Arent Fox

Credit Research Foundation

Subchapter V: Getting the Most Out of Small Business Reorganizations

Presented by
M. Douglas Flahaut, Esq.
Justin A. Kesselman, Esq.
Arent Fox LLP

Arent Fox LLP

- Founded in 1942, Arent Fox is internationally recognized in core practice areas where business and the law intersect. With more than 450 lawyers and professionals, the firm provides strategic legal counsel and multidisciplinary solutions to a global roster of corporations, governments, and trade associations.
- Arent Fox's Bankruptcy & Financial Restructuring practice has been recognized by *Forbes* as one of the best and most recommended firms for bankruptcy and financial restructuring counseling among corporate law firms in America. *U.S. News & World Report* and *Best Lawyers* also ranked our practice as one of the best in the nation in its 2020 "Best Law Firms" rankings.
- The firm handles financial and corporate restructurings and recapitalizations, bankruptcy and strategic litigation, and distressed and stressed asset and corporate acquisitions, all in a variety of industries throughout the country, including healthcare, and Chapter 9 municipal proceedings.

Arent Fox

Credit Research Foundation

A Friend of the Foundation

Arent Fox is proud to be a Friend of the Foundation and a trusted partner and supporter of the Credit Research Foundation for over a decade.

We hope everyone is safely navigating these challenging times. The CRF Board, Bill, and Matt have done an exceptional job over the last nine months innovatively steering the CRF through this new virtual environment.

Arent Fox is grateful for the opportunity to deliver important content and share our insights and ideas with the CRF family. We look forward to seeing all of you in person soon. In the meantime, we hope you enjoy the recorded content and please feel free to reach out with any questions.

– George Angelich
Arent Fox LLP

Arent Fox

Credit Research Foundation

Subchapter V Roadmap

- Overview of Subchapter V
- Who can be a Subchapter V Debtor?
- Key Differences: Traditional Chapter 11 vs. Subchapter V
- Strategies for Trade Creditors
- Around the Bend in Small Business Bankruptcy
- Bonus Topic: New Preference Laws

Arent Fox

Credit Research Foundation

Overview of Subchapter V

- **Who is affected?**
  - Small Businesses and their Creditors
- **What is it?**
  - Streamlined, Faster, and More Cost-Effective Reorganization
- **Where do I find it?**
  - Subchapter V of Chapter 11 (11 U.S.C. §§ 1181-1195)
- **How does it work?**
  - Debtors can reorganize and retain equity by paying disposable income to creditors over 3-5 years
- **When did Subchapter V become available?**
  - February 2020, through Small Business Reorganization Act of 2019 ("SBRA")
- **Why do I need to understand Subchapter V?**
  - Gaining popularity (esp. California, Texas, and Florida) as law develops and economic difficulties
  - Expanded eligibility during COVID-19 crisis (and possibly beyond)
  - Modifies Chapter 11 in some significant ways, including with respect to case timelines and creditors' rights

Arent Fox

Credit Research Foundation

Who Can Be A Subchapter V Debtor?

- Individuals or entities engaged in commercial or business activities (11 U.S.C. § 1182)
- Debtor must affirmatively opt-in (choose) to be a Subchapter V debtor.
- Debtor's total non-contingent and liquidated debts (secured and unsecured) as of the petition date must be "not more than $7,500,000"
  - Originally, only accessible to debtors with $2,725,625 or less of such debts
  - Debt limit will reset on March 27, 2021 without congressional action
- Key Disqualifiers:
  - (1) Any member of a group of affiliated debtors has debts greater than $7,500,000;
  - (2) Debtor is a publically traded company;
  - (3) Debtor is an affiliate of a publically-traded company.
- Thirty (30) days to object to designation after meeting of creditors (Fed. R. Bankr. P. 1020)

Arent Fox

Credit Research Foundation

Traditional Chapter 11 vs. Subchapter V

Traditional Chapter 11	Subchapter V
Debtor-in-Possession or Trustee	Debtor-in-Possession and Trustee
Creditor May File Plan After Debtor Exclusivity Expires	Only Debtor May File Plan
No Plan Solicitation without Disclosure Statement	No Separate Disclosure Statement Requirement
Plan May Be Filed Within 180 Days (or longer)	Plan Must Generally Be Filed Within 90 Days
UST May Appoint Creditors' Committee	No Creditors' Committee, Unless Court-Ordered
Absolute Priority Rule Applies	Absolute Priority Rule Does Not Apply
At Least One Impaired Class Must Assent to Plan	Plan May Be Confirmed Without Creditor Assent
Debtor Pays Fees to UST on Disbursements	No UST Fees
Administrative Claims Paid on Effective Date	**Administrative Claims May Be Paid Over 3-5 Years**

