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Annual Spring Meeting

The Fair-and-Equitable Standard in Subchapter V: Avoiding or Navigating a Contested Confirmation

Hon. Deborah L. Thorne, Moderator

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Introduction to Subchapter V



History of Subchapter V

- The Small Business Reorganization Act of 2019 (SBRA) created new bankruptcy procedures for small businesses filing for reorganization under Chapter 11.
 - Enacted August 23, 2019, effective date February 19, 2020.
- The goal of the SBRA was to provide a quicker, simpler, and cheaper alternative for small business debtors with less than ~\$2.7 million in debt.
 - A case under subchapter V has shorter deadlines for filing reorganization plans, allows for greater flexibility in negotiating restructuring plans with creditors, and does not require the payment of UST quarterly fees.
- The Coronavirus Aid, Relief, and Economic Security (CARES) Act and subsequent extensions increased the debt eligibility limit to \$7.5 million for cases filed on or after March 27, 2020.
- This increased debt limit expired on June 21, 2024. Accordingly, any subchapter V cases filed after this date are subject to the original debt limit as adjusted, or ~\$3.0 million.



Subchapter V Trustee

- Unlike in other chapter 11 cases, a trustee is appointed in each subchapter V case to provide oversight, assist the debtor in possession throughout the process, and provide regular and transparent updates regarding the status of the case.
- The subchapter V trustee also works with the small business debtor and the creditors to *“facilitate the development of a consensual plan of reorganization.”*

“Subchapter V Trustees are the ‘honest brokers,’ who through their efforts have provided credibility in evaluating the debtor’s business’s prospects for a successful reorganization and facilitated negotiation of a plan of reorganization with the debtor’s stakeholders, thereby enabling a small business to reorganize.”

In re Corinthian Commc’n, Inc., 642 B.R. 224, 225 (Bankr. S.D.N.Y. 2022).



Does subchapter V work?

- Statistics published by the UST Program suggest that small business debtors were increasingly electing subchapter V treatment before the \$7.5 debt limit expired.
- However, filings have dropped significantly following its expiration.
 - For example, monthly subchapter V elections declined 12% from 201 in February 2024 to 176 in February 2025.
- UST Program data also suggests that subchapter V cases (compared to non-subchapter V chapter 11 cases) “have had approximately double the confirmed plan percentage and a 20 percent lower dismissal percentage, as well as a shorter time to confirmation.”
 - Of those confirmed plans, 68% have been consensual plans.

Sources: Chapter 11 Subchapter V Statistical Summary Through December 31, 2024, available at: [Chapter 11 Subchapter V Statistical Summary](#); February Commercial Chapter 11s Decrease 42 Percent, Epiq Bankruptcy, available at: [February Commercial Chapter 11s Decrease 42 Percent](#).



Plan Requirements

- At a minimum, a subchapter V plan must contain the following:
 - A brief history of the subchapter V debtor’s business operations;
 - A liquidation analysis;
 - Projections with respect to the ability of the subchapter V debtor to make payments under the proposed plan;
 - The submission of all or a portion of the subchapter V debtor's post-petition income from future earnings or (other future income) to the supervision and control of the trustee “as is necessary for the execution of the plan”; and
 - In a nonconsensual subchapter V plan, appropriate remedies that may include liquidation of nonexempt assets to protect the holders of claims or interests in the event plan payments are not made.

Source: *In re Pearl Res. LLC*, 622 B.R. 236, 243, (Bankr. S.D. Tex. 2020).



Plan Confirmation

- §1191(a), governs the confirmation of a *consensual* subchapter V plan.
- With respect to a *nonconsensual* plan, pursuant to §1191(b):
 - A debtor bears the burden of showing the court that the plan “**does not discriminate unfairly**, and is **fair and equitable**, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.”
 - Once a debtor meets its burden, “the court shall confirm” its plan, even if a creditor objects.



“Fair and Equitable” Standard

- To meet the “*fair and equitable*” test, pursuant to §1191(c), the debtor must show:
 - (A) the plan provides that all of the **projected disposable income** of the debtor to be received in the 3-year period, or such longer period not to exceed 5 years as the court may fix, beginning on the date that the first payment is due under the plan will be applied to make payments under the plan; or
 - (B) the value of the property to be distributed under the plan in the 3-year period, or such longer period not to exceed 5 years as the court may fix, beginning on the date on which the first distribution is due under the plan is not less than the projected disposable income of the debtor.



Projected Disposable Income

- §1191(d) defines “*disposable income*” as the income that is received by the debtor and that is not reasonably necessary to be expended for:
 - The maintenance or support of the debtor or a dependent of the debtor; or
 - A domestic support obligation that first becomes payable after the date of the filing of the petition; or
 - For the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor.



