's business.
- Rather, the Subchapter V trustee takes on a role more similar to that of a Chapter 13 trustee in a consumer bankruptcy case or a Chapter 12 trustee in a family farm bankruptcy case.
- The trustee in Subchapter V cases will ensure the debtor commences payments under its plan, investigate the financial affairs of the debtor and object to the allowance of proofs of claim. The Subchapter V trustee is also expected to assist with the development of a consensual plan of reorganization.

What Are the Principal Duties of the Subchapter V Trustee?

- Section 1183 of the Bankruptcy Code enumerates the duties of a Subchapter V Trustee
- In general, the role of the trustee is to supervise and monitor the Subchapter V case and to participate in the development and confirmation of a plan.
- While the duties of Subchapter V trustee are similar to trustees in Chapter 12 and 13 cases, the Subchapter V Trustee has some unique duties.
  - First, the sub V trustee has the duty to "facilitate the development of a consensual plan of reorganization." 11 U.S.C. § 1183(b)(7). Subchapter V Trustees are expected to be proactive the plan process;
  - Second the Subchapter V Trustee must appear and be heard at the status conference required by 11 U.S.C. § 1188(a); and
  - Third, the trustee must appear and be heard at any hearing concerning: (1) the value of property subject to a lien; (2) confirmation of the plan; (3) modification of the plan after confirmation; and (4) the sale of property of the estate

Other Duties of the Subchapter V Trustee

- The Subchapter V Trustee has a duty to (i) examine proofs of claim and object the allowance of improper claims, (ii) oppose the discharge of a debtor if advisable, (iii) furnish information concerning the administration of the bankruptcy estate to a party in interest and (iv) make a final report.
- Although a Subchapter V Trustee may have a right to obtain information about the debtor's property, business, and financial condition, a Subchapter V trustee does not have the duty to investigate the financial affairs of the debtor.
- Under § 1183(b)(2), the court (for cause and on request of a party in interest, the Subchapter V Trustee, or the U.S. Trustee) may order that the Subchapter V Trustee (1) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business, the desirability of its continuance, and any other matter relevant to the case of formulation of a plan, and (2) file a statement of the investigation, including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor or to a cause of action available to the estate.
- If the court removes the debtor as a debtor in possession, the Subchapter V Trustee shall take possession of the debtor's assets and operate the debtor's business as appropriate. It is also contemplated that the Subchapter V Trustee would be reappointed after confirmation if the debtor is removed as debtor in possession for failure to perform the obligations of a debtor under a confirmed plan. Presumably, the Subchapter V would essentially assume the roles of a Chapter 11 or Chapter 7 Trustee in this event.
- The Subchapter V Trustee may also be required to make payments to creditors under the debtor's confirmed plan.

Fees For the Subchapter V Trustee

- Subchapter V Trustees are entitled to "reasonable compensation for actual, necessary services rendered" and "reimbursement for actual, necessary expenses" under 11 U.S.C. § 330(a) of the Bankruptcy Code. Section 330 essentially requires Subchapter V Trustees to file a fee application, laying out the amount of time spent on the case, the services performed and the necessity of performing such services.
- Fees awarded to the Trustee must be paid by the debtor as an administrative expense of the debtor's case.
- 11 U.S.C § 1191(e) permits payment of administrative expense claims through the plan if the court confirms it under the cramdown provisions of § 1191(b). Accordingly, a Subchapter V Trustee faces deferral of payment of compensation for services in the case.
- In most cases, the Chapter V Trustee will not hire counsel o rother professionals. In view of the intent of SBRA to streamline and simplify chapter 11 cases for small business debtors and reduce administrative expenses, courts may be reluctant to permit a sub V trustee to retain attorneys or other professionals except in unusual circumstances.

Debtor Acts as Debtor In Possession

- Upon the filing of a Chapter 11 Petition and election to proceed under Subchapter V, the small business debtor will retain possession of its assets and continue to operate it business.
  - Unlike in a typical Chapter 11 case, however, the debtor must include with its voluntary petition its most recent balance sheet, statement of operations, cash-flow statement, and Federal income tax return, or include a statement under penalty of perjury that such documents are not available. See 11 U.S.C. § §1187(a), 1116 (1).
  - During the case, the debtor must file periodic reports detailing profitability, receipts, disbursements, comparisons with receipts and disbursements with projections, and whether the debtor is in compliance with the postpetition requirements of the bankruptcy code, including paying taxes and administrative expenses when due.
  - The debtor must also (1) attend meetings scheduled by the court or the U.S. Trustee (including initial debtor interviews, scheduling conferences, and § 341 meetings, unless waived for extraordinary and compelling circumstances); (2) timely file all schedules and statements of financial affairs (unless the court after notice and a hearing grants an extension not to exceed 30 days after the order for relief, absent extraordinary and compelling circumstances); (3) file all postpetition financial and other reports required by the Bankruptcy Rules or local rule of the district court; (4) maintain customary and appropriate insurance; (5) timely file required tax returns and other government filings and pay all taxes entitled to administrative expense priority; and (6) allow the U.S. trustee to inspect the debtor's business premises, books, and records.
- New § 1185(a) provides for removal of a debtor in possession, for cause, on request of a party in interest and after notice and hearing.
  - "Cause" includes "fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after the date of commencement of the case."
  - Upon removal of a debtor in possession, the Subchapter V Trustee will take control of the debtor's assets and may continue to operate the debtor's business.

