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TO

A GUIDE TO THE SMALL BUSINESS REORGANIZATION ACT OF 2019 (JULY 2021 REVISION)

Paul W. Bonapfel
U.S. Bankruptcy Judge, N.D. Ga.

The original version of *A Guide to the Small Business Reorganization Act of 2019* was published at 93 Amer. Bankr. L. J. 571 (2019). Revisions were distributed in February 2020, May 2020, and July 2020. Supplements were added (effectively as "pocket parts") as Chapter XIV in November 2020 and as Chapter XV in April 2021.

The July 2021 revision merged the material in the "pocket parts" into the body of the text (thus eliminating Chapters XIV and XV) and included other editorial revisions.

The American Bankruptcy Institute has published an ebook version:
https://store.abi.org/sbra-a-guide-to-subchapter-v-of-the-u-s-bankruptcy-code.html

III. Debtor's Election of Subchapter V and Revised Definition of "Small Business Debtor"

III B. Eligibility for Subchapter V; Revised Definitions of "Small Business Debtor" and "Small Business Case"

Page 18, add at end of footnote 42

See also In re Caribbean Motel Corp., 2022 WL 50401 (Bankr. D. P.R. 2022) (motel renting rooms by the hour generating five to seven percent of income from providing food service on request and selling goods such as prophylactics and aspirin is not a single asset real estate debtor).

III C. Debtor Must Be "Engaged in Commercial or Business Activities"

Page 20, add at beginning of section

If a debtor is conducting active operations at the time of filing, it plainly meets the eligibility requirement that the debtor be "engaged in commercial or business activities." A nonprofit entity, such as a homeowner's association, meets the requirement even though it does not have a profit motive. *In re Ellingsworth Residential Community Association, Inc.,* 2021 WL 3908525 (M.D. Fla. 2021).

In a chapter 12 case, the court in *In re Mongeau,* 633 B.R. 387 (Bankr. D. Kansas 2021), ruled that debtors who had discontinued their own farming operations were nevertheless "engaged in farming" based on their involvement in the operation of farms of their extended family, their intent to continue farming operations in the future, and their ownership of some farm assets. The court relied in part on subchapter V cases concluding that winding down a business that had ceased operations on the filing date is sufficient to be "engaged" in business activities. *Id.* at 397.

Page 23, add at end of section

In re Rickerson, 2021 WL 5905974 (Bankr. W.D. Pa. 2021), also ruled that eligibility requires that the debtor be engaged in commercial or business activities on the petition date.

III C 2. What activities are sufficient to establish that the debtor is "engaged in commercial or business activities" when the business is no longer operating

Page 26, insert after end of indented quotation in first full paragraph

In re Rickerson, 2021 WL 5905974 (Bankr. W.D. Pa. 2021), rejected *Ikalowych's* conclusion that an employee is "engaged in commercial or business activities" for purposes of sub V eligibility. The court reasoned that the ordinary meaning of the phrase does not encompass "an employee who is in an employment relationship with an employer – at least where the employee has no ownership or other special interest with an employer." *Id.* at *7.

Ikalowych's broad reading, the court explained, "threatens to virtually drain it of any meaning." *Id.* The court continued, *id.*:

> If any person who is an employee is thus engaging in commercial or business activities, and thus potentially eligible to proceed under Subchapter V, why limit it there? What about a debtor whose only source of income is Social Security – cannot such a person nonetheless be said to be engaging in commercial or business activity by purchasing food and gasoline on a regular basis, and therefore potentially be eligible to proceed under Subchapter V?

Page 29, add before third full paragraph (beginning with "The court in In re Blue")

In *Vertical Mac Construction, LLC,* 2021 WL 3668037 (Bankr. M.D. Fla. 2021), the debtor filed a subchapter V case to liquidate its assets and disburse the sale proceeds to creditors.

Shortly after filing the petition, the debtor moved to sell its assets under § 363, and the court approved the sale.

The court denied the U.S. Trustee's objection to eligibility based on the fact that the debtor was no longer operating a business on the filing date. The court concluded that the debtor was engaged in commercial or business activities on the filing date "by maintaining bank accounts, working with insurance adjusters and insurance defense counsel to resolve [various claims] and preparing for the sale of fits assets." *Id.* at * 4.

