



Preliminary Report of the American Bankruptcy Institute Subchapter V Task Force Maintaining the \$7,500,000 Debt Cap for Subchapter V Eligibility



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Recommendation and Supporting Factors:

- The overwhelming consensus of bankruptcy professionals, bankruptcy judges, and academics is that Subchapter V is functioning as Congress intended. Many have commented that Subchapter V is the most effective and useful bankruptcy legislation passed since enactment of the Bankruptcy Code in 1978. Subchapter V debtors are confirming plans at higher rates, more quickly, and at lower costs than non-Subchapter V small business cases and regular Chapter 11 cases.
- The ABI Subchapter V Task Force, which is engaged in an ongoing study of the implementation of Subchapter V, concludes that eligibility for Subchapter V should remain at \$7,500,000 in aggregate noncontingent, liquidated debt (subject to existing adjustment for inflation).
 - Maintaining the debt cap at \$7,500,000 provides consistency and access to Subchapter V as a debt restructuring tool for small businesses that cannot reorganize in a regular Chapter 11 case.
 - Because Congress raised the debt cap so soon after Subchapter V went into effect, most Subchapter V debtors have filed while the \$7,500,000 debt cap has been in place.
 - Reverting to the lower debt cap, which is untested, would make reorganization inaccessible to many small businesses. More than a quarter of Subchapter V debtors would not have been eligible for Subchapter V under the lower cap.
 - Bankruptcy professionals overwhelmingly support making the current \$7,500,000 debt cap permanent.
 - No clear reason, supported by data, exists for reversion to the lower, untested debt cap.

I. Introduction

Congress enacted the Small Business Reorganization Act of 2019 (SBRA) on August 23, 2019, to facilitate the reorganization of small business debtors in the United States. The SBRA, codified as Subchapter V of Chapter 11

of the Bankruptcy Code, became effective on February 19, 2020. Subchapter V provides eligible business debtors with a quicker, less costly, and more feasible path to reorganization than a regular Chapter 11 case.

Soon after enacting the SBRA, Congress authorized a temporary increase to the debt eligibility threshold for Subchapter V from \$2,725,625 to \$7,500,000 in aggregate noncontingent, liquidated secured and unsecured debt, making Subchapter V relief more widely available. The increased debt limit has been extended twice, but the most recent extension is due to sunset on June 21, 2024.

In April 2023, the American Bankruptcy Institute (ABI) created the Subchapter V Task Force (Task Force) charged with reviewing the implementation and administration of Subchapter V. The Task Force includes bankruptcy judges, practitioners, and academics. Because the current debt cap will expire soon, the Task Force has prioritized studying whether \$7,500,000 is the appropriate eligibility threshold for prospective Subchapter V debtors.

The Task Force has sought input from a range of interested bankruptcy professionals and stakeholder groups. To date, the Task Force has convened seven public hearings, held roundtable discussions with trade groups, and deployed a survey inviting comment on Subchapter V. After extensive study, the Task Force recommends that Congress pass legislation that would make the current \$7,500,000 debt cap permanent (subject to the existing adjustment for inflation).

II. Reasons Offered to Maintain the \$7,500,000 Debt Cap

Maintaining the debt cap at \$7,500,000 provides consistency and access to Subchapter V as a debt restructuring tool for smaller businesses that cannot afford or succeed in a regular Chapter 11 case. Because Congress raised the debt cap so soon after Subchapter V went into effect, most Subchapter V debtors have filed while the \$7,500,000 debt cap has been in place. Reverting to the lower cap would make reorganization inaccessible to many smaller businesses. More than a quarter of Subchapter V debtors would have been ineligible for Subchapter V because they have debts above \$3,024,725 (reflecting adjustment on April 1, 2022, pursuant to § 104).

Moreover, a business with \$7,500,000 in noncontingent, liquidated secured and unsecured debt is still a small business when measured by the standards of the U.S. economy. The amount and cost of debt for a small business varies in geographic commercial markets across the country, and \$7,500,000 is calibrated to account for that variation. In larger cities, where the costs (and therefore debts) are higher, businesses with debts above \$3,024,725 will likely continue to struggle to reorganize in a regular Chapter 11 case.

In addition, bankruptcy professionals overwhelmingly support making the current \$7,500,000 debt cap permanent. Finally, no clear reason, supported by data at this time, exists for reversion to the lower, untested debt cap.