Arent Fox

Credit Research Foundation

Strategies for Trade Creditors

- Check whether Debtor has opted-in to Subchapter V
- Verify Debtors' Qualifications for Subchapter V and Consider Objection within 30 Days
  - Within debt limits
  - Accurate "contingent" and "liquidated" designations
  - Check for publicly-traded affiliates
- Pivot to the expedited case timeline
- Carefully review Court notices
  - Court may set Bar Dates and other deadlines sooner than traditional Chapter 11 cases
- Beware the 3-5 Year Stretch of Administrative Claims
  - Evaluate leverage: do you provide an essential product or service to the reorganization?
  - Attempt to negotiate ongoing payment during case and/or payment on plan effective date
- Become more involved, especially given lack of Creditors' Committee

Arent Fox

Credit Research Foundation

Strategies for Trade Creditors (cont.)

- Work with the Subchapter V trustee
  - Monitors Debtor compliance and may oppose the Debtors' discharge
  - Has right to obtain information about Debtors' financial affairs, and duty to furnish information on request
  - Holds funds pending confirmation; returns fund (less admin claims) if plan not confirmed
  - Assists the Debtor in developing a consensual and confirmable plan (11 U.S.C. § 1183(b)(1))
- Evaluate Expanded Powers for Subchapter V trustee
  - Upon request, Court may expand investigatory powers to that of a traditional Chapter 11 trustee (11 U.S.C § 1183(b)(2))
- Scrutinize DIP Financing Requests
  - DIP Financing is a common feature of traditional Chapter 11 cases, typically priming other creditors
  - May be less justified in a Subchapter V case where administrative claims may be stretched
- Consider voting to reject plan
  - Creditor support, although not essential, will be considered by the bankruptcy court
  - Debtors have less flexibility in plan terms without creditor support, and may be motivated to negotiate

Arent Fox

Credit Research Foundation

Around the Bend in Small Business Bankruptcy

- COVID-19 Bankruptcy Relief Extension Act, proposed in Senate on February 25, 2021
  - If passed, will extend $7.5 million debt ceiling to **March 27, 2022**

- Recently enacted Consolidated Appropriations Act, 2021 (CAA) could open up PPP loans to Subchapter V debtors (but not regular chapter 11 debtors)
  - Revisions to the Bankruptcy Code allowing PPP loans as DIP financing are contingent upon approval of the U.S. Small Business Administration (SBA)
  - SBA has not yet revised its regulations to permit PPP loans to debtors
  - CAA included several other changes to bankruptcy laws not contingent on SBA approval

Arent Fox

Credit Research Foundation

New Preference Laws

- Trustees can "avoid" (or claw back) preferential transfers that the debtor made to creditors within 90 days before the bankruptcy case (or 1 year if made to an insider), provided certain conditions are met (11 U.S.C. § 547)
  - Creditors may have defenses, including that the payment was made in the ordinary course of business or the creditor provided new value to the debtor following the transfer.
- The CARES Act added a new requirement that requires the trustee to conduct a reasonable investigation into the existence of potential defenses, prior to bringing a preference lawsuit against a creditor
  - The CARES Act also increased threshold to $25,000 to bring a preference action outside defendant's jurisdiction
- The CAA also added a new defense for suppliers, which provides a preference safe-harbor for payments made pursuant to a forbearance agreement or arrangement. The requirements are technical:
  - The supplier contract underlying the payment deferral agreement must be an "executory contract"
  - Payment must not exceed the amount that was due before March 13, 2020.
  - Protected amount cannot include late fees, penalties, or default interest for failing to make payments that came due before March 13, 2020.

Arent Fox

Credit Research Foundation

Questions?

George P. Angelich
Partner
212.457.5423
george.angelich@arentfox.com

M. Douglas Flahaut
Partner
213.443.7559
douglas.flahaut@arentfox.com

Justin A. Kesselman
Associate
617.973.6102
justin.kesselman@arentfox.com