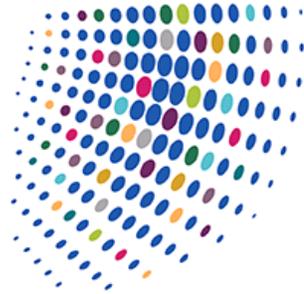


# Alerts & Publications



## CARES Act Expands Simpler Bankruptcy Restructuring Under New Subchapter V to Businesses with Up to Seven and a Half Million in Debt

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Small businesses have historically faced a high barrier to reorganizing through Chapter 11 because, perhaps counterintuitively, bankruptcy has simply been too expensive an option. Not only transaction costs and time required to complete the process, but the likely loss of ownership by small business owners kept small businesses away. To address these issues and provide small businesses a more meaningful opportunity to restructure in Chapter 11, Congress passed the Small Business Reorganization Act of 2019, which became effective in February 19, 2020.<sup>1</sup> More recently, the Coronavirus Aid, Relief, and Economic Security (CARES) Act expanded the scope of small businesses that may qualify for Subchapter V relief. As more small businesses suffer the impact of the global pandemic, this newly available tool may provide the avenue to recovery for many small businesses—not to mention their vendors and employees. This alert highlights the key differences of Subchapter V from a normal Chapter 11 restructuring.

### Eligibility to be a Small Business Debtor

When Subchapter V went into effect, eligibility was limited to debtors engaged in commercial or business activities with noncontingent liquidated debts in an amount no more than \$2,725,625 (excluding debt owing to affiliates or insiders) not less than 50% of which arose from the commercial or business activities of the debtor.<sup>2</sup> Under the CARES Act, this dollar threshold has been increased to \$7,500,000 temporarily through March 27, 2021.<sup>3</sup> Single asset real estate debtors are not eligible.<sup>4</sup>

## Management Retains Control Under the Supervision of a Bankruptcy Trustee

In a typical Chapter 11, either a debtor retains management control over the business and its assets *or*, for cause, a trustee is appointed that displaces management and takes over control. Under Subchapter V, both will co-exist: management of the small business retains control, but a trustee will also be automatically appointed. The trustee will have a narrower set of duties and powers and is tasked with, among other things, “ensur[ing] that the debtor commences making timely payments required by a plan” and “facilitat[ing] the development of a consensual plan of reorganization.”<sup>5</sup>

## Absence of a Creditors’ Committee

Unlike a non-small business Chapter 11 case, the assumption in Subchapter V is that a committee of creditors is *not* appointed unless the bankruptcy court, for cause, orders otherwise.<sup>6</sup> Absence of a committee is intended to reduce administrative costs, avoiding the costs of the committee’s professionals, and speed along the restructuring process.

## Exclusive Opportunity to Propose a Plan

Outside of Subchapter V, a Chapter 11 debtor has a limited period during which it is the sole party permitted to file a plan, and after the lapse of this “exclusivity period”, other parties in interest have the opportunity to present a competing plan.<sup>7</sup> In Subchapter V, however, only the debtor will be permitted to file a plan.<sup>8</sup>

## Accelerated and Streamlined Plan Process

Subchapter V requires a small business debtor to file its Chapter 11 plan within 90 days of the petition date. This deadline can be extended by the court “if the need for the extension is attributable to circumstances for which the debtor should not justly be held accountable.”<sup>9</sup>

The plan process is further streamlined in Subchapter V by eliminating the need to file a disclosure statement separate from the plan.<sup>10</sup> In lieu of a disclosure statement, the plan itself must include: (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.<sup>11</sup>

Lastly, there is no need to obtain the acceptance of an impaired consenting class of creditors for the confirmation of a Subchapter V plan as there would be for other Chapter 11 plans.<sup>12</sup> Although creditors still vote on the plan, the plan may be approved by the court even if no class of creditors accepts. As described below, whether creditors vote for the plan will determine the timing of the company’s discharge from debts.

## Modification of Absolute Priority Rule Allows Owners to Retain Interests

Under the “absolute priority” and “new value” rules, equity holders in a Chapter 11 case are not typically permitted to retain their interests in the company unless either all creditors have been paid in full or the equity holders have provided new value in exchange for the retention of their interests.<sup>13</sup> These rules simply do not apply in a Subchapter V proceeding. As a result, the equity holders of the small business may retain their interests without providing new value even if creditors are not paid in full.<sup>14</sup> The plan need only be “fair and equitable” to holders of unsecured claims. This phrase as used in Subchapter V takes on a meaning more akin to Chapter 13 than Chapter 11: the plan must provide that all of the projected disposable income of the small business debt is applied to pay creditors through the plan for a period of 3 to 5 years.<sup>15</sup>

## Payment of Administrative Expense Claims May be Deferred

Usually, to confirm a Chapter 11 plan, the plan must provide for payment in full of all administrative expense claims (i.e. post-petition expenses) on the effective date of the plan.<sup>16</sup> Under Subchapter V, on the other hand, administrative expenses can be paid over the life of the plan.<sup>17</sup> As a result, creditors doing post-petition business with a debtor may see their claims stretched out over a 3 to 5-year period.

## Discharge

The ultimate goal of any bankruptcy is discharge of debts and an order by the court that the debtor is no longer liable for debts. A small business debtor is entitled to a discharge of liability on its unpaid debts either (1) upon confirmation of the Subchapter V plan if each class of creditors votes to accept the plan, or (2) otherwise, as soon as practicable after the debtor has completed all of the payments under its plan.<sup>18</sup>

## Conclusion

With the above departures from typical Chapter 11 requirements and the expanded size eligibility from the CARES Act, Subchapter V provides small business debtors with a cheaper and quicker restructuring alternative.

<sup>1</sup> See 11 U.S.C. §§ 1181–1195.

<sup>2</sup> 11 U.S.C. § 101(51D).

<sup>3</sup> CARES Act, § 1113.

<sup>4</sup> 11 U.S.C. § 101(51D).

<sup>5</sup> 11 U.S.C. §§ 1183–1184.

<sup>6</sup> 11 U.S.C. § 1102(a)(3).

<sup>7</sup> 11 U.S.C. § 1121.

<sup>8</sup> 11 U.S.C. § 1189(a).

<sup>9</sup> 11 U.S.C. § 1189(b).

<sup>10</sup> 11 U.S.C. §§ 1181(b), 1187(c).

<sup>11</sup> 11 U.S.C. § 1190(1).

<sup>12</sup> 11 U.S.C. § 1191(b).

<sup>13</sup> 11 U.S.C. § 1129(b)(2)(B)(ii)

<sup>14</sup> 11 U.S.C. § 1191(c).

<sup>15</sup> 11 U.S.C. § 1191(c)(2). “Disposable income” means income received by the debtor that is not reasonably necessary for (1) maintenance or support of the debtor or a dependent, (2) a domestic support obligation that first become payable post-petition, or (3) the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor. 11 U.S.C. § 1191(d).

<sup>16</sup> 11 U.S.C. § 1129(a)(9).

<sup>17</sup> 11 U.S.C. § 1191(e).

<sup>18</sup> 11 U.S.C. § 1191(a) and (b).

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