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ANALYSIS

Congressional Inaction Stifles Uptick in Florida Small Business Bankruptcy Filings

Florida leads the nation in small business bankruptcy, but a legislative lapse means Chapter 11 is temporarily off the table for thousands of commercial debtors.

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What You Need to Know

- Since the Small Business Reorganization Act made Chapter 11 accessible to small debtors, Florida has led the nation in small business bankruptcy.

- A legislative lapse allowed a CARES Act provision of the SBRA to expire, lowering the debt limit for eligible small businesses from \$7.5 million to \$2.7 million.
- Bankruptcy lawyers predict the return of the elevated debt limit on the eve of a national insolvency wave as creditors respond to rising interest rates and inflation.

No other state has used subchapter V of Chapter 11 bankruptcy code more extensively than Florida. Since the 2019 Small Business Reorganization Act (SBRA) went into effect in February 2020, 463 small businesses in Florida have restructured under the cheaper, faster form of Chapter 11, about one-seventh of national filings. Many businesses were enabled by a CARES Act provision that raised the debt limit for eligible small businesses from \$2.7 million to \$7.5 million.

Earlier this week, Congress allowed the elevated debt limit to expire, once again putting Chapter 11 out of reach for a majority of small businesses with liabilities in excess of \$2.7 million. It's the latest blow to the Florida bankruptcy bar after two years of depressed filing rates due to government stimulus, low interest rates and lenient lenders.

However, the lapse hasn't dampened the mood of Florida bankruptcy lawyers and their national peers, who are optimistic about the passage of the bipartisan debt-limit legislation and the return of commercial Chapter 11 filings (for real, this time) as the Federal Reserve continues to raise interest rates to combat rising inflation while distressed businesses spend their last Paycheck Protection Program dollars.

Their optimism is bolstered by a recent uptick small business filings, the type that sustained middle-market and corporate bankruptcy lawyers as

large filings remained scarce. In Florida, subchapter V filings more than doubled in the first quarter of 2022 compared to the fourth quarter of 2021 and outpaced any quarter since the onset of the pandemic.

Uncertainty over the debt limit may be to blame, but bankruptcy lawyers said they believe the situation will become dire for thousands of small businesses by the end of the year.

The debt limit bill is likely to succeed in spite of its tardiness because it faces no evident opposition, said Robert Keach of Bernstein, Shur, Sawyer & Nelson in Portland, Maine. Keach, whose congressional testimony preceded the creation of the subchapter, said small businesses that need to restructure imminently should be allowed to file for Chapter 11 and switch to subchapter V when the new law passes, assuming it passes in the next week.

“I think what you’re going to see, at a consistent \$7.5 million debt limit, is 80% of Chapter 11 cases will be subchapter V cases,” Keach said. In the week leading up to the expiration of the \$7.5 million debt limit on March 27, Keach said 81 of the 126 Chapter 11 bankruptcy filings nationwide were subchapter V. A similar bump happened in March 2021 when the debt limit was set to expire and extended at the 11th hour.

“Obviously, that was a spike,” Keach continued. “But I do think that percentage will pertain. There are a lot of deferred problems.”

When interviewed for this article, bankruptcy lawyers around the country cheered the impending permanence of the higher debt limit. In their words, the bill promises to solidify subchapter V as an additional, dependable revenue stream that often generates more fees than a liquidation or out-of-court restructuring—at least for debtor’s attorneys.

Creditors' rights attorneys said the subchapter has reduced their clients' leverage but still benefits everyone involved in many cases.

Why Small Businesses Will File Sooner

Deferred problems may be similar for businesses of all sizes, but Keach said small businesses, in particular, are disadvantaged by not having the same access to robust capital markets as large corporations. During the pandemic, bigger companies have had more time and options for restructuring than small businesses.

Creditors may have been sympathetic to such plights earlier in the pandemic, but Miami bankruptcy attorney Jeffrey Bast said that, too, is changing.



Jeffrey Bast, partner with Bast Amron in Miami.

“I think we’re starting to see the sympathy wear off,” said Bast, co-founder of insolvency boutique Bast Amron. “I’m sure as interest rates pick up, we’ll see further creditor action and activity. That’s going to drive some filings that we can’t work out in an amicable manner.”

To the extent they can afford it, institutional creditors may be more concerned about their image than smaller creditors. “Big lenders don’t want to see their names on the news,” said Alan Rosenberg, a bankruptcy partner at Markowitz Ringel Trusty & Hartog in Fort Lauderdale.

And in the experience of Los Angeles bankruptcy lawyer Zev Shechtman, the most problematic creditors for small businesses aren't on anyone's radar.

"It does seem like institutional creditors are pacing themselves. Once they get aggressive, it could have a domino effect," said Shechtman, a partner at bankruptcy boutique Danning, Gill, Israel & Krasnoff. "The more aggressive creditor actions I've seen have been by non-institutional creditors lately."

How Subchapter V Bolstered the Bankruptcy Bar

The Small Business Reorganization Act is the product of a three-year study by the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11, which Keach, who is also ABI's former president, presented to Congress in June 2019. On the advice of 150 bankruptcy lawyers around the country and the Commission's 22 members, the subsequent report emphasized what many already knew: Chapter 11 doesn't work for small businesses.