III D. What Debts Arise From Debtor's Commercial or Business Activities

Page 30, add after first full paragraph in section

In *Lyons v. Family Friendly Contracting LLC (In re Family Friendly Contracting LLC),* 2021 WL 5540887 (Bankr. D. Md. 2021), the former owner of the business and an affiliate that owned the business premises had sold his interests to the current owners of the debtor and an affiliate. The sale had been financed with bank loans on which the debtor and its affiliate were jointly and severally liable. The bank loans comprised over 90 percent of the debt.

The former owner objected to the debtor's eligibility on the ground that most of the debtor's obligations to the bank were incurred primarily for the benefit of the debtor's owners and affiliate and, therefore, did not arise out of the debtor's commercial or business activities. The court concluded that the loans were part of a "fully integrated transaction" that provided benefits to the debtor. *Id.* at * 4.

In determining how much of the debtor's debt arose from its commercial or activities, the court concluded that the eligibility statute "does not require the court to dissect the various benefits obtained by all the parties and, for purposes of § 1182(1)(A), include only debt that is

linked to a direct benefit obtained by a debtor, while excluding debt that directly benefitted others." *Id.* at * 5. Accordingly, the court ruled that the debtor was eligible.

Page 31, insert before last full paragraph

In re Rickerson, 2021 WL 5905974 (Bankr. W.D. Pa. 2021), considered whether an individual's personal tax obligation qualified as a business debt. The court noted that courts had concluded that, for purposes of determining whether a debtor's debts are "primarily consumer debts" for purposes of dismissal for abuse under § 707(b), a personal tax obligation is neither a consumer nor a business debt. *Id.* at *9 (citing *In re Brashers,* 216 B.R. 59 (Bankr. D. Okla. 1998) and *In re Stovall,* 209 B.R. 849 (Bankr. E.D. Va. 1997)).

The *Rickerson* court declined to rule on that basis, however. Instead, the court concluded that taxes owed with regard to income the debtor earned from previous businesses did not arise from commercial or business activities. The obligation arose from the debtor's failure to address taxes she owned on her income, not her commercial and business activities. *Id.* at *10.

IV. The Subchapter V Trustee

VI A. Appointment of Subchapter V Trustee

Page 43, add at end of section

The trustee must be a "disinterested person. § 1183(a). Section 101(14) defines a disinterested person as a person that, among other things, "does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason." § 101(14)(C).

In *In re 218 Jackson LLC,* 631 B.R. 937 (Bankr. M.D. Fla. 2021), the court ruled that the sub V trustee was not a disinterested person because he was not impartial. The trustee

represented a creditor in a chapter 11 bankruptcy case in which the principals of the debtor were the same as those in the case before it. The trustee's representation of the creditor included representation in a state court lawsuit against the principals.

Noting that a unique duty of a sub V trustee is the facilitation of a consensual plan (See Section IV(B)(1)), the court concluded that a sub V trustee must be independent and impartial. *Id.* at 948. The court observed that the trustee had been "openly and actively adverse" to the debtor and that time records showed "no time trying to bring the parties together or encouraging a consensual plan of reorganization." *Id.*

On the facts before it, the court determined that cause existed to remove the trustee under § 324 because the trustee was not independent and impartial and had an interest materially adverse to the debtor's principals. *Id.* at 949. Because, due to the conflict, the trustee's fees were not reasonable or necessary, the court denied the request for compensation.

IV B. Role and Duties of the Subchapter V Trustee

Page 44

For a general discussion of a subchapter V trustee's role and duties, see *In re 218 Jackson LLC,* 631 B.R. 937, 946-48 (Bankr. M.D. Fla. 2021).