III. Reasons Offered to Lower the Debt Cap to \$3,024,725

As discussed below, a few constituents view the \$7,500,000 cap as too high and advocate for reverting to the original debt cap, which, as noted, is now \$3,024,725 after adjustment for inflation pursuant to § 104. Some trade groups are concerned that making the higher debt cap permanent will increase lending costs and restrict access to capital for all small businesses. Another trade group argues that maintaining Subchapter V eligibility at \$7,500,000 imposes greater costs on more creditors because they lack the protections available in a regular Chapter 11 case. Yet another concern articulated by trade groups is that Subchapter V debtors with confirmed plans are

failing to make plan payments. The Task Force has investigated these claims but has not found sufficient evidence to support the draconian result of reverting the debt cap back down to \$3,024,725, particularly given the strong evidence supporting maintenance of the higher debt cap and the potential unknown consequences of lowering the debt cap at this time.

IV. ABI Subchapter V Task Force Investigation & Analysis

The Task Force has sought and obtained broad input from interested bankruptcy professionals, bankruptcy judges, and trade groups about the operation of Subchapter V. Thus far, the Task Force has convened seven public hearings and multiple roundtable discussions with trade groups, including the National Association of Credit Management, Turnaround Management Association, and National Association of Attorneys General. The Task Force also has deployed a survey inviting comment from bankruptcy professionals on Subchapter V's implementation.

The Task Force's study is ongoing, and a final report memorializing its full investigation and analysis of the subchapter is forthcoming. Because the current debt cap is set to expire on June 21, 2024, the Task Force prioritized its study of the appropriate debt eligibility threshold for prospective Subchapter V debtors. Based on its study thus far, the Task Force finds that Subchapter V is functioning as Congress intended, and the eligibility debt cap should remain at \$7,500,000 in aggregate noncontingent, liquidated debt (subject to existing adjustment for inflation).

A. Subchapter V is Functioning as Congress Intended

The Task Force finds that Subchapter V is functioning as Congress intended. Based on its study, nearly all bankruptcy judges, practitioners, and Subchapter V trustees who provided testimony to the Task Force widely acclaim the subchapter as a success. More than forty witnesses across seven hearings testified that Subchapter V has already proven to be successful in saving small businesses. Anecdotal evidence from the hearings supports this finding.

The Task Force heard testimony that Subchapter V cases are faster, more affordable, and provide a more feasible path to reorganization. U.S. Bankruptcy Judge Hannah Blumenstiel (Northern District of California) testified that the Subchapter V cases in her district are shorter, less costly, and confirm plans at higher rates than non-Subchapter V cases:

Of the 110 SubV cases filed in my district, 61 of them, or 55%, resulted in confirmed plans. Of the 295 non-SubV Chapter 11 cases filed in the Northern District of California since February 19, 2020, just 99 of them, or 34%, resulted in a confirmed plan. The average duration of SubV cases in my district was 407 days, more than 2 months shorter than a non-SubV Chapter 11 case, which lasts an average of 470 days. But the most striking distinction was cost. The average amount of professional fees awarded in a non-SubV Chapter 11 case filed in the Northern District of California was \$679,387. The average amount of professional fees awarded in a SubV case in my district was \$145,790 – a staggering difference.

The Task Force also heard repeatedly that Subchapter V allows business to reorganize that cannot afford the costs of a traditional Chapter 11 case. U.S. Bankruptcy Judge Michael E. Romero (District of Colorado) explained:

[Subchapter V] has opened up the ability for financial rehabilitation to entities previously priced out the more traditional Chapter 11 process. The value of extending a survival opportunity to financially challenged; but valuable members of our communities, can never be underestimated.

The Task Force also heard from witnesses that Subchapter V is more efficient. U.S. Bankruptcy Judge Paul M. Black (Western District of Virginia) testified:

Prior to the enactment of Subchapter V, my experience was that requiring a small business to comply with the same Chapter 11 structure as a large commercial operation was not always a good fit. The absolute priority rule was a practical impediment, and it was expensive, time-consuming, and fraught with battles that were often not worth engaging in for anyone. . . Subchapter V has eliminated a lot of the unnecessary battles and wheel spinning, keeping the focus on timely confirmation of a plan of reorganization.

The kinds of businesses that have been able to use Subchapter V to reorganize are varied and provide important services to the people in their local and regional economies. Witnesses recounted successful reorganizations of businesses such as restaurants, construction companies, an engineering firm, medical practices, a nursing home operator, an underground utilities operator, a recycling center, a business providing cremation services, a litigation support business, a bowling alley, an event rental company, among many others.

The data also support the conclusion of the Task Force and almost all witnesses that Subchapter V is operating as intended. Confirmation rates are higher, most debtors confirm plans more quickly, and dismissals occur earlier. The data show that between 45% and 55% of all Subchapter V cases confirm plans, and 69% of these confirmed plans were consented to by all creditor classes.¹ These confirmation rates are favorable compared with confirmation rates under regular Chapter 11 and other non-Subchapter V small business cases. Pre-SBRA, only about 25% of the debtors with assets or liabilities less than \$10 million were able to confirm a plan in regular Chapter 11.² Subchapter V cases also move more quickly, with most businesses reaching confirmed plans within 6.3 months of filing bankruptcy.