A Streamlined Chapter 11 Process

- Subchapter V includes several features designed to facilitate the efficient and economical administration of the case and the prompt confirmation of a plan.
- The SBRA provides that a committee of unsecured creditors will not be appointed in the case of a small business debtor unless the court for cause orders otherwise. See § 1102(a)(3)
  - While committees are helpful, and indeed necessary in large Chapter 11 cases, the expenses of a committee, their counsel and advisors can be prohibitively expensive for a small business debtor.
- Subchapter V eliminates the requirement that the debtor pay quarterly U.S. Trustee fees, relieving the estate of this expense.
- Subchapter V does away with the requirement for a debtor to file and seek approval of a disclosures statement in connection with its plan of reorganization. See §1181(b) making section 1125 inapplicable to a Subchapter V case.
  - Disclosure statements can be expensive and burdensome to prepare. Moreover, the requirement to obtain court approval of the disclosure statement before soliciting the plan can significantly slow down the plan confirmation process.
  - *However*, a Subchapter V debtor's plan must contain certain information that a disclosure statement typically contains, including: (1) a brief history of the business operations of the debtor; (2) a liquidation analysis; and (3) projections with respect to the ability of the debtor to make payments under the proposed plan of reorganization.1

Other Changes To the Chapter 11 Process

- Section 1188 of the Bankruptcy Code requires that the court hold a status conference not later than 60 days after the commencement of the case.
  - The stated purpose of the status conference is "to further the expeditious and economical resolution" of the case.
  - Not later than 14 days prior to the status conference, the debtor must file, and serve on the trustee and all parties in interest, a report that "details the efforts the debtor has undertaken and will undertake to attain a consensual plan of reorganization." The Chapter V Trustee has the duty to appear and be heard at the status conference.
- New §1195 lessens the bar needed for a small business debtor to hire professionals.
  - Normally, only "disinterested" professionals may be retained by a debtor in possession. A professional that has a prepetition claim against the debtor is not deemed to be disinterested. Thus a professional must either waive its claim or forgo representation of the debtor.
  - Section 1195 holds that a professional is not disqualified from representing the debtor so long as its prepetition claim is less than $10,000.

Changes to the Plan Solicitation Process

- Under Subchapter V, only the debtor may file a plan of reorganization. 11 U.S.C. §1189(a)
- Under §1189(b), the debtor has 90 days form the order for relief to file its plan. There is no deadline to solicit acceptances of the filed plan or obtain confirmation.
- New §1190 contains three provisions governing the contents of a Chapter V Plan.
  - First, new § 1190(1) requires some information that would otherwise be included in a disclosure statement. The plan must include: (1) a brief history of the operations of the debtor; (2) a liquidation analysis; and (3) projections regarding the ability of the debtor to make payments under the proposed plan.
  - Second, new § 1190(2) requires the plan to provide for the submission of "all or such portion of the future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan."

Contents of Subchapter V Plan

- Third, § 1190(3) changes the rule that a plan may not modify the rights of a claim secured only by a security interest in real property that is the debtor's principal residence.
  - New § 1190(3) permits modification of such a claim if the two circumstances specified in subparagraphs (A) and (B) exist. The requirement of subparagraph (A) is that the new value received in connection with the granting of the security interest was "not used primarily to acquire the real property." Subparagraph (B) requires that the new value was "used primarily in connection with the small business of the debtor."
  - This rule could be useful for individual debtors that put up their house as collateral for a business loan. While the other chapters of the bankruptcy code would generally prohibit such modification to a residential mortgage, Subchapter V gives individual debtors greater flexibility and incentive to reorganize their business affairs under Subchapter V.
- Also, Section 1191(e) of Subchapter V allows debtors to pay administrative claims through the plan, rather than at the time of plan confirmation, if the plan is confirmed under the cramdown rules set forth in section 1191.

Plan Confirmation Requirements In a Normal Chapter 11 Case

- In a typical Chapter 11 case, a plan may be consensually confirmed if all the requirements of 11 U.S.C. 1129(a) are satisfied.
- If all of the provisions of Section 1129(a) other than section 1129(a)(8) have been met –i.e. all impaired classes of creditors have not accepted the plan – then the plan can still be "crammed down" on objecting classes of creditors under Section 1129(b) if the plan "does not discriminate unfairly, and is fair and equitable" with regard to each impaired class that has not accepted the plan.
- With respect to unsecured claims, for a plan to be "fair and equitable", the holder of any claim or interest that is junior to the claims of a class that has not accepted the plan will not receive or retain under the plan any property.
- This essentially means that, in a typical case, if all classes of unsecured claims do not accept the plan, then the equity owners of the business cannot retain their equity interest (absent providing a substantial amount of new capital) because the equity owners would be receiving an interest when the more senior unsecured creditors have not been paid in full.

Plan Confirmation Requirements of Subchapter V

- Subchapter V alters these rules for confirming a "cramdown" plan, i.e. a plan where all classes of creditors have not accepted the plan.
- Under §1191(a) of Subchapter V, if all the requirements of Section 1129(a) are satisfied and all classes of creditors have voted to accept the plan, i.e. a "consensual plan" then the Court shall confirm the plan.
- Section 1191(b) changes the "cramdown" requirements for a Subchapter V Plan.
  - First, §1191(b) does away with the requirement that at least one impaired class of creditors vote to accept the plan. The Plan can be "crammed down" even if no class of creditors vote to accept the plan.
  - Second, the requirements to cramdown a class of secured claims remains the same, but the rules for cramdown of unsecured claims is significantly altered.

