




1





## ArentFox Schiff LLP

- ArentFox Schiff is internationally recognized in core practice areas where business and the law intersect. With more than 600 lawyers and professionals, the firm provides strategic legal counsel and multidisciplinary solutions to a global roster of corporations, governments, and trade associations.
- ArentFox Schiff's Bankruptcy 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 2021 "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.

Washington, DC | Chicago | New York | Los Angeles | Boston | San Francisco | Lake Forest | Ann Arbor

**Legal Disclaimer**

This communication is provided by ArentFox Schiff LLP for educational and informational purposes only and is not legal advice or an opinion about specific facts. No attorney-client relationship is created, nor is this a solicitation or offer to provide legal services. If you have any questions about the content of this publication, please contact your ArentFox Schiff attorney.

Smart In Your World2afslaw.com

2

## A Friend of the Foundation

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

The CRF Board, Bill, and Matt have done an exceptional job innovatively steering the CRF through the new virtual environment and now back to live in-person events.

ArentFox Schiff is grateful for the opportunity to deliver important content and share our insights and ideas with the CRF family. We look forward to re-connecting in person and please feel free to reach out with any questions.

– George Angelich  
ArentFox Schiff LLP

3

## SBRA: Small Business Reorganization Act of 2019

- Signed by the President on August 23, 2019
- Provides that a *small business debtor* may elect at the time of filing to proceed under a new subchapter V of Chapter 11
- Codified as new 11 U.S.C. §§ 1181-1195
- Effective February 19, 2020 (180 days after enactment)
- Amended as part of The Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) amendments effective for cases filed on or after March 27, 2020

4

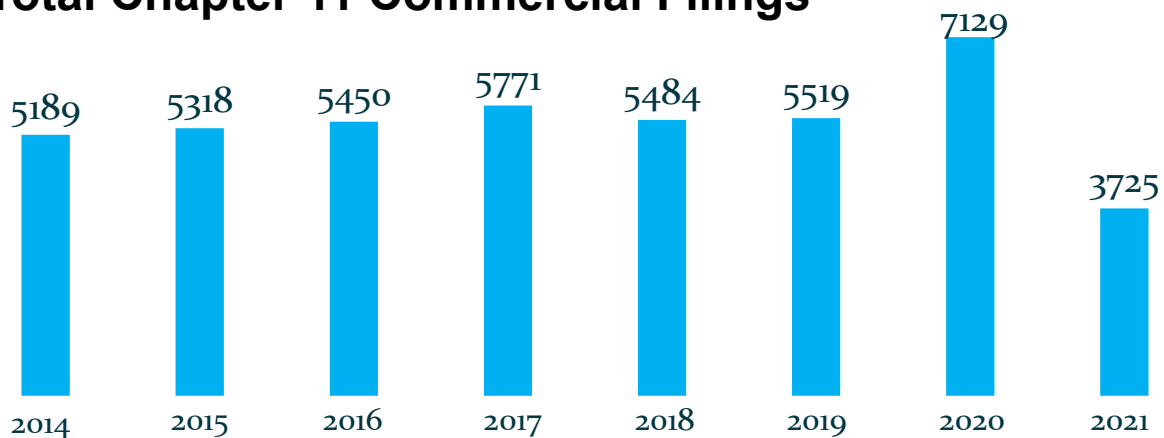
## SBRA: Goals of Key Provisions

- Increase a debtor's ability to negotiate a successful reorganization while retaining control of its business;
- Increase oversight and ensure quick reorganizations; and
- Reduce "unnecessary procedural burdens and costs" by eliminating the creditors' committee and disclosure statement requirements

Debtors electing to proceed under subchapter V are subject to several additional requirements, which includes reporting to the court and parties on progress towards achieving a consensual plan of reorganization and adhering to an accelerated schedule for confirming a plan.