Insufficient data exists showing that Subchapter V debtors are failing to make plan payments. Although the postconfirmation performance of Subchapter V debtors requires further study, the Task Force's preliminary investigation reveals that Subchapter V refiling rates are extremely low. Only .014% of all Subchapter V debtors have filed a second Subchapter V case. To be sure, refiling rates are only a small part of evaluating postconfirmation performance of Subchapter V debtors. With more time, data, and analysis, a more complete evaluation of how Subchapter V debtors perform after confirmation will emerge.

B. Congress Should Make the \$7,500,000 Debt Cap Permanent

After extensive study, the Task Force recommends that Congress pass legislation that would make the current \$7,500,000 debt cap permanent (subject to existing adjustment for inflation).

Maintaining the debt cap at \$7,500,000 provides consistency and access to Subchapter V. Because the current cap has been in effect far longer than it has not, most Subchapter V debtors have filed while it has been in place.

¹ See United States Trustee Program, Chapter 11 Subchapter V Statistical Summary Through November 30, 2023, available at <https://www.justice.gov/media/1221551/dl?inline>; United States Trustee Program, Chapter 11 Subchapter V Statistical Summary Through September 30, 2023, available at <https://www.justice.gov/ust/page/file/1499276/download>.

² Ed Flynn, "Chapter 11 Is for Individuals and Small Business?," XXXVII *ABI Journal* 12, 102-03, December 2018.

The \$7,500,000 debt cap has existed for all but the first six weeks after the effective date of Subchapter V (February 19 to March 26, 2020) and two months in 2022 (March 27 to June 21, 2022) due to temporary legislation that increased the debt cap. Because Congress raised the debt cap so soon after Subchapter V went into effect, no basis exists for evaluating how the lower debt cap version of the subchapter would work. The lower debt cap, therefore, has not been tested through experience. As one bankruptcy judge observed in a written statement to the Task Force, “[q]uery whether that is a test we want to run at the expense of America’s small businesses, especially now as filings are increasing.”

Reverting to the lower debt cap would make reorganization inaccessible to many smaller businesses. About 30% of all Chapter 11 bankruptcy cases filed between February 19, 2020, and September 30, 2023, were Subchapter V cases. Significantly, more than a quarter of these Subchapter V debtors would have been ineligible for Subchapter V relief under the lower cap.

Moreover, the amount of debt for a small business varies based on the nature of the business, its location, and the reason bankruptcy relief is necessary. For instance, the debt cap may function as a measure of a case’s complexity rather than its size because a very small business could have a very large debt if something unexpected happens. As explained to the Task Force, “large debts do not always mean large businesses.” A case study from the Western District of Virginia illustrates this point. Here, restaurant cases involved a Hepatitis A outbreak which resulted in substantial injuries and several deaths. While contingent and unliquidated, the cases resulted in an estimated near \$40,000,000 in claims. Once insurance coverage was settled, a consensual Subchapter V plan was reached with the tort claimants participating in a \$14,000,000 recovery. Administrative costs were low, and insurance coverage proceeds were distributed exclusively to the tort claimants. In a regular Chapter 11 case, administrative costs would have impeded the debtor’s ability to reorganize and continue operating, and the injured claimants likely would not have recovered as much.

Most witnesses who provided testimony to the Task Force overwhelmingly support making the \$7,500,000 debt cap permanent to maintain consistent access to Subchapter V. At each of the Task Force’s seven public hearings, witnesses on panels comprised of bankruptcy judges, Subchapter V trustees, and practitioners advocated for maintaining the Subchapter V debt eligibility threshold at \$7,500,000 to preserve Subchapter V as a meaningful restricting tool.

The Task Force also surveyed American Bankruptcy Institute members about their experiences with Subchapter V and circulated the survey to invite responses from members of other major insolvency organizations. Overall, the survey responses indicate that Subchapter V is achieving its goal of streamlining the reorganization process for smaller businesses. Relevant to eligibility, many respondents, when asked to identify one change to Subchapter V they would like made, advocated for making the \$7,500,000 debt cap permanent or increasing it, while only one advocated for a lower cap. In short, most bankruptcy professionals involved in Subchapter V cases report that the \$7,500,000 debt cap is effective and appropriate and must be maintained.