IV B 1. Trustee's duties to supervise and monitor the case and to facilitate confirmation of a consensual plan

Page 46, add at end of first full paragraph

The trustee's duty to appear and be heard regarding confirmation gives the trustee standing to object to confirmation.[1]

Page 47, add new paragraph at end of section

[1] *In re* Topp's Mechanical, Inc*.,* 2021 WL 5496560 at *1 n.1 (Bankr. D. Neb. 2021)

In *In re 218 Jackson LLC,* 631 B.R. 937, 947 (Bankr. M.D. Fla. 2021), the court observed that, given the trustee's duty to facilitate a consensual plan, the fact that the debtor remains in possession of estate property, and the absence of a requirement that the trustee investigate the financial affairs of the debtor unless the court orders otherwise, "It is not a stretch then to conclude that the subchapter V trustee's role was intentionally designed to be less adversarial."

VI. Administrative and Procedural Features of Subchapter V

VI J. Extension of deadlines for status conference and debtor report and for filing of plan

Page 90, add to footnote 227, after E.g.,

In re Excellence 2000, Inc*.,* 2022 WL 163400 (Bankr. S.D. Tex. 2022).

Page 94, add new paragraph after line 3:

The need to resolve disputes concerning the debtor's interests in property before filing a plan may justify extending the deadline,[2] but not if the debtor has failed to show that the dispute could not have been resolved prior to the deadline, what progress the debtor has made proposing a plan, and that its resolution is essential to the plan, even in the absence of any objection to the extension.[3]

VII. Contents of Subchapter V Plan

Page 97, add at end of footnote 240*:*

The full text of a somewhat elaborate Subchapter V plan is attached to the confirmation order in *In re Abri Health Services, LLC,* 2021 WL 5095489 at * 11 (Bankr. N.D. Tex. 2021).

[2] *In re* HBL SNF, LLC, 2022 WL 291563 (Bankr. S.D.N.Y. 2022).
[3] *In re* Excellence 2000, Inc., 2022 WL 163400 (Bankr. S.D. Tex. 2022).

VIII. Confirmation of the Plan

VIII A. Consensual and Cramdown Confirmation in General

Page 105, add after first paragraph of section

Official Form B315 contemplates a short confirmation order that identifies the plan and recites that all requirements for confirmation have been met. As in many traditional chapter 11 cases, however, courts in subchapter V cases have entered lengthy and detailed confirmation orders with extensive findings of fact and conclusions of law, even in the absence of objections to confirmation.[4]

VIII B. Cramdown Confirmation Under New § 1191(b)

3. Components of the "fair and equitable" requirement in subchapter V cases; no absolute priority rule

Page 111, add at end of section

Section 1191(c) states that the "fair and equitable" requirement *includes* the factors just mentioned. A plan may also not meet the requirement if it proposes to pay a secured creditor more than it is entitled to receive, thereby reducing the money available to pay unsecured claims.[5]

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[4] *E.g., In re* Roundy, 2021 WL 5428891 (Bankr. D. Utah 2021). *In re* Abri Health Services, LLC, 2021 WL 5095489 (Bankr. N.D. Tex. 2021); *In re* Triple J Parking, 2021 Bankr. Lexis 2304 (Bankr. D. Utah 2021).

[5] *In re* Topp's Mechanical, Inc. 2021 WL 5496560 (Bankr. D. Neb. 2021). The secured creditor in the case had a claim for about $ 3.765 million secured by collateral worth about $ 2.125 million, resulting in an unsecured deficiency claim of about $ 1,640,000. The creditor elected treatment under § 1111(b)(2). As Section VIII(E)(1) discusses, the requirement for cramdown confirmation of an undersecured claim when the creditor elects § 1111(b)(2) requires payments that (1) have a value equal to the value of the collateral and (2) total the full amount of the claim.

The plan proposed to pay the creditor the full amount of the secured portion of the claim with interest, about $ 2.625 million. In addition, the plan provided for payment of the unsecured claim, for total payments of about $ 4.265 million.

The trustee contended that payments of interest on the secured portion of the claim should be taken into account in satisfying the requirement that the creditor receive payments that

VIII B 4. The projected disposable income (or "best efforts") test

Page 112, add to footnote 290

In *In re The Lost Cajun Enterprises, LLC,* 2021 WL 6340185 (Bankr. D. Col. 2021), the court confirmed a plan, over the objection of a creditor, that provided for *pro rata* cash payments to unsecured creditors on the plan's effective date, funded by a capital contribution from the debtor's sole member, equal to the debtor's projected disposable income for three years. The court did not consider whether the time should be longer.

