

NATIONAL BANKRUPTCY CONFERENCE

*A Voluntary Organization Composed of Persons Interested in the
Improvement of the Bankruptcy Code and Its Administration*

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December 8, 2023

Re: Maintaining \$7.5 Million Debt Cap in Subchapter V of
Chapter 11 of the Bankruptcy Code

Dear Reps. Massie, Correa and Sens. Durbin and Graham:

The National Bankruptcy Conference strongly supports
maintaining the current \$7.5 million debt cap in subchapter V of
chapter 11 of the Bankruptcy Code.

The National Bankruptcy Conference (“NBC”) is a voluntary,
nonpartisan, not-for-profit organization composed of about sixty
of the nation’s leading bankruptcy judges, academics, and
practitioners. It has provided advice to Congress on bankruptcy
legislation for nearly eighty years. I enclose a Fact Sheet which
provides further information about the NBC. This letter sets out
why it is the strong consensus of the NBC that the cap should
remain at its current level.

Unless Congress acts before June, the cap will automatically be
lowered to approximately \$3 million. About a quarter of the
small businesses that reorganized under the existing subchapter
V cap would no longer be able to do so. Given the costs of a
chapter 11 case outside of subchapter V—costs that are
prohibitive for small businesses—these businesses would likely

face liquidation either in chapter 7 or under state law. The consequences of liquidation of these businesses can be severe: job loss, fire-sale recoveries for secured creditors, and little-to-no recoveries for general unsecured creditors.

These are in addition to the loss of small-business ownership and of the myriad other values small businesses bring to their communities. Creditors of small businesses, as well as the business's employees, suppliers, landlords, and customers, likely will be worse off if the existing cap is not kept in place.

Subchapter V has been an unequivocal success in providing a more streamlined and less costly means of resolving financial distress and has fulfilled the principal goals of the legislation. Fully 55% of subchapter V debtors successfully confirm plans. This stands in contrast to the 31% of comparable debtors who used chapter 11 before subchapter V was put in place. And the reorganizations are faster. Time to confirmation for small businesses has dropped from 10.8 months before subchapter V was enacted to 6.6 months under subchapter V. Moreover, bankruptcy judges dismissed cases that were not going to succeed more quickly (dropping from 6.0 months to 4.7 months).¹

Under subchapter V, creditors continue to have the protections available in a traditional chapter 11 case, including the ability to seek dismissal or conversion of the case, removal of the debtor in possession, and relief from the automatic stay. Secured creditors enjoy the same protection for the value of their collateral in subchapter V that they enjoy in large chapter 11s. The plan must satisfy the same provisions of §1129(b)(2)(A) of the Bankruptcy Code, and creditors have a right to contest in court confirmation of any plan they oppose. A nonconsensual plan can be confirmed only if the plan gives secured creditors at least the value of their collateral.

Nor is there a qualitative difference in the way subchapter V treats unsecured creditors. The only significant change lies in a modification of the long-standing right of old equity to participate in return for providing new value. In traditional reorganizations, old equityholders must contribute new value “in money or money's worth” to receive any recovery under a plan if a class of unsecured creditors rejects the plan (i.e., in a cramdown). *Case v. Los Angeles Lumber Products*, 308 U.S. 106 (1939). Subchapter V similarly requires principals to provide new value in a cramdown, but permits that value to take on a different form. Instead of cash, old equity holders can contribute sweat equity. In return for giving up income that they generate by running the business *in the future*, they are allowed to retain their ownership and their jobs in the company.

¹ See United States Trustee Program, Chapter 11 Subchapter V Statistical Summary Through September 30, 2023, available at <https://www.justice.gov/ust/page/file/1499276/download>.

For unsecured creditors, from a purely business perspective, the prospect of a monthly check in payment of their claims is usually a better bargain than foreclosure and the risks associated with it (such as responsibility for taxes and insurance) that come with a transfer of ownership to the creditors under the absolute priority rule.

Landlords are treated fairly in subchapter V as well. They enjoy the same protections in subchapter V that they do in a traditional chapter 11, including the ability to seek relief from the automatic stay, the ability to force the debtor to decide whether to assume or reject the lease, and the ability to compel the debtor to pay postpetition rent as set forth in §365. In addition, landlords benefit from a more streamlined process in subchapter V as compared with a traditional chapter 11. The plan must be filed within 90 days of the petition, and subchapter V cases move forward faster and are concluded by confirmation or dismissal more quickly than in traditional chapter 11s.

Subchapter V is centered around those businesses whose continued existence depends on the current owners remaining in place. The value of the business cannot be separated from those who own and run it any more than people can be separated from their shadows. Indeed, even when small businesses are broadly conceived to include all businesses with 500 or fewer employees, 37 percent are owned by single person and in 93 percent of these, this sole owner manages the business. See James Ang, Rebel Cole, and Daniel Lawson, *The Role of Owner in Capital Structure Decisions: An Analysis of Single-Owner Corporations*, 14 J. Entrepreneurial Fin. 1 (Fall 2010).

