

Legislative Update

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The \$7.5 Million Subchapter V Debt Limit Should Be Reinstated



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In 2019, Congress introduced the Small Business Reorganization Act (SBRA)¹ to the Bankruptcy Code. The SBRA, codified as subchapter V of chapter 11, became effective on Feb. 19, 2020. Since its enactment, subchapter V has served as a streamlined, cost-effective and efficient bankruptcy option for small businesses and a new opportunity for practitioners. Instantly popular, the newly enacted subchapter V aimed to provide eligible business debtors (*i.e.*, those under the statutory debt limit) with a quicker and cheaper way to reorganize, which was an appealing alternative to the vastly more expensive traditional chapter 11 filing.

Subchapter V's debt limit was initially set to \$2,725,625, but due to the financial stress of the COVID-19 pandemic,² Congress raised it to \$7.5 million. The increased debt limit showed subchapter V's full potential, with filings reaching record levels in 2023 and accounting for 44 percent of all chapter 11 cases in 2023,³ more than 25 percent of all cases filed since February 2020,⁴ and a 79 percent increase in filings from November 2022 to November 2023.⁵ Despite its rapid and proven success, Congress allowed the subchapter V debt limit to sunset on June 21, 2024, resulting in its reversion from \$7.5 million to an adjusted \$3,024,725.⁶

Subchapter V has become a bankruptcy success story for debtors and the insolvency industry. Small businesses have found a viable alternative to a traditional chapter 11 filing that adequately addresses the unique needs of small business debtors. Thus, subchapter V's proven utility for small businesses should not be ignored when the alternative of a traditional chapter 11 filing requires high costs and a slower process.

Restructuring professionals and ABI have urged and recommended that Congress reinstate and make permanent the heightened debt limit. Subchapter V

is a tool that needs a debt limit expansion to maximize its purpose and bring back the previous volume of filings for the benefit of debtors and practitioners. For several reasons, the \$7.5 million debt limit should be reinstated.

Negative Impact of the Decreased Debt Limit

The repercussions of reverting back to the previous debt limit are well-documented. Since the sunset of the \$7.5 million debt limit, subchapter V filings have dropped significantly.⁷ To illustrate the immediate effects, in the month immediately preceding the debt limit's expiration there were 321 subchapter V filings, but the number of monthly filings fell *by almost half* after the expiration to 175 subchapter V filings.⁸ This sudden decrease after the expiration demonstrates that fewer businesses see subchapter V as an available option.

Further, subchapter V is presently needed in our economic climate as small business bankruptcies continue to grow. In September 2024, subchapter V small business elections increased 9 percent to 167, compared to 153 from September 2023.⁹

While there is still more data to be documented from this debt limit sunset, the aforementioned numbers are trending in the same direction (*i.e.*, lower subchapter V filings, higher filings holistically¹⁰). As has been consistently shown, subchapter V is a desired reorganization option for small businesses. Economic headwinds and market cycles create an absolute need for a small business reorganization path. Having to satisfy a lower debt limit is an unnecessary hurdle to small businesses across the U.S. that are already enduring economic strife.

A Heightened Subchapter V Debt Limit Increases the Probability of Successful Reorganization

In addition to increasing the pool of eligible debtors, a higher subchapter V debt limit also

1 P.L. No. 116-54 (2019).

2 P.L. No. 116-136 (2020), as amended by Pub. L. No. 117-5 (2021), as further amended by Pub. L. No. 115-151 (2022) (extending debt limit).

3 See Final Report and Recommendations of the ABI Subchapter V Task Force (2024), subtaskforce.abi.org. ABI is also continuing its study of subchapter V by collecting experiences from those involved, which can be shared at abi.org/substories. Unless otherwise specified, all links in this article were last visited on Dec. 27, 2024.

4 *Id.*

5 See "November Commercial Chapter 11 Filings Increase 141 Percent over 2022," Epiq Global (Dec. 4, 2023), epiqglobal.com/en-us/resource-center/news/november-commercial-chapter-11-filings-increase-141-percent-over-2022-propelled-by-wework-bankruptcy. See also Joy Kleisinger, "The Expiration of the Increased Subchapter V Debt Limit and Its Impact on Small Business Debtors," *XLIII ABI Journal* 3, 8, 48, March 2024, abi.org/abi-journal/the-expiration-of-the-increased-subchapter-v-debt-limit-and-its-impact-on-small-business.