VIII B 4 i. Determination of projected disposable income

Page 113, add at end of page

The definition of "current monthly income" in § 101(10A) specifically excludes Social Security benefits, § 101(10A)(B)(ii)(I), but the subchapter V definition of disposable income does not base the income component on "current monthly income." One commentator has concluded that Social Security benefits are not taken into account in determining projected disposable income in a subchapter V case.[6]

Page 116, add after first two lines

The court in *In re Urgent Care Physicians, Ltd.,* 2021 WL 6090985 at * 10 (Bankr. E.D. Wisc. 2021), permitted an operating reserve based on testimony of the debtor's principal that the

totaled the full amount of its claim. Under this method, the creditor was entitled to receive only approximately $ 1.140 million on its unsecured claim, about $ 500,000 less than the $ 1.190 million the plan proposed to pay. Because the proposed payments to the secured creditor resulted $500,000 less being paid to unsecured creditors, the trustee contended, the plan discriminated unfairly against the unsecured class and was not fair and equitable.

The court concluded that the trustee's interpretation of the cramdown requirements was correct and that, therefore, the plan discriminated unfairly against the unsecured creditors and was not fair and equitable.

[6] Alyssa Nelson, *Are Social Security Benefits "Disposable Income" for the Purposes of Subchapter V?,* 40 Amer. Bankr. Inst. J. 30 (Sept. 2021).

reserve was necessary to protect against shortfalls in cash due to the cyclical nature of the debtor's income.

Page 118, add at end of section

The determination of objections to confirmation based on the PDI requirement requires the court to receive evidence with regard to their accuracy and reliability, which may include testimony from an accountant or financial advisor as well as the debtor's principal.[7]

VIII B 4 ii. Determination of period for commitment of projected disposable income for more than three years

Page 120, add at end of page

Two courts have considered objections to confirmation on the ground that the debtor should pay disposable income to creditors for more than three years.

In re Walker, 628 B.R. 9 (Bankr. E.D. Pa. 2021), which Section VIII(D)(8) discusses in detail, involved a plan that all impaired classes had accepted, so the PDI requirement did not apply. The court rejected the objecting creditor's contention that the debtor's failure to propose payments for more than three years established a lack of good faith.

In re Urgent Care Physicians, Ltd., 2021 WL 6090985 (Bankr. E.D. Wisc. 2021), considered arguments by the U.S. Trustee and creditors that the court should require the debtor to make payments for five years instead of the three years that the plan proposed for the plan to be fair and equitable. The court concluded that a three-year term was appropriate.

The legislative history of subchapter V, the court said, indicated that Congress had recognized that small businesses typically have shorter life-spans than large businesses and that it had enacted subchapter V to permit small businesses to obtain bankruptcy relief in a timely,

[7] *In re* The Lost Cajun Enterprises LLC, 2021 WL 6340185 (Bankr. D. Col. 2021).

cost-effective manner and remain in business, thereby benefitting not only the owners, but also employees, suppliers, customers, and others who rely on the business.

Congress's recognition that small businesses typically have shorter life-spans, the court reasoned, "suggests that a plan term of three years is more reasonable, generally speaking (or as a default), than a five-year term, absent unusual circumstances." *Id.* at *10. The court added that Congress's concern for employees, customers and others, as well as for the small business itself, "reflects an intent to balance the shorter life-span planning of small business and timely cost-effective benefits to debtors, against the benefits to creditors." *Id.*

The court concluded that a three-year term achieved the proper balance. The court noted that the debtor provided outpatient health care for urgent needs, had deferred payments to insiders and some healthcare equipment payments, and had committed to paying at least its projected disposable income. Extending the term for two more years, the court continued, would further defer salary restoration to key staff, and further deferring full repayment of equipment charges could jeopardize availability of the equipment. *Id.* at *11.

The court concluded, *id.* at *11 (citation omitted):

> While at first blush the simple math of an extended plan term might seem to generate a higher payment to unsecured creditors, the inherent risks to the small business debtor of that extension could defeat the unsecured creditors' desire for greater recovery. The three-year term here is fair and equitable, as it properly balances the risks and rewards for both the debtor and its creditors. In these circumstances, the Court declines to fix a longer plan period. A longer plan term would disproportionately harm the debtor in forcing it to accrue additional unpaid expenses and potentially emerge from its reorganization saddled with more debt.

