

Bankruptcy Law Alert

February 2021

New Benefits For Some Businesses Filing Bankruptcy; Many to Lose Eligibility March 27

The Consolidated Appropriations Act, 2021 (CAA), enacted in December 2020, expands on the advantageous reorganization terms already available for distressed companies under Subchapter V of Chapter 11 of the Bankruptcy Code. Now, reorganizing companies have more time to decide whether to keep or reject real property leases and can stretch out lease obligations under a reorganization plan. These benefits build on the important advantages already available in Subchapter V:

- Owners of a small business can retain their equity interests and still shed unsecured debt in many instances.
- Only the filing business may propose a plan of reorganization.
- The filing business can extend payment of its reorganization costs over time.
- There is no official committee of unsecured creditors, just a “standing trustee” with limited authority in the case.

Many small businesses that would benefit from reorganization under Subchapter V will no longer be eligible to file under Subchapter V as of March 27, 2021, however. Since March 2020, Subchapter V has generally allowed companies with noncontingent liquidated debts (excluding obligations to insiders and affiliates) that total \$7.5 million or less to reorganize using its advantageous terms. But this increased debt limit is set to drop back to the prior \$2,725,625 at the end of March. Businesses in financial distress—and their owners—should therefore consider seeking a Subchapter V reorganization well before mid-March in order to avoid the chance that the lowered debt limit could exclude them from the beneficial reorganization terms of Subchapter V.



Additional Subchapter V Benefits for Qualifying Debtors

The CAA expanded the benefits of using Subchapter V to reorganize. These benefits remain in place for bankruptcy cases filed before Dec. 27, 2022.

Reorganizing debtors under Subchapter V can obtain extra time after filing bankruptcy before they must pay rent in many cases. Beyond the 60 days permitted for a debtor to delay rent payment under current law, the CAA now allows a Subchapter V debtor to seek an additional 60-day rent holiday (for a total 120-day rent payment extension) if the business suffers financial hardship as a result of COVID-19. The debtor also can repay the deferred rent over many years under a Subchapter V reorganization plan, an additional advantage for businesses with cash flow concerns.

The CAA gives debtor-lessees extra time to decide whether to keep or shed certain commercial real property leases. Previously under the Bankruptcy Code, these debtors had just 120 days to “assume or reject” a commercial real estate lease and could seek permission only for a 90-day extension of that time from

Attorney Advertising



LOS ANGELES
NEW YORK
CHICAGO
NASHVILLE

WASHINGTON, DC
SAN FRANCISCO
BEIJING
HONG KONG

loeb.com

the bankruptcy court. Under the CAA's amendments to the Bankruptcy Code, all Chapter 11 debtor-lessees will have 210 days to assume or reject commercial real estate leases, a period that can be increased by an additional 90 days with the court's permission. This additional decision time gives bankruptcy debtors that occupy rented business premises enhanced flexibility in formulating a reorganization plan. Debtors may also use the additional time to attempt to renegotiate the terms of their existing leases, particularly in light of the changes in consumer purchasing habits resulting from the COVID-19 pandemic.

The CAA amends Section 364 of the Bankruptcy Code (which governs financing obtained during a bankruptcy case), permitting Subchapter V debtors to apply for and obtain Paycheck Protection Program (PPP) loans. However, the Small Business Administration (SBA) must still act to bring this amendment into effect for small business debtors. Only if the SBA acts will companies in Subchapter V bankruptcy have clear statutory authorization to obtain distressed funding under the PPP program. At this time, the SBA has given no indication that it plans to take steps to make this amendment effective for Subchapter V borrowers.

Even if the SBA ultimately permits Subchapter V debtors to obtain PPP loans, bankruptcy court approval of this financing would still be required. Under the CAA, the court must hear the debtor's request for approval of a PPP loan within seven days. Later, if the loan is not forgiven under the PPP program, the CAA gives this debt "super priority" administrative expense status in the bankruptcy case. This means the PPP loan is paid with priority over any other administrative expenses—though the debtor can repay the PPP loan in installments over time under a Subchapter V reorganization plan (just as a debtor can stretch out other administrative claims too). The CAA also voids any provisions in other loan documents prohibiting the debtor from obtaining a PPP loan.