These businesses can carry substantial debt that can easily exceed the original subchapter V debt cap of \$2.75 million.

- A decent-sized restaurant or brew pub easily can cost several million dollars just to build and equip. A single unforeseen setback such as a catastrophic storm or an outbreak of food-borne illness can sink the entire enterprise.
- A general contractor for a commercial building often enters into a web of contracts that exposes it to multi-million-dollar liabilities if things go wrong. Even a single subcontractor can make a costly mistake, fail, and leave the general contractor responsible for fixing the mess.
- The owner of a small manufacturing operation might have a plant with equipment that itself costs multiple millions. When such a manufacturer goes through a run of bad luck, it can face substantial mortgage obligations, environmental and tax liabilities, and unpaid bills from suppliers.

- Personal service firms, such as medical practices or small law firms, can have substantial debt and reverses that leave them unexpectedly without the revenues that were reasonably anticipated. A single employee can embezzle so much that the entire business is at risk.

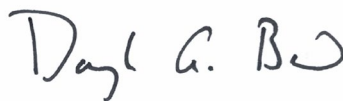
Without the ability to reorganize under subchapter V, such firms will likely face liquidation, an outcome that will yield little, if anything, to creditors, particularly trade creditors, and employees.

Many businesses eligible for relief under subchapter V are similar to family farms that are permitted to reorganize under chapter 12. In 2019, Congress enacted a permanent increase to the chapter 12 debt cap, which amount is currently more than \$11 million. We can perceive no principled policy basis pursuant to which the subchapter V debt limit should be substantially lower than the chapter 12 limit (if anything, the analysis runs the other way, and the subchapter V limit should be increased to track chapter 12).

Subchapter V is a relatively new statute, and as in any such statutory scheme, it may require some adjustment as cases reveal imperfections, uncertainties, or abuses in its operation. Nothing in our experience, however, suggests that the current \$7.5 million cap is itself a source of mischief. We believe that reducing the cap would take away from small business a viable remedy that is proving to be highly workable for the businesses of the sort that subchapter V was intended to serve, as well as valuable for their stakeholders.

As always, we stand ready to help as you work to improve subchapter V and our bankruptcy laws more generally.

Sincerely,

A handwritten signature in blue ink that reads "Douglas G. Baird". The signature is written in a cursive, slightly slanted style.

Douglas G. Baird
Chair, National Bankruptcy Conference

NATIONAL BANKRUPTCY CONFERENCE

A non-profit, non-partisan, self-supporting organization of approximately sixty lawyers, law professors and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws.

History. The National Bankruptcy Conference (NBC) was formed from a nucleus of the nation's leading bankruptcy scholars and practitioners, who gathered informally in the 1930's at the request of Congress to assist in the drafting of major Depression-era bankruptcy law amendments, ultimately resulting in the Chandler Act of 1938. The NBC was formalized in the 1940's and has been a resource to Congress on every significant piece of bankruptcy legislation since that time. Members of the NBC formed the core of the Commission on the Bankruptcy Laws of the United States, which in 1973 proposed the overhaul of our bankruptcy laws that led to enactment of the Bankruptcy Code in 1978, and were heavily involved in the work of the National Bankruptcy Review Commission (NBRC), whose 1997 report initiated the process that led to significant amendments to the Bankruptcy Code in 2005. Most recently, the Conference played a leading role in developing the Small Business Reorganization Act of 2019, Pub. L. 116-54.

Current Members. Membership in the NBC is by invitation only. Among the NBC's 60 active members are leading bankruptcy scholars at major law schools, as well as current and former judges from eleven different judicial districts and practitioners from leading law firms throughout the country who have been involved in most of the major corporate reorganization cases of the last three decades. The NBC includes leading consumer bankruptcy experts and experts on commercial, employment, pension, mass tort, and tax-related bankruptcy issues. It also includes former members of the congressional staff who participated in drafting the Bankruptcy Code as originally passed in 1978 and former members and staff of the NBRC. The current members of the NBC and their affiliations are set forth on the second page of this fact sheet.

Policy Positions. The Conference regularly takes substantive positions on issues implicating bankruptcy law and policy. It does not, however, take positions on behalf of any organization or interest group. Instead, the NBC seeks to reach a consensus of its members - who represent a broad spectrum of political and economic perspectives - based on their knowledge and experience as practitioners, judges, and scholars. The Conference's positions are considered in light of the stated goals of our bankruptcy system: debtor rehabilitation, equal treatment of similarly situated creditors, preservation of jobs, prevention of fraud and abuse, and economical insolvency administration. Conferees are always mindful of their mutual pledge to "leave their clients at the door" when they participate in the deliberations of the Conference.

Technical and Advisory Services to Congress. To facilitate the work of Congress, the NBC offers members of Congress, Congressional Committees and their staffs the services of its Conferees as non-partisan technical advisors. These services are offered without regard to any substantive positions the NBC may take on matters of bankruptcy law and policy.

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