5

## Total Chapter 11 Commercial Filings

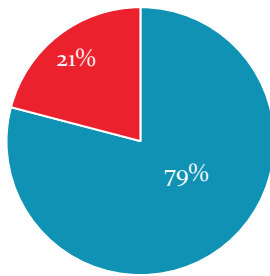


Source: [www.abi.org/newsroom/bankruptcy-statistics](http://www.abi.org/newsroom/bankruptcy-statistics)

6

## Chapter 11 Cases: Standard vs. Subchapter V

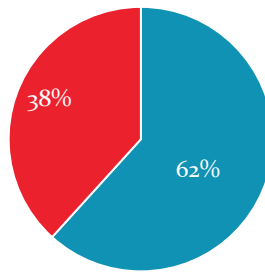
2020 (partial year)



■ Standard Chapter 11 ■ Subchapter V

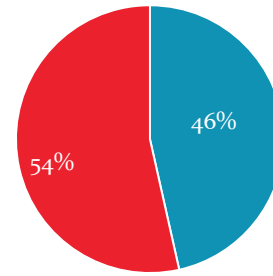
Source: www.abi.org/sbra

2021



■ Standard Chapter 11 ■ Subchapter V

2022 (partial year)



■ Standard Chapter 11 ■ Subchapter V

7

## Gaining Momentum

- 1,362 Subchapter V cases were filed from February-December 2020
- Based on a study of 438 randomly selected cases:
  - Subchapter V debtors were spread across a wide variety of industries, including hospitality, retail, real estate, finance, transportation, construction, and health care
  - More than 50% of Subchapter V cases resulted in confirmed plans by June 2021
  - Approximately 59% of confirmed plans were consensual, **41% were cram-downs**
  - Confirmation was generally achieved within 6 months of the Petition Date
  - Average award of final fees for Subchapter V trustee was \$8,237
    - Source: Hon. Michelle M. Harner, Emily Lamasa and Kimberly Goodwin-Maigetter, "Subchapter V Cases by the Numbers," ABI Journal (Oct. 2021)
- **Contrast:** A prior study of chapter 11 cases from 2008 – 2015 reported confirmation of plans in 25.3% of small business cases and 28% of chapter 11 cases generally
  - Source: Ed Flynn, "Bankruptcy By The Numbers," ABI Journal (Dec. 2018)

8

## Subchapter V Roadmap

- Overview of Subchapter V
- How do I Know It's a Subchapter V Case?
- What Counts as a "Small Business"?
- Key Differences: Standard Chapter 11 vs. Subchapter V
- **Strategies for Trade Creditors**
- Subchapter V in Practice
- Evolving Issues in Subchapter V
- **Timeline and Checklist**

9

## 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 or liquidate faster, retain equity, and pay 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?**
  - Becoming more and more prevalent option for wider range of distressed businesses
  - Modifies Chapter 11 in some significant ways, including with respect to case timelines and creditors' rights

10

## 11 U.S.C. § 1182 provides:

- (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).

11

## What Counts as a “Small Business”?

- Individuals or entities *engaged in commercial or business activities* (11 U.S.C. § 1182)
- 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 about \$2.7 million or less of such debts
  - Debt limit will reset to about \$3 million on March 27, 2022 without congressional action
  - Current efforts to (1) maintain the increased debt limit or increase to **\$10 million**; and (2) make the increase permanent
- In light of these qualifiers, many businesses outside the typical conception of “small business” may be eligible for Subchapter V.
- Key Disqualifiers:
  - (1) Any member of a group of affiliated debtors has debts greater than \$7,500,000;
  - (2) Debtor is a publicly traded company;
  - (3) Debtor is an affiliate of a publicly-traded company;
  - (4) Debtor is a Single Asset Real Estate entity.

12

## Draft Legislation to Permanently Increase Debt Ceiling

### A BILL

To amend title 11, United States Code, to modify the eligibility requirements for a debtor under chapter 13, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*  
 2 *tives of the United States of America in Congress assembled,*  
 \*\*\*

6 **SEC. 2. BANKRUPTCY AMENDMENTS.**

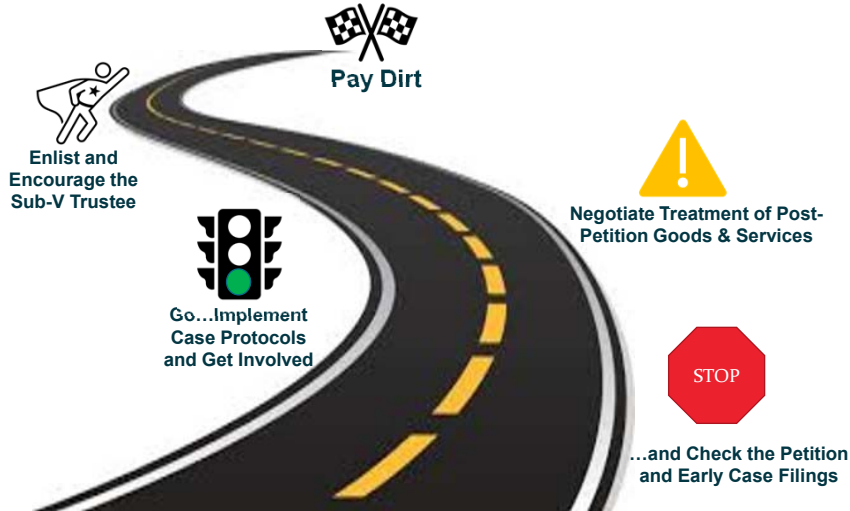
7 (a) CARES ACT AMENDMENT.—Section 1113(a) of  
 8 the CARES Act (Public Law 116–136; 134 Stat. 310) is  
 9 amended by striking paragraph (5).