“Best Efforts” Test

- Instead of the absolute priority rule, §1191(c) imposes a projected disposable income requirement, or “*best efforts*” test, which requires a finding of feasibility.
- The feasibility test, set forth in §1129(a)(11), “requires only that confirmation is not likely to be followed by liquidation or the need for further reorganization unless the plan proposes it.” *In re Pearl Res. LLC*, 622 B.R. 236, 243, (Bankr. S.D. Tex. 2020).
- To demonstrate that a plan is fair and equitable, a debtor “must show a “**sincere effort**” regarding two things: first, it must show that there is a reasoned basis for its projections, and second, it must show that line items deducted from disposable income are indeed “necessary for the continuation, preservation, and operation of the debtor’s business” and therefore fair and equitable to the unsecured creditors.” *In re Premier Glass Services LLC*, 24-05367 (N.D. Ill. Nov. 8, 2024).



Planning for the Initial Client Meeting



Understanding the Small Business Owner Mindset

- Who is the “typical” small business debtor?
 - A small business debtor is an individual or entity **engaged in commercial or business activities** (excluding primarily owning or operating a single piece of real property).
 - A debtor is ineligible for subchapter V if it is a public company or the affiliate of a public company.
- Small business debtors are often family-owned businesses, start-ups, or closely held enterprises.
- As such, you may be faced with unique challenges in dealing with small business owners –
 - Small businesses often lack in-house financial expertise and may struggle with financial management and recordkeeping.
 - Owners’ personal finances are often personally intertwined with the company’s finances.
 - Owners may also have an emotional investment in the business.



Managing Small Business Debtors' Expectations

- Set realistic expectations for the bankruptcy process.
 - **Use clear, non-technical language** to explain bankruptcy concepts.
 - **Reframe the narrative** – bankruptcy is a tool for reorganization, not a failure.
 - **Be upfront** about what is achievable through the subchapter V process.
 - **Build a support team:** Encourage small business debtors to view lawyers, financial advisors, and the subchapter V trustee as resources rather than adversaries.



Financial Transparency (or lack thereof)



Early Assessment of True Financial Position

- Help small business owners understand their true financial position before filing.
 - **Familiarize yourself with the key financial statements.**
 - Having a general understanding of the basic financial statements (income statement, balance sheet, and cash flows) and how they work together will help you better assess your client's position.
 - **Ask the right questions** at the outset about who prepares and maintains the debtor's financial information.
 - Attempt to **verify the debtor's financial information.**
 - For example, if there is an outside auditor, ask for the reports and workpapers, or request copies of all bank statements directly from the bank.



Managing the Less-Than-Transparent Debtor

- **Emphasize the need for financial transparency.**
 - Inaccurate or incomplete financial records can lead to objections, delays, or dismissal of a case.
 - Lack of transparency can also lead to allegations of bad faith, potential fraud claims, or denial of plan confirmation.
- If the owner cannot or will not provide you with the basic financial information about their company, proceed with caution.



Preparing Reasonable Projections



Importance of Reasonable Projections

- Courts expect projections to be based on objective financial data and sound business assumptions.
- Reasonable projections are central to plan feasibility.
- **The debtor bears the burden of proof on confirmation of a subchapter V plan.** *See generally In re Trinity Family Practice & Urgent Care*, 661 B.R. 793 (Bankr. W.D. Tex. 2024).
 - Inaccurate or unreasonable projections place plan confirmation at risk.



Developing Reasonable Projections

- **Start with historical financials.**
 - Analyze two-to-three years of financial statements, bank accounts, and tax returns. Review trends and adjust for/normalize non-recurring items (i.e. COVID-19, merger/acquisition, sale of a business line, natural disaster, etc.).
- **Develop (and document) assumptions.**
 - What drives revenue? Consider market trends, key customers, seasonality.
 - Evaluate fixed and variable costs.
 - Ask whether the business has any necessary capital expenditures.
 - Plan for debt service (secured and unsecured) as well as tax obligations.
- **Relying on financial advisors or turnaround consultants** to assist with preparing projections can support credibility.



Predicting the Unpredictable

- **Assessing the impact of tariffs.**
 - Proposed sweeping tariffs could affect imports from almost every country and across a whole universe of goods.
 - Industries to watch include automotive industry, construction and homebuilding, consumer electronics, retail.
- **Assessing the impact of cancelled federal grants.**
 - Recent cancellations of millions of dollars of federal grants, especially those for education, arts and humanities, and scientific and medical research, could result in drastic cash flow needs.



