

## Best Practices Series – Distressed Debt: **Small Business Bankruptcies**

Michael D. Fielding<sup>1</sup>  
Husch Blackwell LLP  
4801 Main Street, Suite 1000  
Kansas City, MO 64112  
816-983-8000

[michael.fielding@huschblackwell.com](mailto:michael.fielding@huschblackwell.com)

[www.huschblackwell.com](http://www.huschblackwell.com)

1. What is a Sub-Chapter V Bankruptcy?
  - a. Amendment to the Bankruptcy Code which became effective in February 2020
  - b. It greatly streamlines small business Chapter 11 bankruptcies
  - c. It is codified at 11 U.S.C. § 1181 *et. seq.*
2. What is Different under Sub-Chapter V?
  - a. 60-day status conference
  - b. Ch. 11 plan due 90-days from bankruptcy petition
  - c. No creditors committee
  - d. Debtor provides most recent financial statements
  - e. No disclosure statement required as part of the Ch. 11 plan.
  - f. Only Debtor can file a Ch. 11 plan
  - g. No quarterly US Trustee fees
  - h. It is much easier to confirm a Ch. 11 plan
  - i. Court can confirm plan even if all classes of creditors reject it
  - j. Administrative expense claims can be paid during plan (not at confirmation)
  - k. "Absolute priority" rule does not apply
  - l. Debtor only has to pay disposable income for 3-5 years
  - m. Discharge granted if plan payments are successfully made
  - n. Debtor retains ownership of assets
3. What is the Role of a Subchapter V Trustee?
  - a. Ch. 11 Trustee is more supervisory (similar to Ch. 12 and 13 Trustee)

---

<sup>1</sup> Michael D. Fielding is a partner in the Food & Agribusiness unit of Husch Blackwell LLP in Kansas City, Missouri where he helps clients successfully resolve difficult problems involving distressed agricultural and commercial loans. He currently serves as President of the Ag Law Section of the Kansas Bar Association. He has published more than 40 articles on a variety of legal issues and regularly presents on successfully resolving debt with insolvent and bankrupt debtors. Listed in the 2021 and 2022 editions of Best Lawyers in America, he has been named multiple times as a "Best of the Bar" honoree by the Kansas City Business Journal, and he was recognized in 2019 and 2022 by IFLR 1000 as being Highly Regarded in Restructuring and Insolvency (Missouri). He is licensed in Missouri, Kansas, Iowa, Nebraska, Utah and numerous federal courts and is board certified in Business Bankruptcy by the American Board of Certification.

# HUSCH BLACKWELL

- b. Trustee keeps Debtor's cash payments until plan is confirmed or denied
- c. Facilitate the development of a consensual plan
- 4. What remains the same in Subchapter V?
  - a. Automatic stay
  - b. Adequate protection
  - c. Normal debtor-in-possession operations
  - d. Debtor-in-possession financing requirements
  - e. Section 363 free & clear sales
  - f. Executory contracts/unexpired leases
  - g. Section 523 discharge exceptions
- 5. Eligibility Requirements
  - a. No more than \$7.5 million in debt
  - b. Must be engaged in commercial or business activity
  - c. Cannot be a single asset real estate
  - d. Must have more than 50% of its debt from commercial or business activities
  - e. If debtor is one in a group of affiliated debtors, debt cap on the aggregate cannot exceed \$7.5 million
- 6. Dismissal or Conversion of Sub-Chapter V Cases
  - a. Party in interest may seek dismissal or conversion to Chapter 7 for "cause"
  - b. Cause includes:
    - i. substantial or continuing loss to the estate and the absence of a reasonable likelihood of rehabilitation
    - ii. gross mismanagement of the estate
    - iii. failure to maintain insurance
    - iv. unauthorized use of cash collateral that is substantially harmful to a creditor
    - v. unexcused failure to timely comply with reporting and filing requirements
- 7. Why Should Lenders Consider DIP Financing in Sub-Chapter V cases?
  - a. Chapter 11 can actually benefit a secured lender if the debtor/borrower can shed significant unsecured debt
  - b. DIP financing provides a means for "loan-to-own" lenders to more effectively accomplish their objectives
  - c. DIP lending may be profitable
- 8. Academic Research Validates the Benefits of DIP Financing
  - a. Companies that obtain DIP financing are more likely to emerge from Chapter 11 than companies that do not obtain DIP financing.
  - b. The duration of the bankruptcy is shorter when the pre-petition lender is also the DIP lender.
  - c. Smaller debtors tend to obtain DIP financing from their pre-petition lenders.
  - d. Bankruptcy proceedings tend to be shorter for debtors with DIP financing.
  - e. DIP financing provides an effective means for doing a prompt turnaround in bankruptcy.
- 9. Debtor's Possible Cash Sources in Bankruptcy
  - a. Use of existing cash collateral