6 11 U.S.C. § 104, as adjusted for inflation.

7 See Alexander Lugo, "Subchapter V Bankruptcy Filings Plummeted After Congress Let Its Qualification Threshold Sunset," *ALM Global* (Oct. 18, 2024), law.com/dailybusinessreview/2024/10/18/subchapter-v-bankruptcy-filings-plummeted-after-congress-let-its-qualification-threshold-sunset/?sreturn=20241206164715 (subscription required to view article).

8 *Id.* (providing number of filings in June 2024 and July 2024, respectively).

9 See "Bankruptcy Statistics," ABI, abi.org/newsroom/bankruptcy-statistics.

10 *Id.*

resulted in an increase of post-confirmation business viability. The survival rate for organizations with confirmed subchapter V plans in December 2023 is 86 percent higher than the 70 percent survival rate of nonsubchapter V cases.¹¹ As such, businesses reaching plan confirmation in subchapter V maintain strong chances of continued viability upon emergence from bankruptcy.

Even more importantly, subchapter V *more than doubles* the probability of successful reorganization for organizations “near the \$7.5 million threshold.”¹² This documented correlation between businesses near the \$7.5 million debt limit and successful subchapter V reorganizations suggests that those same businesses would not survive post-confirmation if limited to a traditional chapter 11 process.

The Simplified Procedures Provide Broader Access to Reorganization for Small-Business Debtors

Returning to pre-pandemic debt adjustments has been disruptive to an already successful tool. The SBRA was a product of diligent research and studies of small business reorganizations, and the simplified procedures are meant to match the needs of small business debtors. Subchapter V is aimed at, among other things, addressing the costly nature of a traditional chapter 11 filing for a small business debtor. Subchapter V removes the (1) disclosure statement requirement, (2) appointment of a creditors’ committee(s), and (3) need for U.S. Trustee quarterly fees, which are usually paid by traditional chapter 11 debtors.

Further, subchapter V allows small business equityholders to retain their interests in the debtor entity by eliminating the so-called absolute-priority rule, which expands avenues for plan confirmations.¹³ Such procedures have removed barriers to create greater access for small business debtors and remove the costly aspects of chapter 11 (including related litigation). Increasing the debt limit would similarly expand access to those debtors who are above the current threshold, but who could successfully reorganize under subchapter V.

Proven Successful

Subchapter V’s success is generally withheld in the entities that have filed and confirmed their plans. Such reorganized entities were able to reap the benefits of a bankruptcy process that works and was created for their needs. From 2020 through June 30, 2024, there were 8,498 subchapter V cases filed,¹⁴ a quarter of all chapter 11 cases filed. As compared to traditional chapter 11 small business cases, subchapter V cases have enjoyed nearly double the percentage of confirmed plans, half the percentage of dismissals, and a shorter path to plan confirmation.¹⁵

11 Edith Hotchkiss, Benjamin Iverson & Xiang Zheng, “Can Small Business Survive Chapter 11?,” March 12, 2024, papers.ssrn.com/sol3/papers.cfm?abstract_id=4726391.

12 *Id.*

13 11 U.S.C. § 1181(a).

14 See “Chapter 11 Subchapter V Statistical Summary Through November 30, 2024,” U.S. Trustee Program, justice.gov/ust/page/file/1499276/dl?inline.

15 *Id.*

Moreover, the ability of distressed small businesses to survive reorganization serves a broader economic purpose. Small businesses are vital to the American economy. As of 2023, the U.S.’s 33.2 million small businesses employ more than 61 million people.¹⁶ Unfortunately, about half of small businesses close within their first five years of opening.¹⁷

Subchapter V’s increased debt limit would augment the number of those small businesses that may qualify for subchapter V’s protections. The businesses of many subchapter V debtors continue to operate after bankruptcy. For example, a recent study found that the survival rate for companies that emerge from chapter 11 with subchapter V confirmed plans as of December 2023 is 86 percent, or 16 percent higher than traditional chapter 11 cases.¹⁸

As previously highlighted, subchapter V has proven to be a vehicle that works exceedingly well for businesses that are on the higher end of the eligibility threshold. As filings grow, it is imperative for those businesses to be availed of the opportunity of choosing a bankruptcy process specifically tailored with those needs in mind.