Cramdown Under Subchapter V

- Subchapter V does not change existing law about permissible cramdown treatment of secured claims –for a class of secured claims, a subchapter V plan is "fair and equitable" if it meets the existing rules for secured claims stated in § 1129(b)(2)(A).
- For unsecured claims, the rules are significantly different. For a Subchapter V plan to be fair and equitable to unsecured creditors, §1191(b) requires that:
  - (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.
- Section 1191(b)(3) further requires that (A) the debtor will be able to make all payments under the plan or there is a reasonable likelihood that the debtor will be able to make all payments; and (B)the plan provides appropriate remedies, which may include the liquidation of assets, to protect the holders of claims or interests in the event that the payments are not made.

Cramdown Under Subchapter V

- What is "disposable income" that must be applied to make payments under the Plan?
  - Under §1191(d) "disposable income" means, the 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
    - a domestic support obligation; or
    - the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor.
  - With regard to business income, the rule likely contemplates the payment of items such as payroll, utilities, rent, insurance, taxes, acquisition of inventory or raw materials, and other expenses ordinarily incurred in the course of running a business.

Questions about the Subchapter V Cramdown Rule

- It is not clear how courts will determine how much revenue is "reasonably necessary" to be expended for the "continuation, preservation, or operation of the business".
- Could the "disposable income" definition account for reserves, capital expenditures or efforts to grow the business through increasing inventory, assets or marketing.
- How will the plan commitment period be fixed by the Court? Will it be the minimum of 3 years or a longer period up to 5 years? Courts will have to determine what facts and circumstances justify a longer commitment period and, if so, how much longer the period should be.

The Revised Cramdown Rules of Subchapter V Allows Small Business Owners To Retain Ownership

- One of the significant, if not the most significant benefit of Subchapter V is that a debtor's equity owner will be able to retain ownership and control of the business.
  - With the removal of the absolute priority rule, small business owners will be able to retain control of their businesses even if creditors do not vote to accept the plan. In fact, the plan can be confirmed even if no class of creditors vote to accept the plan, just so long as "disposable income" is used to make plan payments to creditors.
  - These new rules remove a significant risk seen in traditional Chapter 11 cases where it is difficult for equity owners to exit bankruptcy with their ownership interests intact.
  - For many small and family owned businesses, only the existing owners are able or willing to continue running the business.
  - Many business owners might not be willing or able to invest the resources needed to fund a bankruptcy case and then risk losing the business anyway if unsecured creditors are not paid in full and object. Many owners will just walk away, and the business, and its jobs and services will be lost to the community.

Payments To Creditors Under the Confirmed Plan

- Subchapter V has different provisions for the disbursement of payments to creditors and the role of the trustee depending on whether the court confirms a consensual plan or a cramdown plan.
  - If the confirmed plan is consensual, i.e. all classes of creditors vote to accept the plan-the Subchapter V Trustee will be terminated when the plan is consummated and the debtor will presumably be required to make plan payments.
  - If the plan is confirmed through cramdown, § 1194(b) provides for the Subchapter V trustee to make payments to creditors under the plan unless the plan or the order confirming it provides otherwise.
  - Because the Subchapter V trustee must make payments under a cramdown plan, the trustee's service does not terminate upon its substantial consummation. The trustee's service continues, at a minimum, until the trustee has made the required disbursements.
- The statute contains no standards for the court to determine under what circumstances a plan or confirmation order may provide that the trustee will not make payments. For example, may a nonconsensual plan provide for the debtor to make postpetition installment payments on a mortgage or other long-term debt that is being cured and reinstated, or regular payments on an unexpired lease of real or personal property that is being assumed?

Discharge For Debtors Under Subchapter V

- The discharge that a debtor receives in a sub V case and its timing depend on whether consensual or cramdown confirmation occurs.
  - If the Plan is consensual, then the debtor receives a discharge upon confirmation of the plan, the same as a regular chapter 11 debtor receives under § 1141(d) of the Bankruptcy Code.
  - If the plan is a cramdown plan, then the debtor receives a discharge as provided in § 1192 of the Bankruptcy Code.
  - New § 1192 provides for discharge to occur "as soon as practicable" after the debtor completes all payments due within the first three years of the plan, "or such longer period not to exceed five years as the court may fix." Presumably, any longer period will be the same length as the court fixes for the commitment of projected disposable income in connection with cramdown confirmation under new § 1191(b), but the statute does not expressly so state.

Default and Remedies After Confirmation of a Subchapter V Plan

- If a debtor defaults and fails to make payments required under a confirmed plan, creditors must decide what remedies are available and how to invoke them.
- In a consensual plan, creditors should require that the plan include remedies they may enforce if the debtor fails to make payments required under the plan.
  - Remedies could include a security interest in favor of creditors, a confession of judgment, or required liquidation of assets.
  - Secured creditors and lessors should ensure they can enforce the terms of their agreements upon default.
- When one or more classes of impaired creditors do not accept the plan, the requirements for cramdown confirmation in new § 1191(c) provide the source of remedies for default.
  - Cramdown confirmation requires that the plan provide "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."

Creditors Retain Most of Their Rights In Subchapter V Cases

- For secured creditors, to confirm a plan over the objection of a secured creditor, the debtor's plan must provide either (i) that the holder of the secured claim retain its lien and receive deferred cash payments equal to the value of its collateral, or (ii) for the sale of the creditor's collateral free and clear of the creditor's lien with such lies to attach to the proceeds of sale, subject to the right of the secured creditor to credit bid for its collateral.
- Prior to plan confirmation, secured creditors also retain the right to demand adequate protection against the diminution in the value of their collateral. This could include regular payments or additional liens. Creditors also retain their right to seek relief from the automatic stay in order to realize the value of their collateral.