Predicting the Unpredictable

- Accounting for non-traditional businesses.
 - **Normalizing income impacted by COVID-19:** Company produced large, independent, in-person media events which were significantly and negatively impacted by the COVID-19 pandemic. *Pepcom, Inc.*, 21-15475 (Bankr. S.D. Fla.).
 - **Projecting revenue from the commercialization of treatments in on-going clinical trials:** Clinical-stage biopharmaceutical firm focused on developing innovative cancer immunotherapy treatments. *Immunsys, Inc.*, 20-24196 (Bankr. S.D. Fla.).
 - **Assessing non-traditional and unpredictable revenue streams:** Debtor was a blogger and YouTuber who filed bankruptcy following a defamation judgment secured by Cardi B against Debtor. *Latasha Transrina Kebe*, 23-14082 (Bankr. S.D. Fla.).
 - **Assessing commission-driven income:** Debtor was an on-line entrepreneur engaged in online event ticket re-sales and receiving passive income from a number of LLCs, several joint ventures, and investments in non-fungible tokens for so-called digital basketball cards. *Harry Beck Greenhouse*, 21-12844 (Bankr. S.D. Fla.).



Preparing a Liquidation Analysis

- §1190(1)(B) requires that a debtor include a liquidation analysis in its plan of reorganization.
 - Generally, a liquidation analysis is based on assumptions about a debtor's assets and liabilities and is used to assess the proceeds that would be available to creditors in a hypothetical liquidation of the debtor.
- A debtor should consider engaging a valuation expert if certain assets values are uncertain, complex, or material to plan confirmation (e.g. real estate, specialized or industry-specific machinery and equipment, intellectual property, cryptocurrency, other intangible assets).



Facilitating a Consensual Plan



Facilitating a Consensual Plan

- Identify key creditors by class and claim type and begin discussions before filing or early in the case.
 - Evaluate claim amounts and leverage scenarios.
 - Document outreach efforts and plan negotiations.
- Provide the subchapter V trustee with timely updates, draft projections, and plan terms.
 - Use feedback to identify areas of concern and re-evaluate assumptions.
- Plan for plan objections.
 - Be proactive when assessing common challenges to feasibility, unfair discrimination, and reasonableness of projections.



Creative Solutions for Two-Party Disputes



Navigating Two-Party Disputes

- Leverage the subchapter V trustee as a third-party neutral to help mediate disputes or propose a compromise.
- Offer plan concessions or modifications without undermining feasibility or derailing your timeline.
 - For example, can you slightly increase payments, adjust timing of payments, or offer other security or non-monetary concessions?
- Assess whether the proposed plan meets the requirements of §1191(b) (permitting a “cramdown” confirmation) and evaluate risks of a contested plan hearing.



Strategies for Post-Confirmation Success



Post-Confirmation – Keys to Success

- Remind debtors that they are accountable for following the confirmed plan and for making the required payments on time.
- Recommend that debtors take part in ongoing financial education, improve bookkeeping and recordkeeping practices (if necessary), implement regular financial reviews, and seek professional guidance when needed.
- Be proactive if circumstances change – if disputes arise or plan modifications become necessary, seek early guidance to assess whether informal resolution is possible or if formal modification is necessary.



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Lauren P. Berret, CPA is a director in EisnerAmper LLP's Bankruptcy and Restructuring Services Group in Philadelphia. With over 10 years of experience, she specializes in restructuring and investigative advisory services and primarily focuses on distressed companies, unsecured creditors, senior lenders and trustees in the middle-market environment. In addition, Ms. Berret provides forensic accounting and litigation support services, drawing on her experience as a certified public accountant and licensed attorney. Throughout her career, she has been part of the bankruptcy and restructuring groups at several national accounting and advisory firms. She has served as a financial advisor to numerous unsecured creditors' committees and liquidating trustees. She also assisted in several bankruptcy litigation matters and was responsible for the review, analysis and sensitivity testing of financial projections, the assessment of historical financial condition, and a review of market commentary to assess capital adequacy in multiple engagements. Ms. Berret has conducted forensic investigations and reviews for business entities of all types and sizes and has prepared investigative and expert reports for use by key parties. Prior to providing advisory services, she spent four years practicing law as a consumer bankruptcy attorney, representing debtors in chapter 7 and 13 bankruptcy proceedings. Ms. Berret is a member of the Turnaround Management Association (TMA) and serves on its global DE&I Committee. She also serves as the DE&I Committee Chair of the TMA Philadelphia/Wilmington Chapter and received the TMA 2024 "Emerging Leader" Award. In addition, Ms. Berret co-chairs the International Women's Insolvency & Restructuring Confederation's (IWIRC's) Greater Philadelphia Network, and she is a 2024 ABI "40 Under 40" honoree. She received her B.S. in political science and psychology, and her accounting certification, from the University of Pittsburgh, and her J.D. from Duquesne University.