- Legislation has been drafted (not yet finalized or introduced) to amend the CARES Act by striking the provision sunsetting the \$7.5 million debt ceiling.
- The \$7.5 million ceiling will be increased for inflation at 3-year intervals (beginning in 2025).
- The draft legislation also corrects certain language issues in Subchapter V, including an important clarification on the eligibility of corporate affiliates (limiting the exclusion to affiliates of public companies).

## How do Sub V and Standard Chapter 11 Differ?

Standard Chapter 11	Subchapter V
Debtor-in-Possession <u>or</u> Trustee	Debtor-in-Possession <u>and</u> Trustee
Creditors may file Plan after Debtor exclusivity expires	Only Debtor may file Plan
No solicitation without approved Disclosure Statement	No Disclosure Statement, Faster solicitation timeline
Plan may be filed within 180 Days (or longer)	Plan must generally be filed within 90 days
UST appoints Creditors' Committee	No Creditors' Committee, unless Court-Ordered
Claims Bar Date set by motion	Claims Bar Date may be set automatically within 60-90 days (or earlier by motion)
At least one impaired class must assent to the Plan	Plan may be confirmed <u>without</u> creditor assent
Cram-Down Plans Must Satisfy Absolute Priority Rule: Owners must provide new value to retain equity	Revised Cram-Down: no Absolute Priority Rule; Debtor pays disposable income over 3-5 years
Administrative Claims Paid on Effective Date	Administrative Claims May Be Paid Over 3-5 Years

# Trade Creditor's Strategic Roadmap



15

## How Do I Know It's a Subchapter V Case?

– Check the Petition: the Debtor must affirmatively elect to be a Subchapter V Debtor:

8. Under which chapter of the Bankruptcy Code is the debtor filing? Check one:

Chapter 7

Chapter 9

Chapter 11. Check all that apply:

A debtor who is a "small business debtor" must check the first sub-box. A debtor as defined in § 1182(1) who elects to proceed under subchapter V of chapter 11 (whether or not the debtor is a "small business debtor") must check the second sub-box.

The debtor is a small business debtor as defined in 11 U.S.C. § 101(51D), and its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than \$2,725,025. If this sub-box is selected, attach the most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return or if any of these documents do not exist, follow the procedure in 11 U.S.C. § 1116(1)(B).

The debtor is a debtor as defined in 11 U.S.C. § 1182(1), its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than \$7,500,000, and it chooses to proceed under Subchapter V of Chapter 11. If this sub-box is selected, attach the most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return, or if any of these documents do not exist, follow the procedure in 11 U.S.C. § 1116(1)(B).

A plan is being filed with this petition.

Acceptances of the plan were solicited prepetition from one or more classes of creditors, in accordance with 11 U.S.C. § 1126(b).

The debtor is required to file periodic reports (for example, 10K and 10Q) with the Securities and Exchange Commission according to § 13 or 15(d) of the Securities Exchange Act of 1934. File the Attachment to Voluntary Petition for Non-Individuals Filing for Bankruptcy under Chapter 11 (Official Form 201A) with this form.

The debtor is a shell company as defined in the Securities Exchange Act of 1934 Rule 12b-2.

Chapter 12

– Thirty (30) days to object to designation after meeting of creditors (Fed. R. Bankr. P. 1020)

16



## Engaging the Subchapter V Trustee

- Operationalize an early case letter or email to the Subchapter V Trustee:

Dear [Mr./Ms.] [Subchapter V Trustee]:

We understand you have been appointed as Subchapter V Trustee of [Debtor]. I am the [title] of [Creditor], a creditor of [Debtor]. We are looking to get up to speed quickly in the Debtors' bankruptcy case and request a conference on the following topics:

- The Debtor's Plan and timeline of the case;
- Proposed payments to creditors;
- The Debtor's assets, including any causes of action;
- Evaluation of liens on the Debtor's assets;
- Efforts undertaken to market the Debtor's assets;
- Releases of insiders; and
- Available information about the Debtor's financial condition and viability as a going concern.