Creditors Retain Most of Their Rights In Subchapter V Cases

- Counterparties to executory contracts with the debtor are entitled to the cure of all defaults under the contract if the debtor seeks to assume the contract and may also be entitled to adequate assurance of future performance where appropriate.
- Landlords are entitled to payment of rent accruing post-petition until their lease is assumed or rejected, and upon assumption, the debtor must pay any unpaid prepetition rent.
- Unsecured creditors are entitled to the satisfaction of the best interests of creditors test, namely that creditors receive at least as much under the confirmed Subchapter V Plan as they would in a chapter 7 liquidation.

Takeaways

- Subchapter V can be a very effective tool for small businesses to reorganize.
  - By permitting only debtors to file reorganization plans, doing away with the absolute priority rule, and allowing business owners to retain their equity interest without paying all unsecured creditors in full, Subchapter V allows business owners to maintain control of the reorganization.
  - By eliminating creditors' committees, the requirement to file a disclosure statement and shortening plan timelines, expenses can be significantly reduced in comparison to typical large Chapter 11 cases.
  - Like all bankruptcy cases, a filing under Subchapter V will halt all collection actions, centralize the claims resolution process and give businesses breathing room to formulate a reorganization plan and eliminate debt.

Takeaways

- Subchapter V offers a viable alternative for small businesses to stay in business, while streamlining its capital structure and operations.
- The main downside to Subchapter V is the small amount of debt permitted to reorganize. While the CARES act significantly increased the debt limits to qualify (from $2,725,675 to $7,500,000), it still only allows a modest amount of debt and that increase in debt limits expires in less than a year.
- The quick timeline to formulate and file a plan means many debtors will need to enter bankruptcy with a scheme to reorganize already formulated.
- Still, small businesses are a major driver of jobs and wealth for millions of Americans. Subchapter V will allow more of these small businesses to survive economic turmoil and emerge as leaner and stronger businesses.

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Small Business Bankruptcies: Subchapter V isn't just for the Smallest Businesses

by Andrew E. Weissman | Aug 18, 2020

The CARES ACT Expands Eligibility For Subchapter V Providing More Businesses a Viable Option to Reorganize.

Earlier this year, the Small Business Reorganization Act of 2019, which created the new Subchapter V of the Bankruptcy Code (11 U.S.C. §§ 1181-1195 "Subchapter V"), went into to effect. The intent of the

effective process. Traditional Chapter 11 cases were often seen as too expensive, time consuming and unpredictable for smaller business debtors. Subchapter V seeks to simplify the reorganization process by eliminating some of the large expenses of a Chapter 11 Bankruptcy case, including funding a creditors' committees and certain United States Trustee fees, while also speeding up the process by requiring a reorganization plan to be filed within 90 days of the bankruptcy filing and eliminating the requirement to file a disclosure statement. Subchapter V also provides small business owners a better opportunity to retain ownership of their business through the reorganization process by eliminating the "absolute priority" rule (owners can retain their equity in a Subchapter V small business over the objection of a class of unsecured creditors, without paying those creditors in full).

As originally enacted, only small business debtors with up to $2,725,625 in secured and unsecured non-contingent liquidated debt were eligible to elect to reorganize under Subchapter V. Shortly after Subchapter V became effective, in response to the Covid-19 crises and as part of the Coronavirus Aid, Relief and Economic Security (CARES) Act, Congress temporarily expanded the debt cap for businesses to reorganize under Subchapter V to $7,500,000 in secured and unsecured non-contingent liquidated debt. The expanded debt cap will enable more struggling businesses to take advantage of the debtor friendly provisions of Subchapter V while the economy recovers from the economic fallout from the pandemic.

Who is Eligible To Reorganize Under Subchapter V

to be a Subchapter V debtor. With its CARES Act amendment, Bankruptcy Code Section 1182 defines a debtor eligible for Subchapter V as a person or business:

> 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 the date of the filing of the petition or the date of the order for relief in an amount not more than $7,500,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor.

Of note, a debtor that is (i) a member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $7,500,000 (excluding debt owed to 1 or more affiliates or insiders); (ii) a corporation subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 or (iii) an affiliate of an issuer, as defined in section 3 of the Securities Exchange Act of 1934, is *not* eligible for Subchapter V.

In determining eligibility of a debtor for Subchapter V, debts that are contingent (such as a claim based on a guarantee of a third-party debt) or unliquidated (such as a tort claim) are not included. Thus, in theory, a larger business that has reduced its liquidated non-contingent debts bellow $7.5 million, but is facing significant amounts of

claims.

The Small Business Trustee

Unlike a typical Chapter 11 case, Subchapter V requires that the United States Trustee appoint a disinterested person to serve as the trustee for the Subchapter V case. Distinct from trustees in Chapter 7 cases, the Subchapter V trustee does not take possession of the debtor's assets or operate the debtor's business. Rather, the Subchapter V trustee takes on a role more similar to that of a Chapter 13 trustee in a consumer bankruptcy case. The trustee in these cases will ensure the debtor commences payments under its plan, investigate the financial affairs of the debtor and object to the allowance of proofs of claim. The Subchapter V trustee is also expected to "facilitate the development of a consensual plan of reorganization." See 11 U.S.C. § 1183. In addition, if the court removes a debtor from its role as a debtor-in-possession, the trustee will take control of the debtor's assets and operate the debtor's business.

Streamlined Chapter 11 Reorganization

A significant advantage for a debtor proceeding under Subchapter V is that it offers a significantly streamlined, relatively quick and cost-effective reorganization process. First, committees of unsecured creditors are not formed in Subchapter V cases unless the court for cause orders otherwise. Thus, the expense to the debtor's estate of a creditors' committee together with its counsel and other advisors will be eliminated.

days of the commencement of the case and may only be extended if the court finds that "the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable." Also, only the debtor may file a plan of reorganization. By compressing the case timelines, limiting opportunities to extend the deadlines, and only allowing debtors to file plans, debtors can more efficiently and economically reorganize their businesses.

