Written Statement of Brian L. Shaw

American Bankruptcy Institute's Subchapter V Task Force

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I am a member of Cozen O'Connor's Bankruptcy, Insolvency & Restructuring Group, resident in the firm's Chicago office. For thirty years, my core bankruptcy practice has focused on the middle market and other privately owned businesses. As such, the Venn diagram that comprises my professional life now includes a material overlap with the world of Subchapter V. This has enabled me to experience the SBRA in practice as counsel for Subchapter V debtors, secured and unsecured creditors, and counterparties to executory contracts, and has left me with thoughts, opinions and suggestions – all of which are mine personally and should not be attributable to my firm or colleagues. Most importantly, and admittedly, all my thoughts on Subchapter V should be taken within the context that I personally believe that the SBRA was the most systematically beneficial set of amendments to the Bankruptcy Code that I have witnessed since I started in the practice.

For more than a decade and up until the last two quarters, the number of Chapter 11 business bankruptcy filings precipitously dropped. Reasons for this dramatic decrease in the use of the Bankruptcy Code by distressed businesses included, but were not limited to, a generally robust economy, low interest rates, an increasing amount of over leveraged debtors who have no value for their unsecured creditors, and the increasing baseline administrative costs associated with Chapter 11.

The last point hit putative small business debtors particularly hard. Administrative costs associated with even the most basic Chapter 11 filing continued to increase, regardless of the amount of assets and claims at issue with a particular debtor, pushing the costs of Chapter 11 out of the reach of the many of the small businesses that needed it most. Moreover, if the small business' owners wanted to keep their business, they would be required to pay additional "new value" to retain their ownership interest. Increasingly, this meant that rather than reorganize, small business were dying on the vine and shutting down, possibly ending up in a Chapter 7 case. The SBRA's modifications to Chapter 11 addressed the cost issue head on – by almost eliminating the existence of creditors' committees and abolishing the absolute priority rule – so that small business are again willing to consider and pursue Chapter 11 filings. That alone is the best evidence of the SBRA's effectiveness – it has brought the option of Chapter 11 back into the tool box for small businesses and their counsel.

So, with the backdrop that I am, on the whole, a fan of Subchapter V, I make the following observations about the use, effectiveness and scope of Subchapter V as it moves through its fourth year of existence.

Use: When the SBRA became effective in 2020, it was ceremoniously dubbed by many as Chapter 11 Lite, or as Chapter 13 for small businesses. The incorrect implication of these phrases was that this new Chapter 11 option for small businesses was both simple and cheap, so much so, that anyone could afford and navigate the process. So, while the enactment of the SBRA was getting widespread news coverage, it was more often than not accompanied by the misguided message that Subchapter V was a simple, low cost version of Chapter 11 that most attorneys could handle regardless of their previous bankruptcy experience. It was an unfortunate message has led to problems when Subchapter V debtors and their counsel underestimating the complexities and costs of Subchapter V and being unprepared for its realities.

In addition, counsel and unsuspecting debtors often believe that Subchapter V magically makes difficult issues that a debtor would face in a regular Chapter 11 case go away. But that is not true. If a secured creditor wants to fight a Subchapter V debtor's use of cash collateral, it can still force the debtor into a full blown cash collateral hearing. If a creditor wants to repeatedly move to modify the automatic stay, or to sue principals of the Subchapter V debtor in another forum, those issue will still exist. And the Subchapter V debtor still has to propose and obtain confirmation of a plan of reorganization, which even with no absolute priority rule and the debtor's expanded cram down powers, is still a complicated bankruptcy document and process.

Finally, the misguided Chapter 11 Lite moniker has resulted in a less expected issue that is raised by sophisticated parties that are surprised when they occasionally find themselves in a Subchapter V. That issue is the erroneous belief that Subchapter V is only for the cheap and easy cases – and that anything that is complicated or deemed sophisticated should not be able to take advantage of Subchapter V despite fitting within its debt cap defined parameters – which belief is wrong.

And that statement, of all of the Chapter 11 Lite issues, best reflects the continuing misperception of Subchapter V that needs to be overcome in order to further increase its use. Namely, that Subchapter V is NOT only for the low-debt, legally uncomplicated debtors or cases with mom and pop owners. Rather, it is a more cost effective version of Chapter 11 for those entities that fit within certain economic guidelines, and the sophistication of the debtor's business or potential legal issues in a putative bankruptcy case are irrelevant to that determination.