Please advise of some dates and times over the next week when you would be available for a call.

Kind regards,

[Creditor Representative]

- Consider what information you may be able to provide to the Subchapter V Trustee to create pressure on the Debtor to improve the Plan.

17

## Evolving Issues in Sub V: The role of the Trustee

- Generally, the aggressiveness or passivity of Subchapter V Trustee varies from case to case
- Likewise, attempts to circumvent or minimize the Trustee's role have had varying outcomes
  - In re Wildwood Villages, LLC: Attempt to create class action distribution process denied as an attempted "overlay" on Subchapter V Trustee's duty to distribute payments after confirmation.
- Disinterestedness of the Trustee
  - In re 218 Jackson, 2021 Bankr. LEXIS 2232 (MD Fla. Aug. 17, 2021): subchapter V trustee who represented a creditor in a simultaneous bankruptcy of another company with common management was removed after aggressive conduct. The Bankruptcy Court denied his fee application and ordered disgorgement of fees.
- Confidentiality and Privilege Issues
  - It is unclear to what extent the Trustee can hand over the Debtor's information to creditors. Some commentators suggest the common interest doctrine applies, which requires (1) communication made by separate parties in a matter of common interest, (2) communication was designed to further that effort, and (3) the privilege has not been waived.
    - Camisha L. Simmons, "Can Subchapter V Trustees Invoke the Common-Interest Doctrine?" 40-DEC. Am. Bankr. Inst. J. 18 (Dec. 2021).
  - Settlement discussions / communications always confidential.

18

## Proofs of Claim

Claims bar dates vary in Subchapter V Cases but often are automatically set by the court earlier than in other Chapter 11 or Chapter 7 cases – i.e. within 60-90 days of the petition date.

- Watch for the notice of claims bar date.
- Same proof of claim form as all other bankruptcy cases – i.e., Form B 410.
- Because the Subchapter V Trustee will be new to the case, clearly and concisely describe the nature of your claim in a rider or attachment which can be included as an exhibit to the proof of claim along with the documents supporting the claim.
- Rider may also want to include certain reservation of rights, e.g.:
  - “Claimant reserves the right to (i) further amend, modify, supplement, or update this claim at any time or in any respect; (ii) file a request for allowance and/or payment of administrative expenses in accordance with 11 U.S.C. §§ 365, 503 and 507; (iii) enforce its setoff and contribution rights or otherwise as set forth in 11 U.S.C. § 553 and/or as permitted under applicable state law; (iv) file additional proofs of claim in respect to any other claim, liability, or indebtedness of the Debtor to Claimant; and (v) assert additional fees, costs, and charges owed under the subject claim according to proof.”
  - “The filing of this claim is not: (i) a waiver or release of Claimant’s rights against any person, entity, or property; (ii) a consent by Claimant to the jurisdiction with respect to the subject matter of this claim, any objection, or other proceeding commenced in this case against or otherwise involving Claimant; (iii) a waiver of the right to move to withdraw the reference, or otherwise to challenge the jurisdiction of this Court, with respect to the subject matter of this claim, any objection or other proceeding commenced with respect thereto or any other proceeding commenced in this case against or otherwise involving Claimant, or to assert that the reference has already been withdrawn with respect to the subject matter of this Claim, any objection or other proceeding commenced with respect thereto or any other proceeding commenced in this case against or otherwise involving Claimant; (iv) an election of remedy; or (v) a waiver of any past, present, or future defaults or breaches.”

19

## Strategies for Trade Creditors

- Check whether Debtor has opted-in to Subchapter V and Pivot to the expedited case timeline: Get In Early
  - Become more involved, especially given lack of Creditors’ Committee
- Verify Debtors’ Eligibility for Subchapter V and Consider Objecting
  - Within debt limits?
  - Accurate “contingent” and “liquidated” designations?
  - Does it have publicly-traded affiliates?
- Carefully review pleadings and Court notices, especially early in the case
  - 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
- Scrutinize liquidation analysis and compare to plan projections: where is the best path to realizable value?
- Special consideration if you are secured: 1111(b) election