Third, there is no requirement that the debtor file a disclosure statement in connection with its plan of reorganization unless the Court order otherwise. In a standard Chapter 11 case, a debtor must file a hefty disclosure statement that lays out the terms of the plan, describes the debtor's operating history, its assets, debts, and includes a liquidation analysis. This disclosure statement must be approved by the court and circulated to all creditors. Subchapter V does away with this expensive, laborious and time-consuming process, instead requiring that the Debtor's plan include a brief history of the business operations of the debtor, a liquidation analysis, and projections with respect to the debtor's ability to make payments under the proposed plan.

The downside to this streamlined process is that the debtor will have little time to stabilize its business under bankruptcy protection while working out a plan to reorganize. Under Subchapter V, the debtor must work quickly to formulate and present a plan. Small businesses would be wise to consider reorganization options and plans before filing for relief.

Perhaps the most significant advantage of a Subchapter V bankruptcy is that equity owners have a better chance to retain control of the reorganized business. In a typical bankruptcy case, existing owners cannot retain equity in the debtor business over the objection of a class of unsecured creditors, unless the class is paid in full or the owners contribute new capital into the company. In other words, in order to "cram down" a plan on a class of creditors and retain ownership, those creditors must be paid in full or accept the plan. This rule, called the "absolute priority rule", does not apply in Subchapter V bankruptcy cases.

Rather, as long as unsecured creditors receive a distribution of the debtor's "disposable income" for a period of three years (or up to five years if extended by the court), equity holders may retain the equity in the debtor and continue to manage the debtor's business, even where creditors do not vote to accept the plan and object to confirmation. As long as the plan "does not discriminate unfairly" and is "fair and equitable" with respect to impaired unsecured creditors, the court shall confirm the plan. In fact, the debtor *does not* need to obtain the acceptance of any impaired class of creditors.

The available options and flexibility for equity owners to retain ownership of their businesses through the reorganization process is a significant incentive to proceed under Subchapter V. In small business cases, giving up the equity is usually not a viable option because owners of small businesses are often the only managers willing or able to run the business. In addition, business owners might not be willing or able to invest the resources needed to fund a bankruptcy case and then risk

jobs, will be lost to the community.

Many Creditor Protections Remain Intact

Notwithstanding the many debtor friendly provisions in Subchapter V, most of the key creditor protections of the Bankruptcy Code remain in place. First, in order to confirm a plan over the objection of a secured creditor, the debtor's plan must provide either (i) that the holder of the secured claim retain its lien and receive deferred cash payments equal to the value of its collateral, or (ii) for the sale of the creditor's collateral free and clear of the creditor's lien with such lies to attach to the proceeds of sale, subject to the right of the secured creditor to credit bid for its collateral.

Second, prior to the time for plan confirmation, secured creditors also retain the right to demand adequate protection against the diminution in the value of their collateral. This could include regular payments or additional liens. Creditors also retain their right to seek relief from the automatic stay in order to realize the value of their collateral.

While unsecured creditors lose the protection of the "absolute priority rule" in a plan confirmed under Subchapter V, they retain the protection of the "best interests of creditors test". That test requires that creditors receive at least as much under a plan of reorganization as they would receive if the debtor were liquidated under Chapter 7 of the Bankruptcy Code.

Counterparties to executory contracts with the debtor are entitled to the cure of all defaults under the contract if the debtor seeks to assume the contract and may also be entitled to adequate assurance of future

upon assumption, the debtor must pay any unpaid prepetition rent.

Takeaway

Subchapter V can be a very effective tool for small businesses to reorganize. By permitting only debtors to file reorganization plans and allowing business owners to retain their equity interest without paying all unsecured creditors in full, Subchapter V allows business owners to maintain control of the reorganization. By eliminating creditors' committees, the requirement to file a disclosure statement and shortening plan timelines, expenses can be significantly reduced in comparison to typical large Chapter 11 cases. Like all bankruptcy cases, a filing under Subchapter V will halt all collection actions, centralize the claims resolution process and give businesses breathing room to formulate a reorganization plan and eliminate debt.

In short, Subchapter V offers a viable alternative for small businesses to stay in business, while streamlining its capital structure and operations. The main downside to Subchapter V is the small amount of debt permitted to reorganize. While the CARES act significantly increased the debt limits to qualify (from $2,725,675 to $7,500,000), it still only allows a modest amount of debt and that increase in debt limits expires in less than a year. Also, the quick timeline to formulate and file a plan means many debtors will need to enter bankruptcy with a scheme to reorganize already formulated.

Still, small businesses are a major driver of jobs and wealth for millions of Americans. Subchapter V will allow more of these small businesses to survive economic turmoil and emerge as leaner and stronger businesses.

For any questions about this article or about a bankruptcy matter you may have, please contact Andrew E. Weissman or call (312) 648-2300.

[DISCLAIMER – This information is solely for information purposes and does not constitute legal advice. Please contact SFBBG with all legal questions.]

← Hell Hath No Fury Like a Principal Scorned

H. R. 3311

One Hundred Sixteenth Congress of the United States of America

AT THE FIRST SESSION

Begun and held at the City of Washington on Thursday, the third day of January, two thousand and nineteen

An Act

To amend chapter 11 of title 11, United States Code, to address reorganization of small businesses, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Small Business Reorganization Act of 2019".

SEC. 2. REORGANIZATION OF SMALL BUSINESS DEBTORS.