Effectiveness: When properly used, Subchapter V is a remarkable tool for the debtor and its equity. Its elimination of creditors' committees and the absolute priority rule, and the ability to stretch administrative claim payments over three to five years, enables small business owners to both afford to file for Chapter 11 protection and keep their business. The SBRA's effectiveness is not complicated, as the removal of the cost burden (which can easily cut administrative expenses in half) and the absolute priority rule has made the psychology of a small business bankruptcy filing much easier to address.

Subchapter V has also proven effective for creditors. Yes, it is true that Subchapter V enables a debtor to stretch creditor payments over a three to five year period without the creditors consent (or affirmative vote). However, when compared to the other viable alternatives for many of these debtors, such as shutting its doors and liquidating, even nominal payments over three to five years achieves a better result for creditors. Moreover, the benefit to creditors may be further enhanced if the debtor is able to continue to do business with the creditor on a going forward basis.

I also do not prescribe to the concept that the SBRA was an anti-creditor act. I have yet to see any indication that Subchapter V is being systematically used to harm creditors as a whole – nor has any such systematic harm been brought to my attention. Moreover, nothing in Subchapter V alleviates the strict laws and rules under which a debtor-in-possession operates, nor removes all of the tools that the Bankruptcy Code gives parties in interest to address and punish misbehaving debtors-in-possession. Some creditors may argue that the exclusivity provision of Subchapter V harms creditors by removing the threat and leverage of a competing plan, but as a practical matter, that is not an undertaking most Subchapter V creditors will consider. And more importantly, it is the protection of that exclusive period that buttresses one of the main benefits of Subchapter V, which is equity keeping its interests, and its removal would undermine that benefit and defeat a basic tenet of the SBRA.

I also believe Subchapter V has been effective for the bankruptcy system as a whole. First, a statutory scheme that is meant to help rehabilitate the economically vulnerable needs to be accessible to the most economically vulnerable that need that help. The SBRA has done that, at least for those businesses that qualify as a "small business debtor" under Subchapter V. Second, the SBRA promotes compromise. The SBRA provides debtors and creditors with certain limitations that discourage zero-sum litigation while pushing the parties towards compromise. So, for example and as noted above, only the debtor can file a plan of reorganization under Subchapter V. That means while a creditor may be disgusted by the debtor's proposed plan, the creditor will have to choose between the debtor's less than satisfactory proposal or the self-harm brought on by a successful motion to convert or dismiss the bankruptcy case (which will presumably insure little or no return to the unhappy creditor).

On the other hand, while a debtor may be able to cramdown its "disgusting" plan on its unhappy creditors, doing so comes with very real costs such as three to five more years of trustee and court supervision and no discretion over the use of its otherwise disposable income during that period – even when the debtor outperforms its plan projections. For what it is worth, in our shop, the restrictions placed on the debtor under a non-consensual plan are described as the "golden handcuffs" for a reason and often they will give a Subchapter V debtor pause and the motivation to compromise with its unhappy creditors. So, while far from a perfect (because bankruptcy is never perfect), the SBRA does effectively promote compromise in a system that greatly benefits from it.

Scope: Subchapter V is a good thing and I believe that the current debt cap should be made permanent and then increased – as it remains the case that many putative debtors with noncontingent liquidated debt in an amount above $7.5 million either still cannot afford Chapter

11, or are not inclined to endure the cost and intangible pain associated with it only to have their family business “saved” for someone else’s benefit. Those are the same economic and psychological realities that Subchapter V has successfully addressed. How high the debt cap should be raised would require some thought, analysis and a lot of congressional persuasion, but historical information that could help identify where the debt cap could fall includes identifying a debt level under which most cases do not generate a creditors committee, or looking at the debt level of all Chapter 11s to see if there is a natural break point between small and larger companies and cases– with the hope being that an increased debt cap can make Chapter 11 accessible to even more companies that currently cannot afford it – as the current form of the SBRA did for those debtors with debt levels under the current cap.

Finally, as also noted above, I believe the eligibility of Subchapter V should remain focused on the debt cap, and stay away from any carve out’s for certain types of debtors or cases that some people feel should not benefit from Subchapter V’s provisions. Any such modifications would risk subjecting the SBRA to some of the same ills as the Bankruptcy Code, generally, when subjected to hyper focused special interests and weaken it. As such, I hope that any future increase in the debt cap is done so without any new restrictions.