In addition, the CAA favors certain creditors that give concessions to financially troubled companies that later enter bankruptcy. Under the CAA, some landlords and suppliers accepting deferred payments from debtors before bankruptcy will not have preference liability once the company enters bankruptcy, even where prior law

would have provided otherwise. Normally, deferred debt repayments in the 90 days before a bankruptcy can expose the recipient to a preference clawback. Under the CAA, these payments will not trigger preference liability as long as (1) they were pursuant to an executory contract or lease entered into before the bankruptcy filing; (2) the lease or executory contract was amended after March 13, 2020, to provide for deferred payments; and (3) the amendment did not permit late fees, penalties or interest greater than would have been due absent the amendment.

Even Businesses With Debts Greater than \$7.5 Million May Qualify for Subchapter V

Many qualifying businesses have already elected to proceed under the increased \$7.5 million debt limit, including those with actual claims against them far in excess of \$7.5 million. For example, a number of retail and restaurant debtors, along with their affiliates, have successfully elected to proceed under Subchapter V with outstanding trade and secured debt below the \$7.5 million cap, but with contingent debt (including for rejecting burdensome leases and executory contracts) that ultimately brings the total for actual claims over the \$7.5 million cap.

Certain businesses remain ineligible for Subchapter V treatment, irrespective of the amount of their debt. These nonqualifying entities include companies required to file reports with the Securities and Exchange Commission (SEC) and their affiliates, businesses with the primary activity of owning single-asset real estate, and companies in affiliated debtor groups with debt totaling more than \$7.5 million. So while Subchapter V is a powerful tool for qualifying debtors, limits to its use remain.

Benefits of Subchapter V for Qualifying Debtors

As we noted in our [alert of April 2020](#), utilizing Subchapter V to reorganize in lieu of typical reorganization under Chapter 11 provides advantages to qualifying businesses and their owners. Indeed, since Subchapter V took effect in February 2020, hundreds of businesses have elected to take advantage of the benefits it offers.

Unlike a typical Chapter 11 bankruptcy, in a Subchapter V case:

- Only the debtor can propose a reorganization plan. While the plan must be filed within 90 days of the bankruptcy's commencement, the debtor can seek an extension if the reason is "attributable to circumstances for which the debtor should not justly be held accountable."
- The debtor need not file a disclosure statement with the plan.
- The debtor's owners can retain their equity even if objecting creditors are not paid in full, provided that the proposed plan otherwise meets the requirements for confirmation.
- No impaired class of claims need vote in favor of a plan's confirmation, even if the plan pays creditors less than in full.
- Administrative expenses incurred by the debtor after it files for bankruptcy can be paid over time, even if creditors object.
- No official committee of unsecured creditors is appointed. Instead, a disinterested standing trustee facilitates confirmation of a plan and seeks to ensure the debtor's compliance.
- The debtor does not need to pay certain governmental fees required in other bankruptcy cases.
- An individual debtor can modify debt secured by a principal residence if the debt was used primarily in connection with the debtor's business and not to acquire the residence.

As a result of these advantages, debtors have much more leverage to reorganize under Subchapter V over the objection of creditors. The process is also less expensive and more streamlined than a typical Chapter 11 case. And the CAA has further enhanced the potential advantages of a Subchapter V filing.

Businesses Facing Financial Hardship Should Evaluate Reorganization Options Now to Take Advantage of Subchapter V

Subchapter V is a powerful tool for many financially troubled businesses. The CAA has made Subchapter V even more useful—and flexible—for qualifying debtors. However, since the increased limit of \$7.5 million in noncontingent liquidated debt is set to expire on March 27, 2021, and return to the former \$2,725,625 debt limit, businesses experiencing financial distress should carefully consider their options before the end of March. Timely consideration will help ensure that companies in need of reorganization can take advantage of Subchapter V at the higher debt limit, if they otherwise qualify.

Related Professionals

William M. Hawkins whawkins@loeb.com
Bethany D. Simmons bsimmons@loeb.com

This is a publication of Loeb & Loeb and is intended to provide information on recent legal developments. This publication does not create or continue an attorney client relationship nor should it be construed as legal advice or an opinion on specific situations.

© 2021 Loeb & Loeb LLP. All rights reserved.
6567 REV1 02-08-2021