(a) IN GENERAL.—Chapter 11 of title 11, United States Code, is amended by adding at the end the following:

"SUBCHAPTER V—SMALL BUSINESS DEBTOR REORGANIZATION

"§ 1181. Inapplicability of other sections

"(a) IN GENERAL.—Sections 105(d), 1101(1), 1104, 1105, 1106, 1107, 1108, 1115, 1116, 1121, 1123(a)(8), 1123(c), 1127, 1129(a)(15), 1129(b), 1129(c), 1129(e), and 1141(d)(5) of this title do not apply in a case under this subchapter.

"(b) COURT AUTHORITY.—Unless the court for cause orders otherwise, paragraphs (1), (2), and (4) of section 1102(a) and sections 1102(b), 1103, and 1125 of this title do not apply in a case under this subchapter.

"(c) SPECIAL RULE FOR DISCHARGE.—If a plan is confirmed under section 1191(b) of this title, section 1141(d) of this title shall not apply, except as provided in section 1192 of this title.

"§ 1182. Definitions

"In this subchapter:

"(1) DEBTOR.—The term 'debtor' means a small business debtor.

"(2) DEBTOR IN POSSESSION.—The term 'debtor in possession' means the debtor, unless removed as debtor in possession under section 1185(a) of this title.

"§ 1183. Trustee

"(a) IN GENERAL.—If the United States trustee has appointed an individual under section 586(b) of title 28 to serve as standing trustee in cases under this subchapter, and if such individual qualifies as a trustee under section 322 of this title, then that individual shall serve as trustee in any case under this subchapter. Otherwise, the United States trustee shall appoint one disinterested person

to serve as trustee in the case or the United States trustee may serve as trustee in the case, as necessary.

"(b) DUTIES.—The trustee shall—

"(1) perform the duties specified in paragraphs (2), (5), (6), (7), and (9) of section 704(a) of this title;

"(2) perform the duties specified in paragraphs (3), (4), and (7) of section 1106(a) of this title, if the court, for cause and on request of a party in interest, the trustee, or the United States trustee, so orders;

"(3) appear and be heard at the status conference under section 1188 of this title and any hearing that concerns—

"(A) the value of property subject to a lien;

"(B) confirmation of a plan filed under this subchapter;

"(C) modification of the plan after confirmation; or

"(D) the sale of property of the estate;

"(4) ensure that the debtor commences making timely payments required by a plan confirmed under this subchapter;

"(5) if the debtor ceases to be a debtor in possession, perform the duties specified in section 704(a)(8) and paragraphs (1), (2), and (6) of section 1106(a) of this title, including operating the business of the debtor;

"(6) if there is a claim for a domestic support obligation with respect to the debtor, perform the duties specified in section 704(c) of this title; and

"(7) facilitate the development of a consensual plan of reorganization.

"(c) TERMINATION OF TRUSTEE SERVICE.—

"(1) IN GENERAL.—If the plan of the debtor is confirmed under section 1191(a) of this title, the service of the trustee in the case shall terminate when the plan has been substantially consummated, except that the United States trustee may reappoint a trustee as needed for performance of duties under subsection (b)(3)(C) of this section and section 1185(a) of this title.

"(2) SERVICE OF NOTICE OF SUBSTANTIAL CONSUMMATION.—Not later than 14 days after the plan of the debtor is substantially consummated, the debtor shall file with the court and serve on the trustee, the United States trustee, and all parties in interest notice of such substantial consummation.

"§ 1184. Rights and powers of a debtor in possession

"Subject to such limitations or conditions as the court may prescribe, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all functions and duties, except the duties specified in paragraphs (2), (3), and (4) of section 1106(a) of this title, of a trustee serving in a case under this chapter, including operating the business of the debtor.

"§ 1185. Removal of debtor in possession

"(a) IN GENERAL.—On request of a party in interest, and after notice and a hearing, the court shall order that the debtor shall not be a debtor in possession for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after the date of commencement of the case, or for failure to perform the obligations of the debtor under a plan confirmed under this subchapter.

"(b) REINSTATEMENT.—On request of a party in interest, and after notice and a hearing, the court may reinstate the debtor in possession.

"§ 1186. Property of the estate

"(a) INCLUSIONS.—If a plan is confirmed under section 1191(b) of this title, property of the estate includes, in addition to the property specified in section 541 of this title—

"(1) all property of the kind specified in that section that the debtor acquires after the date of commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13 of this title, whichever occurs first; and

"(2) earnings from services performed by the debtor after the date of commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13 of this title, whichever occurs first.

"(b) DEBTOR REMAINING IN POSSESSION.—Except as provided in section 1185 of this title, a plan confirmed under this subchapter, or an order confirming a plan under this subchapter, the debtor shall remain in possession of all property of the estate.

"§ 1187. Duties and reporting requirements of debtors

"(a) FILING REQUIREMENTS.—Upon electing to be a debtor under this subchapter, the debtor shall file the documents required by subparagraphs (A) and (B) of section 1116(1) of this title.

"(b) OTHER APPLICABLE PROVISIONS.—A debtor, in addition to the duties provided in this title and as otherwise required by law, shall comply with the requirements of section 308 and paragraphs (2), (3), (4), (5), (6), and (7) of section 1116 of this title.

"(c) SEPARATE DISCLOSURE STATEMENT EXEMPTION.—If the court orders under section 1181(b) of this title that section 1125 of this title applies, section 1125(f) of this title shall apply.

"§ 1188. Status conference

"(a) IN GENERAL.—Except as provided in subsection (b), not later than 60 days after the entry of the order for relief under this chapter, the court shall hold a status conference to further the expeditious and economical resolution of a case under this subchapter.

"(b) EXCEPTION.—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.