Soneet R. Kapila, CPA, CFE, CIRA is a founding partner of KapilaMukamal, LLP in Fort Lauderdale, Fla., and ABI's Immediate Past President and Acting Chair. For more than 30 years, he has concentrated his efforts in the areas of consulting in insolvency, fiduciary and creditors' rights matters. Mr. Kapila is a federal bankruptcy trustee and serves as an examiner, CRO, chapter 7 and 11 trustee, subchapter V trustee, liquidating trustee, corporate monitor (SEC appointments), and as a state and federal court-appointed receiver. He has been appointed in numerous matters in the Southern and Middle Districts of Florida. As a trustee plaintiff, Mr. Kapila has managed complex litigation in significant cases. He advises and represents debtors, secured creditors and creditors' committees in formulating, analyzing and negotiating plans of reorganization. As a recognized expert in fraudulent conveyance, Ponzi schemes and insolvency issues, Mr. Kapila has provided expert testimony and litigation-support services to law firms involving complex insolvency issues and commercial damages. He has worked in conjunction with the SEC, FBI and U.S. Attorney's Office, and he has served both as a consultant and expert witness for litigation matters in state and federal courts. Mr. Kapila has spoken to various groups, including ABI, New York Law School, St. Thomas University Law School, and the National Conference of Bankruptcy Judges, Southeastern Bankruptcy Law Institute, National Association of Bankruptcy Trustees (NABT), Receiver's Forum, Association of Insolvency and Restructuring Advisors, Florida Institute of Certified Public Accountants, Turnaround Management Association, University of Miami School of Law, Florida International University School of Law, American Bar Association and the National Business Institute on topics related to insolvency, underperforming businesses and insolvency taxation. He is a Fellow of the American College of

Bankruptcy and a past-president and past-chairman of the Association of Insolvency & Restructuring Advisors, for which he serves on its board of directors. Mr. Kapila has served on the advisory boards of ABI's Southeast Bankruptcy Workshop and Caribbean Insolvency Symposium. He also co-authored ABI's *Fraud and Forensics: Piercing Through the Deception in a Commercial Fraud Case* (2015). Mr. Kapila received his M.B.A. in 1978 from Cranfield School of Management.

Ciara L. Rogers is a partner with Waldrep Wall Babcock & Bailey PLLC in Winston-Salem, N.C., where her practice focuses on debtors' and creditors' rights, chapter 11 bankruptcy, representing bankruptcy trustees in chapter 7 and 11 cases, serving as a subchapter V trustee, and litigating adversary proceedings. In 2022, she was certified as a specialist in business bankruptcy by the North Carolina State Bar Board of Legal Specialization. Ms. Rogers has taught a foundations of bankruptcy course and lectured on bankruptcy topics at local law schools, and she regularly speaks at conferences on various bankruptcy-related topics. In 2023, she was selected as one of the ABI's 40 Under 40 honorees. Previously, Ms. Rogers clerked for Hon. J. Rich Leonard and Hon. Randy D. Doub of the U.S. Bankruptcy Court for the Eastern District of North Carolina. She serves as the director of the Stubbs Bankruptcy Clinic at Campbell University's Norman A. Wiggins School of Law in Raleigh, N.C. In that capacity, she supervises law students in providing *pro bono* bankruptcy representation to low-wealth individuals in the Eastern District of North Carolina. Ms. Rogers received dual B.S. degrees in history and political science from Averett University and her J.D. from North Carolina Central University School of Law.

Hon. Deborah L. Thorne is a U.S. Bankruptcy Judge for the Northern District of Illinois in Chicago, appointed on Oct. 22, 2015. Prior to joining the bench, she was a partner in the Chicago office of Barnes & Thornburg LLP, where she was a member of its Financial Insolvency and Restructuring Department. Her practice included the representation of creditors and other parties in insolvency proceedings, and she frequently served as a federal equity receiver in commodity fraud cases brought by the Commodity Futures Trading Commission. In addition, she co-chaired the Women's Initiative for the firm. Judge Thorne is past chair of the Chicago Bar Association Bankruptcy and Restructuring Committee and past chair of the Bankruptcy Committee for the Seventh Circuit Bar Association. She previously served as ABI's Vice President-Communications and Information Technology and is the author of ABI's *Preference Defense Handbook: The Circuits Compared* and a co-author of ABI's *Interrupted! Understanding Bankruptcy's Effects on Manufacturing Supply Chains*. Judge Thorne is a Fellow of the American College of Bankruptcy. She served as Education Committee chair for the National Conference of Bankruptcy Judges from 2019-20 and as its president from 2021-22. Judge Thorne is included in *The Best Lawyers in America* for bankruptcy and creditor/debtor rights law, is recognized as a Leading Lawyer in Illinois, and has been recognized by *Illinois Super Lawyers* every year since 2003. For seven years, she chaired Women Employed, a Chicago nonprofit policy organization focused on improving the lives of low-wage women through enhancing access to post-secondary education and improving job quality. Judge Thorne received her B.A. from Macalester College, her M.A.T. from Duke University and her J.D. with honors from Illinois Institute of Technology Chicago-Kent College of Law.