Between 2008 and 2017, only 25% of companies with assets or liabilities less than \$10 million had their Chapter 11 reorganization plans confirmed, the ABI found. By comparison, the confirmation rate was 40% for companies with more than \$10 million in assets. An unknown number of other small businesses opted to liquidate and close shop. For them, Chapter 11 meant a prohibitively lengthy process, costly disclosure and reporting requirements, a lack of tools to help small business owners who aren't versed in finance, and an uphill battle for business owners to keep their ownership interest.



Alan Rosenberg of Markowitz Ringel Trusty + Hartog. Courtesy photo

“Under Chapter 11, creditors make it very expensive for debtors to be in bankruptcy,” Rosenberg said.

By contrast, subchapter V expedites small business bankruptcy by placing a 90-day deadline on debtors to file a reorganization plan, and plans often receive confirmation in under six months. Unlike Chapter 11, creditors can’t file their own reorganization plan. Creditors also lose “absolute priority,” meaning unsecured creditors don’t have to be paid in full before debtors are allowed to retain their property under a reorganization plan. The subchapter replaces U.S. trustees with subchapter V trustees who incur considerably lower fees. Debtors are also given more time to pay administrative and legal fees.

Despite the ABI’s recommendation of a \$10 million debt limit, the SBRA went into effect in February 2020 with a debt limit of \$2.7 million. “We never intended for it to stay at \$2.7 million,” Keach said. “There was some desire to see how it worked and move it up. ... It happened faster because of the pandemic.”

The original debt limit lasted barely a month; the CARES Act, passed and signed in late March 2020, raised the debt limit to \$7.5 million, where it stayed until this week.

Subchapter V has proved enormously successful in helping small businesses reorganize. About 30% of the roughly 10,000 commercial

Chapter 11 filings since February 2020 have been subchapter V, according to data from Epiq Bankruptcy and the ABI. Among small business filings, 75% were subchapter V, according to the American Bankruptcy Trustee Journal.

Roughly two-thirds of confirmed plans were consensual and supported by creditors, the Journal found. And bankruptcy attorneys have placed the approximate confirmation rate of subchapter V plans at 50% or higher, making them twice as successful as Chapter 11 filings for small businesses.

Attorneys who represent creditors and debtors said the subchapter has meant a higher volume of cases that generate fewer fees per case, a welcome tradeoff as complex commercial Chapter 11s dried up.

“You could look at it as a wash,” said Fort Lauderdale creditors’ rights partner James Silver of Kelley Kronenberg. “I still think, because of that subset of cases that would never have filed but for subchapter V, that ultimately the balance dips in favor of it being a good thing for bankruptcy practitioners.”

The subchapter doesn’t necessarily benefit all of Silver’s clients, however. Large creditors lost their blocking vote in the subchapter, and smaller creditors can sometimes benefit from an unsecured creditors committee to protect their interests when a large creditor gets aggressive. In other cases, the committee may be an unnecessary expense for creditors.

But some creditors themselves like the subchapter, as evidenced by the lack of coordinated opposition from lenders to the pending legislation.



Robert P. Charbonneau, Partner, Agentis, Coral Gables

“Unlike in a regular Chapter 11, when the debtor is left to their own devices, there’s a subchapter V trustee that ends up being a go-between between the debtor and the creditors,” said Agentis Law founding member Robert Charbonneau of Miami, who represents creditors. “I’m told from the creditor perspective, they like that the subchapter V trustee can act as a sounding board and get [creditors] the best outcome possible under the code.”

And while the streamlining has cut legal fees for creditors’ rights attorneys, that’s not necessarily a bad thing for maintaining lasting client relationships.

“Some of my clients have been with me for 30 years, so our goal is to minimize the fees because of the long-term relationship,” said Chuck Tatelbaum, a 55-year creditors’ rights attorney at the midsize Fort Lauderdale law firm Tripp Scott. “That doesn’t necessarily translate into dollars today, but it translates into dollars in the future when you’re able to do it on a more expeditious basis.”

The Future of Subchapter V

Although Keach said retroactivity provisions in the SBRA should allow small businesses to file for Chapter 11 and switch to subchapter V, others in the bankruptcy bar said the lapse in the debt limit may still prevent filings.

“For the time being, it’s pretty tragic,” said Rosenberg. “It’s going to eliminate access to a really powerful insolvency tool for small business debtors who need bankruptcy to get back on their feet.”

And while a permanent \$7.5 million debt limit would be subject to annual increases to adjust for inflation, some attorneys said they feel the debt limit should be \$10 million to align the subchapter with the Family Farmer Relief Act. The 2019 Act, another subsection of the SBRA, raised the Chapter 12 debt limit for family farmers and fishermen from \$4.2 million to \$10 million.

“I don’t know why one segment is \$10 million when the vast majority of small business bankruptcies are only \$7.5 million,” Charbonneau said. “I think people should get engaged and write their congressional representatives to ask for a \$10 million debt limit for subchapter V.”

Whatever happens with the debt limit, subchapter V will play a critical role in commercial restructuring when the insolvency wave hits.

“I do think when filings go up, we will see a lot more subchapter Vs and a higher level of utilization,” Shechtman said. “That’s another reason why keeping the \$7.5 million debt limit is important: It would be unfortunate if it didn’t extend to more debtors to make bankruptcy accessible when bankruptcy relief is needed by more companies.