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A Debtor's Eligibility for Relief Under Subchapter V of Chapter 11

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INTRODUCTION

In February of 2020, the Small Business Reorganization Act of 2019 (“SBRA”) became effective and added a new subchapter (“Subchapter V”) to title 11 of the United States Code (the “Bankruptcy Code”).¹ Subchapter V, which is incorporated into chapter 11 of the Bankruptcy Code, was established to create an efficient process for small business debtors to “reorganize quickly, inexpensively, and efficiently.”² To proceed under Subchapter V, a debtor must meet the definition of a debtor under section 1182(1) of the Bankruptcy Code and must elect its application pursuant to section 103(i) of the Bankruptcy Code.³ Under Subchapter V, an individual qualifies as a debtor if they are a “person” with less than \$2,725,625⁴ in aggregate debt, engaged in commercial or business activities, with at least than 50% of their total debts arising from such activities.⁵

¹ *In re Blue*, 630 B.R. 179, 186 (citing Pub. L. No. 116-54, 133 Stat. 1079 (2019)).

² *In re Seven Stars on the Hudson Corp.*, 618 B.R. 333, 336 (Bankr. S.D. Fla. 2020).

³ Section 103(i) “applies only in a case under chapter 11 in which a debtor (as defined in section 1182) elects that subchapter V of chapter 11 shall apply.”

⁴ The enactment of the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) temporarily increased the aggregate debt amount a debtor may have from \$2,725,625 to \$7,500,000 to provide more relief to debtors affected by the COVID-19 Pandemic. *See* Pub. L. No. 116-136, § 1113, 134 Stat 281 (2020). This increase is set to sunset on March 27, 2022, absent an act of congress.

⁵ 11 U.S.C. § 1182(1)(A).

Since its addition to the Bankruptcy Code, courts are divided when interpreting the eligibility requirements under Subchapter V. Specifically, interpretations differ when determining (1) what being “engaged in commercial or business activities means and whether a debtor must “currently” be engaged in commercial or business activities; (2) what constitutes a “commercial or business activit[y]”; and (3) whether a debtor’s debts must be related to their current business activities. *See* 11 U.S.C. § 1182(1)(A); *In re Blue*, 630 B.R. at 189, 191; *In re Vertical Mac Constr., LLC*, No. 6:21-bk-01520-LVV, 2021 Bankr. LEXIS 2285 at *5–6 (Bankr. M.D. Fla. July 23, 2021).⁶

This memorandum addresses (1) whether a debtor must be currently engaged in commercial or business activities to qualify for subchapter V; and (2) whether a debtor’s scheduled business debts must be related to their current business activities. Part I focuses on court’s plain meaning analysis of the phrase “engaged in commercial or business activities” and its application to the facts of a case. Part II analyzes the policy considerations courts employ when determining whether a debtor’s scheduled business debts must be related to their current business activities.

DISCUSSION

I. Statutory Construction of 11 U.S.C. § 1182(1)(A)

To proceed under Subchapter V:

the debtor must meet the definition of a “person”; (2) the debtor must be “*engaged in commercial or business activities*”; (3) the debtor cannot have aggregate debt exceeding \$2,725,625 as of the date of petition; and (4) at least 50 percent of the debtor’s debts arise from the commercial or business activities of the debtor.⁷

⁶ *See* 11 U.S.C. § 1182(1)(A); *In re Blue*, 630 B.R. at 189, 191; *In re Vertical Mac Constr., LLC*, No. 6:21-bk-01520-LVV, 2021 Bankr. LEXIS 2285 at *5–6 (Bankr. M.D. Fla. July 23, 2021).

⁷ *In re Offer Space, LLC*, 629 B.R. 299, 304 (Bankr. D. Utah 2021) (emphasis added).

The division among courts arises when determining whether a debtor is engaged in commercial or business activities.

A. Plain Meaning Analysis of “Engaged in Commercial or Business Activities”

As with any statutory interpretation, the starting point is with the textual language of the statute. Since the Bankruptcy Code does not define the terms “engage”, “commercial”, and “business”, courts have used alternative definitions to guide its interpretation.⁸ First, courts have concluded that “engaged” is to be “involved in activity: occupied, busy.”⁹ Second, the word “commercial” means “the exchange or buying and selling commodities on a large-scale involving transportation from place to place.”¹⁰ Third, “business” means “a usually commercial or mercantile activity engaged in as a means of livelihood.”¹¹ Despite the plain meaning of such terms, courts remain split on whether a debtor must be *currently* engaged in commercial or business activities to meet the requirements of section 1182(1)(A).¹²

B. Some Courts do not Require a Debtor to be Currently Engaged in Commercial or Business Activities

Courts have held that a small business debtor is not required to be “currently” engaged in commercial or business activities.¹³ The courts reasoned that a debtor is

⁸ See *In re Blue*, 630 B.R. at 188–89 (citation omitted).

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² See *In re Thurmon*, 625 B.R. 417 (Bankr. W.D. Mo. 2020) (“[E]ngaged in’ is written . . . in the present tense. To add the word ‘currently’ to the phrase ‘engaged in’ would be redundant, because the currency of the involvement or activeness is inherent in the idea of being ‘engaged in’ something.”); *In re Ikalowych*, 629 B.R. 261, 280 (Bankr. D. Colo. 2021) (“[T]he phrase ‘engaged in’ . . . is a past participle used as an adjective to describe the present state of the noun ‘person.’”).