VIII B 5. Requirements for feasibility and remedies for default

Page 122, add after first full paragraph (ending with "in the plan")

The court in *In re Moore & Moore Trucking, LLC,* 2022 WL 120189 (Bankr. E.D. La. 2022), held that a provision in a plan that permitted the objecting secured creditor to foreclose in the event of default was an appropriate remedy that met the requirement of § 1191(c)(3)(B).

Page 124, add after first two lines

Other courts have similarly relied on testimony from an accountant[8] or credible testimony from the debtor's principal[9] to conclude that a plan meets the feasibility requirement of § 1191(c)(2).

Page 124, add at end of section

The court in *In re Lupton Consulting LLC,* 2021 WL 3890593 (Bankr. E.D. Wisc. 2021), concluded that the plan was not feasible because the debtor's financial projections submitted by its principal were not reliable in view of historical data and discrepancies with operating reports..

VIII D 1 Classification of claims; unfair discrimination

Page 128, add at end of section

Unfair discrimination may also occur when a plan proposes to pay a secured creditor more than it is entitled to receive, thereby reducing the money available to pay unsecured claims.[10]

[8] *In re* Moore & Moore Trucking, LLC, 2022 WL 120189 (Bankr. E.D. La. 2022).
[9] *In re* Urgent Care Physicians, 2021 WL 6090985 (Bankr. E.D. Wisc. 2021).
[10] *In re* Topp's Mechanical, Inc. 2021 WL 5496560 (Bankr. D. Neb. 2021). The case is discussed *supra* note 5.

VIII D 2 Acceptance by all classes and effect of failure to vote.

Page 129, add at end of second line

Other bankruptcy courts in the Tenth Circuit have reached the same result.[11]

VIII E. § 129(b)(2)(A) Cramdown Confirmation and Relating Issues Dealing With Secured Claims Arising in Subchapter V Cases

VIII E 1. The § 1111(b)(2) election

Page 142, add to footnote 352

The court in *In re Topp's Mechanical, Inc.* 2021 WL 5496560 (Bankr. D. Neb. 2021), after explaining the competing views, adopted the majority view, concluding that "the interest component of a debtor's stream of payments may serve a dual purpose of satisfying the allowed claim of the creditor and providing present value to the creditor." *Id.* at *6. Because the debtor's plan proposed to pay the secured creditor more than it was entitled to receive as a result of the § 1111(b)(2) election, the debtor had less money to pay to unsecured creditors, who had not accepted the plan. The court therefore ruled that the plan discriminated unfairly and was not fair and equitable.

Page 142, last full paragraph, replace first two sentences

Three courts have considered a creditor's right to make the § 1111(b) election in a subchapter V case. The issue was whether the creditor could not invoke the election because its interest was "inconsequential."

[11] *In re* The Lost Cajun Enterprises, LLC, 2021 WL 6340185 at * 7 (Bankr. D. Col. 2021); *In re* Roundy, 2021 WL 5428891 at * 2 (Bankr. D. Utah 2021); *In re* Robinson, 632 B.R. 208, 218 (Bankr. D. Kansas 2021).

Page 148, add at end of section

The third case is *In re Caribbean Motel Corp.,* 2022 WL 50401 (D. P.R. 2022). The creditor held a claim of about $ 3.1 million secured by collateral worth $ 550,000, about 15% of its claim. Without determining which approach to use, the court concluded that the value of the collateral was not inconsequential. *Id.* at *5-6.

X. Discharge

X B. Discharge Upon Confirmation of a Cramdown Plan Under § 1191(b)

Page 163, add new paragraph at end of section

Catt v. Rtech Fabrications, LLC (In re Rtech Fabrications LLC), 2021 WL 4204800 (Bankr. D. Idaho 2021), followed *Satellite Restaurants* and *Cleary Packaging* and likewise ruled that the exceptions to discharge in § 523(a) are not applicable to an entity in a sub V case.