A Majority of the Industry Supports a Heightened Subchapter V Debt Limit

Bankruptcy professionals have long valued expediency and efficiency,¹⁹ and subchapter V’s heightened debt limit proved to be just that. While critics of a higher limit have focused on debtors that have sought to abuse the process by disputing the debts owed to stay under the debt limit, the majority of the insolvency industry generally favors a permanent increase. Importantly, ABI created the Subchapter V Task Force, which unveiled its final report of recommendations. The key recommendation was establishing a permanent filing eligibility debt limit of \$7.5 million in aggregate, non-contingent, liquidated debt to reorganize under subchapter V.²⁰

ABI recognized bankruptcy professionals’ and judges’ repeated compliments on subchapter V. Hon. **Michael E. Romero** of the U.S. Bankruptcy Court for the District of Colorado remarked that subchapter V “has opened up the ability for financial rehabilitation to entities previously priced out of the more standard Chapter 11 process. The value of extending a survival opportunity to financially challenged but valuable members of our communities can never be underestimated.”²¹

Moreover, the lower debt limit not only reduces the amount of eligible debtors, it is bad for those practitioners who have gained specialty experience in subchapter V fil-

16 “Frequently Asked Questions About Small Businesses,” Small Bus. Admin. (March 2023), advocacy.sba.gov/wp-content/uploads/2023/03/Frequently-Asked-Questions-About-Small-Business-March-2023-508c.pdf.

17 See “Small Business Statistics,” Chamber of Commerce (July 24, 2024), chamberofcommerce.org/small-business-statistics.

18 See Hotchkiss, *et al.*, *supra* n.11.

19 See Christopher D. Hampson & Jeffrey A. Katz, “The Small Business Prepack: How Subchapter V Paves the Way for Bankruptcy’s Fastest Cases,” 92 *Geo. Wash. L. Rev.* 851 (2024).

20 See ABI Final Report, *supra* n.3.

21 Written Statement of Hon. Michael E. Romero, at 6, ABI Subchapter V Task Force Hearing (Operation of the Case) (July 28, 2023), subtaskforce.abi.org/hearings/july-28-2023-virtual-public-hearing.

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ings. According to **Steven Weiss**, a frequent subchapter V trustee, “nearly half of his subchapter V cases fell out of eligibility due to the debt limit.”²² The majority of financial restructuring and bankruptcy professionals, as well as judges, are urging Congress to restore the increased debt limit. As the ABI Subchapter V Task Force reinforced in its report, small businesses are at the core of the American economy, and a permanent increased debt limit would maximize predictability and trust in small business reorganizations.

Conclusion

Despite being relatively new and growing, subchapter V has had an impact on the financial restructuring and bankruptcy industry. Notably, subchapter V has been tested through one of the most devastating economic recessions in recent history: the beginning and aftermath of a global

pandemic. Subchapter V consistently offered the essential bankruptcy option for distressed small business debtors in the U.S. with their unique concerns in mind.

The \$7.5 million debt limit was in place for the majority of subchapter V’s lifetime, covering a period of all but the first six weeks after its effective date (Feb. 19 to March 26, 2020) and two months in 2022 (March 27 to June 21, 2022).²³ The \$7.5 million limit is part of subchapter V’s success, and such a heightened debt limit must stay, as (1) the sunset of the \$7.5 million debt limit caused negative effects on the small business community; (2) a heightened subchapter V debt limit increases the probability of successful reorganizations; (3) subchapter V has greater reorganization access to small business debtors through simplified procedures; (4) subchapter V has proven its success; and (5) subchapter V has been broadly supported by professionals in the bankruptcy industry. **abi**

²² See Steven Weiss, “Has Subchapter V Solved the Problems of Small Business Bankruptcies? Views and Reflections of Subchapter V Trustees on the First Two Years of the New Law: Thoughts on Subchapter V,” 31 No. 3 *Norton J. Bankr. L. & Prac. Art.* 1 (2022).

²³ See ABI Final Report, *supra* n.3.

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