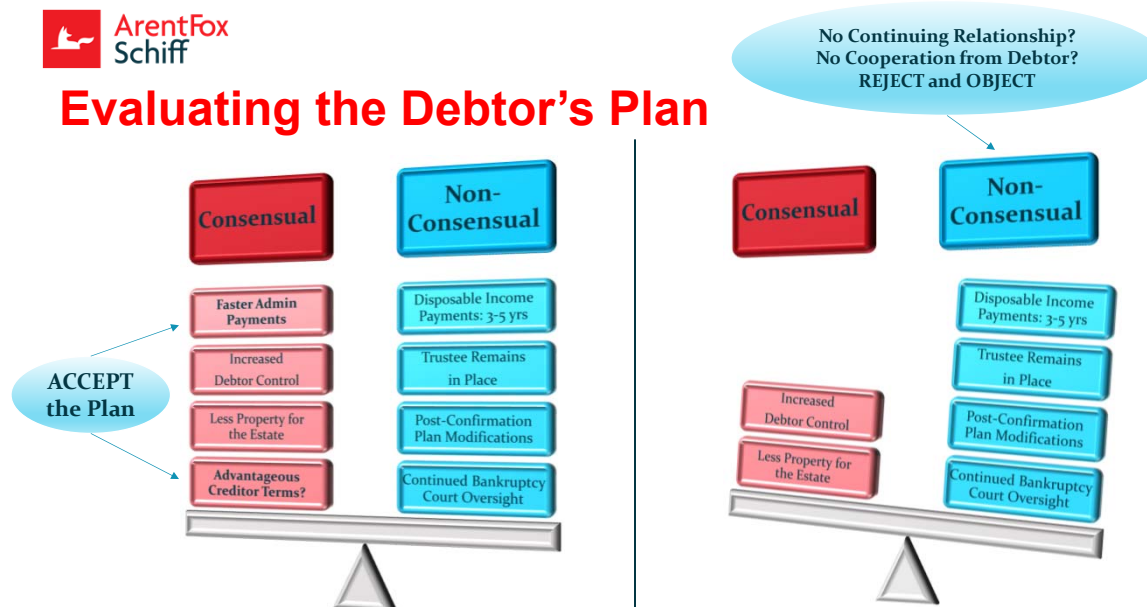
20

## 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 standard Chapter 11 trustee (11 U.S.C § 1183(b)(2))
- Scrutinize DIP Financing Requests
  - DIP Financing is a common feature of standard 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

21

## Evaluating the Debtor's Plan



22

## Subchapter V in Practice

- Soho Operational Logistics Corp. (“SOL”), based in New York, supplies and maintains point of sale software for restaurants and other food retail establishments across the country, including a chain of fast-casual eateries in Southern California, called Bengal’s Bagels.
- Bengal’s Bagels experienced reduced revenues during the COVID-19 pandemic, had trouble maintaining adequate staffing, and accrued significant liabilities to employees, landlords, taxing authorities, and trade vendors, including more than of \$100,000 in past due invoices from SOL. Although SOL has not terminated the contract, it stopped providing software updates and other services until Bengals Bagels comes current.
- Meanwhile, during the recent run-up to the Super Bowl, local sports fans boycotted stores to show solidarity with the L.A. Rams. Bengals Bagels was forced, at least temporarily, to close all locations. Current liabilities are less than \$7.5 million, but potential lease default damages would push them over \$10 million.
- Bengals Bagels files for Subchapter V in California, filing numerous documents with the Bankruptcy Court, including a Plan contemplating (i) the re-opening of half of its locations and rejection of leases for the remainder; (ii) the sale of the remaining operations and IP, along with vendor contracts (including SOL) assigned to the buyer; (iii) the payment of all pre- and post-petition obligations over 5 years. The Debtor has demanded that SOL resume software updates to fix a critical bug that is impeding resumption of operations.