¹³ *In re Wright*, No. CV 20-01035-HB, 2020 WL 2193240 *1 (Bankr. D.S.C. Apr. 27, 2020) (“[N]othing [in legislative history of the SBRA] or in the language of the definition of a small business debtor, limits application to debtors currently engaged in business or commercial activities”); *In re Bonert*, 619 B.R. 248 (Bankr. C.D. Cal. 2020) (finding that debtor’s redesignation under subchapter V was proper because debtor was engaged in commercial or business activities); *In re Blanchard*, No. 19-12440, 2020 WL 4032411 *1 (Bankr. E.D. La. July 16, 2020) (adopting the reasoning of *Wright*).

engaged in commercial or business activities when “addressing residual business debts” from “prior operations.”¹⁴

C. Courts that Mandate Debtors be Currently Engaged in Commercial or Business Activities

Other courts deviated from the *Wright* line of cases and held that a debtor must be currently engaged in commercial or business activities to qualify as a small business debtor under subchapter V.¹⁵ Although these courts agree that a debtor must be currently engaged in commercial or business activities as of the petition date, the court in *Ikalowych* cautioned that “focusing only on the exact nano-second the petition was filed is . . . too narrow.”¹⁶ As such, the court assessed the totality of the circumstances of the events “preceding and subsequent to the [p]etition [d]ate” to determine whether a debtor was engaged in commercial or business activities.¹⁷ A debtor is not engaged in commercial or business activities when it has completely sold its business with no intention of reinstating or when the business was defunct years before filing for bankruptcy.¹⁸

II. 11 U.S.C. § 1182(1)(A) does not Require a Debtor’s Scheduled Business Debts to be Related to Their Current Business Activities

¹⁴ See *In re Wright*, 2020 WL 2193240 at *3 (winding down of debtor’s business constituted engaged in commercial or business activities); *In re Bonert*, 619 B.R. at 255–56 (“[T]he majority of the Debtors’ liabilities are business debts stemming from their prior operation of . . . a bakery.”).

¹⁵ See *In re Thurmon*, 625 B.R. at 421 (relying on the plain meaning of “engaged in” to establish that debtors’ did not meet the requirements of subchapter V); *In re Johnson*, No. 19-42063-ELM, 2021 WL 825156 at *6 (Bankr. N.D. Tex. Mar. 1, 2021) (“[A] person ‘engaged in’ commercial or business activities is a person occupied with or busy in commercial or business activities - not a person who at some point in the past had such involvement.”); *In re Ikalowych*, 629 B.R. at 281 (“[T]he Court must assess whether the Debtor was ‘engaged in commercial or business activity’ as of the Petition Date.”); *In re Offer Space, LLC*, 629 B.R. at 303 (adopting *Thurmon*’s reasoning when defining the term “engaged in”).

¹⁶ *In re Ikalowych* 629 B.R. at 282.

¹⁷ *Id.* (distinguishing the facts from the instant case to the facts in *Johnson* and *Thurmon* to find that debtor’s current winding down of their business satisfied section 1182(1)(A)); *In re Offer Space, LLC*, 629 B.R. at 305 (adopting *Ikalowych*’s “totality of the circumstances” test).

¹⁸ See *In re Thurmon*, 625 B.R. at 423 (stating debtors “sold the business with no intent to return to it”); *In re Johnson*, 2021 WL 825156 at *2 (finding debtors did not convert their case and elect subchapter V until about a year and a half from the time their last business was operational).

The SBRA was primarily enacted to facilitate “successful reorganizations” but was also intended for “secondary or even tertiary purposes” such as “providing relief for small business debtors who intend to liquidate their businesses without the cumbersome structure that . . . exists in Chapter 11.”¹⁹ Objectants to a debtor’s election for subchapter V have argued that there must be a “nexus” between the debtor’s current engagement in commercial or business activities and their scheduled debts which arose from said commercial or business activities.²⁰ Courts, however, have allowed debtors to use subchapter V to address defunct and non-defunct commercial and business activities.²¹ Being currently engaged in commercial or business activities is not “limited to those [activities] incident to winding up a previous business.”²²

CONCLUSION

The addition of subchapter V to the Bankruptcy Code has provided relief for many small business debtors who hope to avoid a more complex system under Chapter 11. Since its enactment in 2020, subchapter V has generated issues that courts have struggled to address. First, to determine whether a small business debtor qualifies for subchapter V relief, courts have been tasked with interpreting what being “engaged in commercial or business activities” means. Second, courts have had to assess the relationship between a debtor’s scheduled debts and their commercial or business activities. With a congressional intent in defining certain phrases in the statute, courts have applied their own analysis to reach conclusions that conform with the purpose of the SBRA resulting in different outcomes throughout the bankruptcy courts. Without

¹⁹ *In re Offer Space, LLC*, 629 B.R at 308.

²⁰ *In re Blue*, 630 B.R at 191.

²¹ *See In re Blue*, 630 B.R at 191 (holding that a plain reading of section 1182(1)(A) does not require “a connection of debts to current business activities”); *See Blanchard*, 2020 WL 4032411, at *2 (permitting debtors to proceed under subchapter V, even though debts arose from defunct and non-defunct businesses).

²² *In re Blue*, 630 B.R at 191 (permitting debtor’s freelance consulting services to suffice as engagement in commercial or business activities absent a relation to her defunct business).

clearer guidance from Congress, courts will continue to differ in their interpretations of 11 U.S.C. 1182(1)(A).