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Distressed Businesses: On the Road to Recovery

It's a Brave New Bankruptcy World — Enter Subchapter V 11

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It's a Brave New Bankruptcy World — Enter Subchapter V 11

by Lamar Hawkins

“I know I need to file bankruptcy for my business, but I have heard a Chapter 11 is just too expensive.” — Worried Business Owner

Enter the federal government: In rare form, the federal government did businesses and individuals a solid by creating a new form of Chapter 11, called a Subchapter V Chapter 11. It is like a “classic” Chapter 11, but the Subchapter V 11 has streamlined features, which result in significant savings. Consider this, businesses and individuals could potentially save 50% of legal fees for processing a Subchapter V 11, over a classic Chapter 11.

Having confirmed the first consensual Subchapter V 11 Plan in the state of Arizona, let me guide you through the process.

Qualification

The debtor needs to have less than \$7.5 million of debt and the debts need to be primarily (more than 50%) business debts rather than consumer debts. These parameters encompass most small businesses and even some rather large businesses, and most individuals that wouldn't want or be able to qualify for a Chapter 7 or Chapter 13.

The Subchapter V Process

Like all bankruptcy types, a Subchapter V 11 involves the automatic stay, which puts creditors on hold. The administrative steps are very similar to a classic Chapter 11, except that everything is on the fast track. A debtor needs to move through the process quickly. Fortunately, moving quickly also means savings.

The Subchapter V 11 involves: meetings with the United States Trustee's office; a creditors meeting; having budgets approved if a creditor has an interest in the cash, inventory, and accounts receivables and other “first day” motions; a Plan of Reorganization; and ultimately a payment to creditors over time so that the debtor can obtain a discharge. If the debtor's Plan is “consensual” with the creditors, the debtor can achieve their discharge on the same date as the Court confirms the Plan. Confirmation can occur within five months of the bankruptcy filing. Which means that in a Subchapter V 11, it is possible for an individual to obtain a discharge almost as fast as they would obtain one in a Chapter 7 proceeding! Compare the three- to five-year delay in a Chapter 13 or the extensive delay in a Classic 11.

Subchapter V Trustee

A special feature of a Subchapter V 11 is the appointment of a Subchapter V trustee. “Wait! I've heard that trustees are terrible to deal with!” The “V trustee” is not anything like a trustee in any other form of bankruptcy. The V trustee really should have a different name like “assistant” or “helper” or “negotiator.” The V trustee does not run anything — not the business, not the checkbook, not even the plan filing. The V trustee's job is to help the debtor through the process, to negotiate as needed with creditors and to help make sure the debtor gets its Plan confirmed.

Combining an Individual and Business Subchapter V 11

Often a troubled business has owners that have guaranteed much of the debt. The business's problems cause family problems. It is common to jointly administer the bankruptcy of individuals that own the business and the business itself together at the same time. This can result in significant savings over filing separately run cases.

Cost Savings

A Classic 11 can indeed be very expensive depending upon the complexity of the business and the hostility of the

creditors. Since the Subchapter V 11 is streamlined and moves quickly, the savings in legal fees alone could be 50% over a Classic 11.

Complicated Legal Issues

Now is when your eyes may glaze over. A Classic 11 deals with complicated bankruptcy concepts like: (1) the absolute priority rule (neither absolute, nor priority, nor really a rule), and (2) needing a consenting impaired class. If someone were to explain these esoteric concepts to you, first you would yawn, then you might understand them for a few minutes, but later you wouldn't likely remember a thing that they said. Welcome to Classic 11. In a Classic 11, these concepts are critical, hence hiring a bankruptcy attorney may help you. But in a Subchapter V 11, these concepts are OFF the table.

In the Subchapter V 11, all that must be proven is that the Plan is "fair and equitable". Yes, there are various tests for what that means for various types of creditors, but that proof is much easier than the Classic 11 requirements.

Requirements of the Subchapter V Plan

The Plan Subchapter V 11 must include (a) a brief history of the business operations of the debtor; (c) a liquidation analysis; and (c) projections with respect to the ability of the debtor to make payments.

Presently, just about every debtor's history will have some reference to the problems caused by COVID-19. Plus, whatever else caused the debtor to get to the bankruptcy court steps.

A liquidation analysis shows what creditors would get if the debtor had filed a Chapter 7 (liquidation). Commonly, this analysis shows that in a Chapter 7, unsecured creditors would receive little to no return, so that the reorganization effort is best for everyone.

The debtor's projections show how the debtor can operate profitably and pay its creditors over time, including a likely nominal return to unsecured creditors.

The Subchapter V 11 Plan classifies creditors into classes similar to a Classic 11. Creditor claims are treated consis-

tent with what rights the creditor might have to collateral, priority status, and special circumstances. The Subchapter V 11 Plan can change the terms of pre-bankruptcy contracts; such as the debt on a residential property can be written down to the value of the collateral, the loan payment terms can be modified to be consistent with the market place, and even due dates can be extended. Even taxes can be paid over time.

A standard Subchapter V 11 Plan is for three years, but can be shorter or longer depending upon the facts and circumstances of the case and negotiations with creditors.

Ultimately, the unsecured creditors are only going to receive the liquidation value of the assets of the estate. A number that is commonly very low, and at the appropriate time, the debtor receives a discharge just like every type of bankruptcy; the "fresh start" of the process.

The standard confirmation requirements of a Classic 11 are in play, but with competent counsel, those elements can be achieved. In the Subchapter V 11, several of those elements go away, such

as the absolute priority rule, a consenting impaired class, and special requirements for individuals in a Classic 11.

The debtor establishes a separate Plan Fund that if the Plan is consensual, the debtor itself administers to make payments to creditors, and if the plan is not consensual, the debtor uses the V trustee to administer the payments.

Please Sir, May I Have Some More?

To the fearful business owner or individual quoted at the beginning, welcome to the brave new world of Subchapter V 11. You can save your business. You can restructure your debts to a payment that you can afford. You can cause significant unsecured debt to be discharged, all thanks to the new Subchapter V 11 process.

Keep a connection with a good bankruptcy attorney, so you can ask the tough questions when problems arise. ●

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