## Is SOL Out of Luck?

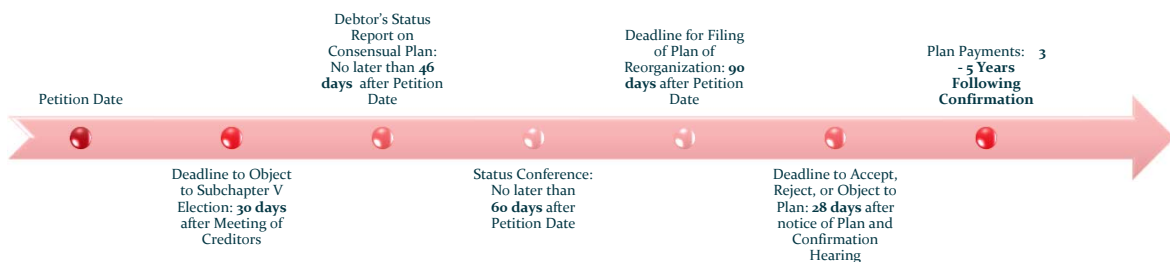
- What should SOL’s first steps be?
  - Check the Petition for Subchapter V election
  - Review the terms of the proposed assumption and assignment of its contract, including cure amount
- Should SOL refuse to resume services?
  - No, the contract has not been terminated and SOL must be wary of the automatic stay. However, SOL should demand continued performance by Bengal’s Bagels under the terms of the contract post-petition.
  - Practice Pointer: A goods supplier may have different rights under the Uniform Commercial Code.
- What leverage points can SOL press?
  - Gauge bargaining position based on critical role in the reorganization and sale
  - Consider and/or signal an objection and vote against the Plan to obtain better terms
  - Engage with the Subchapter V Trustee, whose focus is to secure a consensual Plan
  - Consider an objection to Bengal’s Bagels’ Subchapter V eligibility

## Should Bengal's Bagels be in Subchapter V?

- As of the Petition Date, is Bengals Bagels *engaged in commercial or business activities*?
  - Yes. Courts have generally construed this broadly to include : (a) maintaining bank accounts; (b) collecting accounts receivable; (c) maintaining at least some personnel; (d) engaging in efforts to sell assets; (e) analyzing litigation claims.
    - In re Vertical Mac Construction, LLC, 2021 WL 3668037 (Bankr. M.D. Fla. July 23, 2021).
    - In re Offer Space, LLC, 629 B.R. 299 (Bankr. D. Utah 2021).
  - Examples of disqualified companies are those that have been closed for some time, have no remaining personnel, and have largely liquidated their assets prior to filing for bankruptcy.
    - In re Thurmon, 625 B.R. 416 (Bankr. W.D. Mo. 2020).
  - The cases underscore that although Subchapter V was intended to facilitate “reorganizations”, it has generally been construed to allow liquidations, so long as there are materials and/or assets requiring commercial activity to liquidate.
- Will Bengal's Bagels' rejection of leases affect its eligibility?
  - No. Although leases are rejected as of the Petition Date, it requires a post-petition act and therefore lease rejection damages are contingent and unliquidated as of the Subchapter V filing and are not counted against the cap.

25

## Subchapter V Timeline and Checklist



- Check the Petition for Subchapter V election
- Evaluate Debtor's qualification for Subchapter V
- Review all Court notices for bar dates and deadlines
- Calendar the expedited timeline, bar dates, and deadlines
- Work with the Subchapter V Trustee to further your interests
- Re-assess continued supply of goods and services on credit in light of possible 3-5 year stretch of payments
- Negotiate payment terms for post-petition goods and services
- Carefully evaluate treatment under Plan and consider voting to reject, but raise concerns with Subchapter V Trustee first
- Consider moving to expand Subchapter V Trustee's powers

**Legal Disclaimer**

This communication is provided by ArentFox Schiff LLP for educational and informational purposes only and is not legal advice or an opinion about specific facts. No attorney-client relationship is created, nor is this a solicitation or offer to provide legal services. If you have any questions about the content of this publication, please contact your ArentFox Schiff attorney.

26



Contact ArentFox Schiff with questions about Subchapter V, Bankruptcy and Creditor Rights

New York



**George P. Angelich**  
Partner  
212.457.5423  
[george.angelich@afslaw.com](mailto:george.angelich@afslaw.com)

Los Angeles



**M. Douglas Flahaut**  
Partner  
213.443.7559  
[douglas.flahaut@afslaw.com](mailto:douglas.flahaut@afslaw.com)

Boston



**Justin A. Kesselman**  
Partner  
617.973.6102  
[justin.kesselman@afslaw.com](mailto:justin.kesselman@afslaw.com)

Smart In Your World

Washington, DC | Chicago | New York | Los Angeles | Boston | San Francisco | Lake Forest | Ann Arbor

[afslaw.com](http://afslaw.com)

27



**AFSLAW.COM**

Washington, DC | Chicago | New York | Los Angeles | Boston | San Francisco | Lake Forest | Ann Arbor

28