Indeed, the Task Force heard some witnesses advocate for increasing the Subchapter V debt cap to \$10,000,000, which would align more closely with Chapter 12’s debt cap for family farmers. In 2019, Congress enacted a permanent increase to the Chapter 12 debt cap, which is currently \$11,097,350. Chapter 12-eligible family farmers are a specialized kind of smaller business, and the higher debt cap for these entities reflects the scale and scope of their operations. Prospective Subchapter V debtors are likewise smaller businesses, so some rationale exists for mirroring the debt limits of Subchapter V and Chapter 12.

In comparison, reverting to the lower cap would align Subchapter V eligibility more closely with Chapter 13 eligibility, which provides bankruptcy relief for consumers with regular income. In 2022, Congress temporarily increased the debt cap for Chapter 13 eligibility to \$2,750,000. While Subchapter V debtors may be more like Chapter 12 farm debtors subject to an \$11,097,350 debt cap than Chapter 13 consumer debtors subject to a \$2,750,000 debt cap, many small businesses may not have the same extensive debt structure as farms that would justify an increase of the debt cap to \$10,000,000 at this time. The Task Force believes that further research, data, and study are needed prior to making any such adjustment.

A few expressed concerns to the Task Force that the higher debt cap inadequately protects unsecured creditors. The Task Force understands why creditors might voice these concerns, as Subchapter V does change the timetable for, and the scope of the absolute priority rule in, a small business case. There does not appear to be any quantifiable data to evaluate these concerns. The Task Force did, however, study these concerns under statutory language and in light of the testimony and other evidence offered at the public hearings. The projected disposable income test, which requires payment of earnings to creditors over a three-to-five-year period and is a prerequisite to an owner retaining the business, appears to be an effective modification of the cramdown standard in a Subchapter V case.

In addition, creditors in a Subchapter V case have many of the protections that they would have in a regular Chapter 11 case, including the ability to (i) seek conversion or dismissal of the case, (ii) request removal of the debtor in possession or expansion of the powers of the trustee, (iii) move for relief from the automatic stay or to compel assumption or rejection of an executory contract or lease, and (iv) object to confirmation of the debtor's plan. Thus, although unsecured creditors' rights are different in a Subchapter V case, such concerns do not justify reducing the debt cap back to \$3,024,725.

A few also expressed concern about debtor abuse of Subchapter V if the \$7,500,000 debt cap remains in place. To be sure, not every kind of entity that meets the existing cap can or should be in a Subchapter V case. The Task Force heard testimony on this point throughout its hearings. Most of that commentary emphasized that the Bankruptcy Code has built-in mechanisms to deal with those entities and prevent such abuse. The statute has other eligibility criteria that gate debtors from Subchapter V. Congress excluded categories of debtors—"single asset real estate" debtors, affiliated debtors, and publicly traded companies and their affiliates—to ensure only small business debtors targeted by Subchapter V could elect Subchapter V. In addition, bankruptcy courts have proven themselves well-equipped to address eligibility issues that are appropriately raised by the United States Trustee and other parties in cases. Further, bankruptcy courts can remove Subchapter V debtors in possession and convert or dismiss cases in appropriate circumstances. In short, bankruptcy courts have existing tools to filter out debtors that should not be in Subchapter V.

Moreover, the Task Force heard testimony that Subchapter V has improved the reorganization process and outcomes not only for debtors but also creditors. One experienced Subchapter V trustee described the higher debt cap as "an improvement in the chapter 11 process, particularly because of the shift away from fights over class-gerrymandering and creditor vetoes, with a refocused emphasis on economic recovery by comparing liquidation to future plan projections." The trustee explained that:

In Subchapter V the parties tend to focus more quickly on economic recovery rather than creditor-veto holdout power. And prior to Subchapter V, in those cases where debtors could overcome an unsecured creditor veto with an impaired secured creditor class vote, debtors would often be incentivized to pay general unsecured creditors little or nothing and employ the new value corollary to circumvent the absolute priority rule on cramdown plans, and few of these types of cases

for small business debtors seem to attract competing plans that render a better result for unsecured creditors.

Another practitioner testified that “Subchapter V has also proven effective for creditors,” because allocating payments over a three-to-five-year plan achieves a better result for creditors “as compared to the other viable alternatives for many of these debtors, such as shutting its doors and liquidating.”

V. Conclusion

Subchapter V has proven to be successful in saving small businesses, benefiting numerous owners, employees, and creditors. The Task Force finds, after extensive study, that strong support exists to support legislation that would maintain eligibility for Subchapter V at \$7,500,000 in aggregate noncontingent, liquidated debt. Access to Subchapter V is imperative for this category of debtors that cannot reorganize in a regular Chapter 11 case and would otherwise liquidate and close, thus harming owners, employees, and creditors. After evaluating the data, testimony, and other information available, the Task Force also concludes that cause for reverting to the lower debt cap does not exist.

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