# HUSCH BLACKWELL

- b. Post-petition financing (and no pre-petition loan)
  - c. Post-petition financing with “roll-over” agreement
10. Cash Collateral & Adequate Protection
- a. Cash collateral consists of “Cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired...and includes the proceeds, products, offspring, rents, or profits of property...” 11 U.S.C. § 363(a).
  - b. General Rule for Cash Collateral
    - i. The debtor can do normal, ordinary course transactions without court approval, BUT
    - ii. Debtor cannot use cash collateral unless lender consents OR The Court authorizes use of cash collateral
11. Best Practices to Protect Cash Collateral
- a. If no agreement regarding use of cash collateral exists, lender should immediately file a “Notice of Non-Consent to Use of Cash Collateral” at the outset of the case.
  - b. Absent an agreement with the borrower, the Lender should freeze bank accounts upon learning of the filing.
  - c. Immediately seek adequate protection
  - d. Lenders are only entitled to adequate protection beginning on the date they seek it.
  - e. A common practice is to file a motion for adequate protection or, alternatively, motion for relief from the automatic stay.
12. Post-Petition Financing Considerations
- a. Priming Liens – Requirements
    - i. Debtor must show it is unable to obtain credit at a lower tier, and Adequate protection must be granted to the secured lenders being primed.
    - ii. Debtor has the burden of proving adequate protection.
  - b. Practical Issues with Priming Liens
    - i. Difficult to obtain a priming lien because debtors typically don’t have assets with large equity cushion
  - c. Roll-up of Pre-Petition Secured Debt
    - i. Pre-petition debt is subject to adjustment by cramdown.
    - ii. Post-petition debt is not subject to adjustment and must be paid in full upon emergence from bankruptcy.
  - d. Two kinds of roll-up
    - i. Lump sum—post-petition advance pays pre-petition debt in full immediately plus additional new monies do debtor.
    - ii. Creeping—revolving credit reopened and A/R collections pay down pre-petition and new draws on line are post-petition. Over time, new advances replace old debt until all debt is post-petition. Usually involves increased availability on the line, overadvances and/or changed advance rates.

# HUSCH BLACKWELL

- e. The net effect of both is to replace pre-petition debt as post-petition.
- 13. Key Provisions in DIP Financing Agreement & DIP Orders
  - a. Admissions in DIP Agreements and Orders
  - b. Post-Petition Liens
  - c. Scope of lien
  - d. Cross-collateralization
  - e. Perfection of Liens
  - f. Budgets
  - g. Default Provisions & Remedies
  - h. Monetary terms (loan amount, rate, fees, etc.)
  - i. Key milestones
  - j. Prohibitions on use of estate funds to investigate liens
  - k. Cross-collateralization provisions
  - l. Provisions that bind the estate (findings of fact)
  - m. Any liens on Chapter 5 causes of action
  - n. Carve-outs
  - o. Limitations on future borrowings
  - p. Releases and Waivers
  - q. Waiver of claims
  - r. Waiver of right to contest secured status of lender's loans
  - s. Waiver of 11 U.S.C. § 506(c) surcharge right (iffy in 8<sup>th</sup> Cir.)
- 14. Section 363 Sales Considerations
  - a. Section 363 allows sale of assets free & clear of liens and encumbrances in certain situations.
  - b. Does lender consent? Can a better deal be had?
  - c. Is anyone else interested in the assets?
  - d. Will creditors do better under a 363 sale?
  - e. A Plan & 363 can be combined
- 15. Section 1111(b) Election
  - a. It can only be asserted by secured creditors
  - b. Allows full payment of secured lender's claim without interest over time
  - c. Applies to real and personal property
  - d. Not available when collateral value is "inconsequential"
  - e. Most effective for secured creditors in an undersecured position
- 16. Best Practices for Lenders in a Sub-Chapter V Bankruptcy
  - a. Debtor must file plan within 90-days of bankruptcy
  - b. Be proactive—seek to negotiate early
  - c. Work with trustee to negotiate a better plan treatment
  - d. Negotiate both your claim treatment and overall plan
  - e. Extract concessions for supporting the plan
- 17. Section 1191(a) Plan Confirmation vs. Section 1191(b) Plan Confirmation
  - a. 1191(a) Plan Confirmation
    - i. Debtor makes plan payments

# HUSCH BLACKWELL

- ii. Trustee's service terminates freeing up additional disposable income to pay creditors
  - iii. Discharge immediately happens on plan confirmation
  - iv. Automatic stay terminates
  - v. Debtor cannot modify plan once payments start
  - b. 1191(b) Plan Confirmation
    - i. Trustee continues on matter for 3-5 years
    - ii. Trustee disburses funds
    - iii. No discharge until plan payments are completed
    - iv. Automatic stay remains in place
    - v. Debtor can modify the plan
    - vi. Risk that the case interminably drags on (more attorney's fees)
18. Possible Ways to Challenge a Plan
- a. Challenge Disposable Income
    - i. "Disposable income" – debtor's current monthly income less reasonably necessary expenses for the support of the debtor and the operation of the debtor's business.
    - ii. How is disposable income calculated?
    - iii. Is excess cash available for creditors?
    - iv. Is disposable income dedicated to creditors for 3-5 years?
  - b. Challenge Feasibility
    - i. Debtor is not likely to be able to make all payments under the plan
    - ii. Plan fails to include appropriate remedies to protect claimants if payments are not made
  - c. Challenge "Best Interests" of Creditors Test
  - d. Are creditors better off if assets are liquidated in Chapter 7?
  - e. How are liquidation values ascertained?
  - f. Would creditors be better off through a § 363 sale?
  - g. Plan Discriminates Unfairly

These materials have been prepared solely for information and educational purposes, do not create an attorney-client relationship with the authors or Husch Blackwell LLP, and should not be used for legal counseling in specific situations. These materials reflect only the personal views of the author(s) and are not necessarily the views of Husch Blackwell LLP or its clients.