"(c) REPORT.—Not later than 14 days before the date of the status conference under subsection (a), the debtor shall file with the court and serve on the trustee and all parties in interest a report that details the efforts the debtor has undertaken and will undertake to attain a consensual plan of reorganization.

"§ 1189. Filing of the plan

"(a) WHO MAY FILE A PLAN.—Only the debtor may file a plan under this subchapter.

"(b) DEADLINE.—The debtor shall file a plan not later than 90 days after the order for relief under this chapter, except that the 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.

"§ 1190. Contents of plan

"A plan filed under this subchapter—

"(1) shall include—

"(A) a brief history of the business operations of the debtor;

"(B) a liquidation analysis; and

"(C) projections with respect to the ability of the debtor to make payments under the proposed plan of reorganization;

"(2) shall provide for the submission of all or such portion of the future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan; and

"(3) notwithstanding section 1123(b)(5) of this title, may modify the rights of the holder of a claim secured only by a security interest in real property that is the principal residence of the debtor if the new value received in connection with the granting of the security interest was—

"(A) not used primarily to acquire the real property; and

"(B) used primarily in connection with the small business of the debtor.

"§ 1191. Confirmation of plan

"(a) TERMS.—The court shall confirm a plan under this subchapter only if all of the requirements of section 1129(a), other than paragraph (15) of that section, of this title are met.

"(b) EXCEPTION.—Notwithstanding section 510(a) of this title, if all of the applicable requirements of section 1129(a) of this title, other than paragraphs (8), (10), and (15) of that section, are met with respect to a plan, the court, on request of the debtor, shall confirm the plan notwithstanding the requirements of such paragraphs if the plan does 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 plan.

"(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—

"(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.

"(d) DISPOSABLE INCOME.—For purposes of this section, the term 'disposable income' means the income that is received by the debtor and that is not reasonably necessary to be expended—

"(1) for—

"(A) the maintenance or support of the debtor or a dependent of the debtor; or

"(B) a domestic support obligation that first becomes payable after the date of the filing of the petition; or

"(2) for the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor.

"(e) SPECIAL RULE.—Notwithstanding section 1129(a)(9)(A) of this title, a plan that provides for the payment through the plan of a claim of a kind specified in paragraph (2) or (3) of section 507(a) of this title may be confirmed under subsection (b) of this section.

"§ 1192. Discharge

"If the plan of the debtor is confirmed under section 1191(b) of this title, as soon as practicable after completion by the debtor of all payments due within the first 3 years of the plan, or such longer period not to exceed 5 years as the court may fix, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided in section 1141(d)(1)(A) of this title, and all other debts allowed under section 503 of this title and provided for in the plan, except any debt—

"(1) on which the last payment is due after the first 3 years of the plan, or such other time not to exceed 5 years fixed by the court; or

"(2) of the kind specified in section 523(a) of this title.

"§ 1193. Modification of plan

"(a) MODIFICATION BEFORE CONFIRMATION.—The debtor may modify a plan at any time before confirmation, but may not modify the plan so that the plan as modified fails to meet the requirements of sections 1122 and 1123 of this title, with the exception of subsection (a)(8) of such section 1123. After the modification is filed with the court, the plan as modified becomes the plan.

"(b) MODIFICATION AFTER CONFIRMATION.—If a plan has been confirmed under section 1191(a) of this title, the debtor may modify the plan at any time after confirmation of the plan and before substantial consummation of the plan, but may not modify the plan so that the plan as modified fails to meet the requirements of sections 1122 and 1123 of this title, with the exception of subsection (a)(8) of such section 1123. The plan, as modified under this subsection, becomes the plan only if circumstances warrant the modification and the court, after notice and a hearing, confirms the plan as modified under section 1191(a) of this title.

"(c) CERTAIN OTHER MODIFICATIONS.—If a plan has been confirmed under section 1191(b) of this title, the debtor may modify the plan at any time within 3 years, or such longer time not to exceed 5 years, as fixed by the court, but may not modify the plan so that the plan as modified fails to meet the requirements of section 1191(b) of this title. The plan as modified under this subsection becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan, as modified, under section 1191(b) of this title.

"(d) HOLDERS OF A CLAIM OR INTEREST.—If a plan has been confirmed under section 1191(a) of this title, any holder of a claim or interest that has accepted or rejected the plan is deemed to have accepted or rejected, as the case may be, the plan as modified, unless, within the time fixed by the court, such holder changes the previous acceptance or rejection of the holder.

"§ 1194. Payments

"(a) RETENTION AND DISTRIBUTION BY TRUSTEE.—Payments and funds received by the trustee shall be retained by the trustee until confirmation or denial of confirmation of a plan. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan. If a plan is not confirmed, the trustee shall return any such payments to the debtor after deducting—

"(1) any unpaid claim allowed under section 503(b) of this title;

"(2) any payment made for the purpose of providing adequate protection of an interest in property due to the holder of a secured claim; and

"(3) any fee owing to the trustee.

"(b) OTHER PLANS.—If a plan is confirmed under section 1191(b) of this title, except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan.

"(c) PAYMENTS PRIOR TO CONFIRMATION.—Prior to confirmation of a plan, the court, after notice and a hearing, may authorize the trustee to make payments to the holder of a secured claim for the purpose of providing adequate protection of an interest in property.

"§ 1195. Transactions with professionals

"Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title, by a debtor solely because that person holds a claim of less than $10,000 that arose prior to commencement of the case.".

(b) CLERICAL AMENDMENT.—The table of subchapters at the beginning of chapter 11 of title 11, United States Code, is amended by adding at the end the following:

"SUBCHAPTER V—SMALL BUSINESS DEBTOR REORGANIZATION

"1181. Inapplicability of other sections.
"1182. Definitions.
"1183. Trustee.
"1184. Rights and powers of a debtor in possession.
"1185. Removal of debtor in possession.
"1186. Property of the estate.
"1187. Duties and reporting requirements of debtors.
"1188. Status conference.
"1189. Filing of the plan.
"1190. Contents of plan.
"1191. Confirmation of plan.

SEC. 3. PREFERENCES; VENUE OF CERTAIN PROCEEDINGS.

(a) PREFERENCES.—Section 547(b) of title 11, United States Code, is amended by inserting ", based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses under subsection (c)," after "may".

(b) VENUE OF CERTAIN PROCEEDINGS.—Section 1409(b) of title 28, United States Code, is amended by striking "$10,000" and inserting "$25,000".

SEC. 4. CONFORMING AMENDMENTS.

(a) TITLE 11.—Title 11, United States Code, is amended—

(1) in section 101—

(A) in paragraph (51C), by inserting "and has not elected that subchapter V of chapter 11 of this title shall apply" after "is a small business debtor"; and

(B) in paragraph (51D)—

(i) in subparagraph (A)—

(I) by striking "or operating real property or activities incidental thereto" and inserting "single asset real estate"; and

(II) by striking "for a case in which" and all that follows and inserting "not less than 50 percent of which arose from the commercial or business activities of the debtor; and"; and

(ii) in subparagraph (B)—

(I) by striking the period at the end and inserting a semicolon;

(II) by striking "does not include any member" and inserting the following: "does not include—"(i) any member"; and

(III) by adding at the end the following:

"(ii) any debtor that is a corporation subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)); or

"(iii) any corporation that—

"(I) is subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)); and

"(II) is an affiliate of a debtor.";

(2) in section 103—

(A) by redesignating subsections (i) through (k) as subsections (j) through (l), respectively; and

(B) by inserting after subsection (h) the following:

"(i) Subchapter V of chapter 11 of this title applies only in a case under chapter 11 in which a small business debtor elects that subchapter V of chapter 11 shall apply.";

(3) in section 322(a), by inserting "1183," after "1163,";

(4) in section 326—

(A) in subsection (a), by inserting ", other than a case under subchapter V of chapter 11" after "7 or 11"; and

(B) in subsection (b), by inserting "subchapter V of chapter 11 or" after "In a case under";

(5) in section 347—

(A) in subsection (a)—

(i) by inserting "1194," after "726,"; and

(ii) by inserting "subchapter V of chapter 11," after "chapter 7,"; and

(B) in subsection (b), by inserting "1194," after "1173,";

(6) in section 363(c)(1), by inserting "1183, 1184," after "1108,";

(7) in section 364(a), by inserting "1183, 1184," after "1108,";

(8) in section 523(a), in the matter preceding paragraph (1), by inserting "1192" after "1141,";

(9) in section 524—

(A) in subsection (a)—

(i) in paragraph (1), by inserting "1192," after "1141,"; and

(ii) in paragraph (3), by inserting "1192," after "523,";

(B) in subsection (c)(1), by inserting "1192," after "1141,"; and

(C) in subsection (d), by inserting "1192," after "1141,";

(10) in section 557(d)(3), by inserting "1183," after "1104,";

(11) in section 1102(a), by striking paragraph (3) and inserting the following:

"(3) Unless the court for cause orders otherwise, a committee of creditors may not be appointed in a small business case or a case under subchapter V of this chapter."; and

(12) in section 1146(a), by inserting "or 1191" after "1129".

(b) TITLE 28.—Title 28 United States Code, is amended—

(1) in section 586—

(A) in subsection (a)(3), by inserting "(including subchapter V of chapter 11)" after "7, 11";

(B) in subsection (b), by inserting "subchapter V of chapter 11 or" after "cases under" the first place it appears;

(C) in subsection (d)(1), by inserting "subchapter V of chapter 11 or" after "cases under" each place that term appears; and

(D) in subsection (e)—

(i) in paragraph (1), by inserting "subchapter V of chapter 11 or" after "cases under";

(ii) in paragraph (2), by inserting "subchapter V of chapter 11 or" after "cases under" each place that term appears; and

(iii) by adding at the end the following:

"(5) In the event that the services of the trustee in a case under subchapter V of chapter 11 of title 11 are terminated by dismissal or conversion of the case, or upon substantial consummation of a plan under section 1183(c)(1) of that title, the court shall award compensation to the trustee consistent with services performed by the trustee and the limits on the compensation of the trustee established pursuant to paragraph (1) of this subsection.";

(2) in section 589b—

(A) in subsection (a)(1), by inserting "subchapter V of chapter 11 and" after "cases under"; and

(B) in subsection (d)—

(i) in the matter preceding paragraph (1), by inserting "subchapter V of chapter 11 and" after "trustees under"; and

(ii) in the undesignated matter following paragraph (8), by inserting "subchapter V of chapter 11 and" after "cases under"; and

(3) in section 1930(a)(6)(A), by inserting ", other than under subchapter V," after "chapter 11 of title 11".

SEC. 5. EFFECTIVE DATE.

This Act and the amendments made by this Act shall take effect 180 days after the date of enactment of this Act.

SEC. 6. DETERMINATION OF BUDGETARY EFFECTS.

The budgetary effects of this Act, for the purpose of complying with the Statutory Pay-As-You-Go Act of 2010, shall be determined by reference to the latest statement titled "Budgetary Effects of PAYGO Legislation" for this Act, submitted for printing in the Congressional Record by the Chairman of the House Budget Committee, provided that such statement has been submitted prior to the vote on passage.

Speaker of the House of Representatives.

Vice President of the United States and
President of the Senate.