

Avoiding an ambush

New small business bankruptcy procedures streamline relief for financially strapped hotel owners

by ROBERT W. LANNAN



4.5-MINUTE READING TIME



FOR A FINANCIALLY DISTRESSED HOTEL OWNER, Chapter 11 bankruptcy is sometimes the last – and best – option for reorganizing and saving the business. However, until recently, Chapter 11 cases were unavoidably cumbersome, time consuming, and expensive, even for small businesses. Moreover, the likelihood of a small business owner still owning a business emerging from Chapter 11 was extremely low.

In 2020, a new set of provisions within Chapter 11 called Subchapter V ("five") went into effect, making reorganization in Chapter 11 faster, less complicated, and less expensive for many small businesses. It's now a process in which a business owner's equity interest in the business is more likely to survive, and the new law's effective date coincided with the escalation of COVID-19. Moreover, in the CARES Act and subsequent legislation, Congress increased the limit on the debt a small business owner must hold to reorganize under Subchapter V.

Before the CARES Act, a business could carry no more than \$2,725,625 in debt to be eligible for Subchapter V bankruptcy filing. As of this writing, until March 27, 2022, a business may hold up to \$7,500,000 in debt and still be eligible to do so. (By the time this article is printed, Congress may have further postponed this sunset date.)

This increase in eligibility was followed by an increase in Subchapter V filings but not as many in the hotel industry as some had expected. Federal relief, including the Paycheck Protection Program and Economic Injury Disaster Loans, and forbearance by many lenders from foreclosures have saved many small hotel businesses from bankruptcy. However, for other small hotel businesses in financial distress, Subchapter V is the best available remedy.

In any Chapter 11 case, the objective of the reorganizing business (the "debtor") is to obtain court approval ("confirmation") of a "plan of reorganization," pursuant to which the debtor pays its creditors while continuing to operate its business. This distinguishes Chapter 11 from Chapter 7, in which full control of the debtor's assets is automatically given to a trustee, who liquidates the assets and pays the creditors from the proceeds. Subchapter V of Chapter 11 does provide for the appointment of a trustee, but the trustee's powers are much more limited than in Chapter 7. For small business debtors, Subchapter V facilitates confirmation of a plan of reorganization in three ways: by (1) making it faster, (2) making it less complicated and expensive, and (3) reducing the debtor's required obligations to some creditors.

FASTER

Subchapter V implements procedures to get a small business through the bankruptcy process much more quickly. This is accomplished partly by placing fire under the feet of the debtor. In an ordinary Chapter 11 case, the debtor is given an exclusive right to file

a plan of reorganization for a period of 120 days (the "exclusivity period"), which may be extended. Afterward, creditors may propose their own competing plans. In a Subchapter V case, only the debtor may file a plan of reorganization, and it must be filed within 90 days, and an extension is more difficult to obtain. As another example, in an ordinary Chapter 11 case, there is a two-step confirmation process in which a debtor must first obtain court-approval of a "disclosure statement" highlighting important components of its plan of reorganization, and then must use that disclosure statement to solicit approval of the plan from creditors.

**"For other small hotel businesses in financial distress,
Subchapter V is the best available remedy."**

LESS EXPENSIVE

Elimination of the requirement for disclosure statements is one of several means by which Subchapter V makes the Chapter 11 process less expensive for a small business debtor. Another is the virtual elimination of creditors' committees. If an ordinary Chapter 11 case is large enough, unsecured creditors can form an official committee that plays a role in the case and whose attorneys and other professionals are paid by the debtor. Subchapter V imposes a presumption against creditors' committees in small business cases. Unlike other Chapter 11 debtors, debtors in Subchapter V are exempt from paying fees to the U.S. Trustee's Office, an agency of the Justice Department involved in the bankruptcy process.

EASIER CONFIRMATION OF PLANS OF REORGANIZATION

It is easier in Subchapter V than in other Chapter 11 cases for a debtor to obtain confirmation of a plan of reorganization. Ordinarily, a Chapter 11 plan does not allow the owner of a business to retain any equity interest unless all classes of creditors are either paid in full or vote to accept the plan. This "absolute priority" rule does not apply in Subchapter V. It's replaced by a less-stringent test in which the secured interests of lenders with liens on property must be protected and the debtor must contribute all "projected disposable income" into the plan for a period of three-to-five years. This

makes it easier for a small-business debtor to emerge from bankruptcy as a viable business with the same ownership after a plan of reorganization is carried out.

This article merely scratches the surface to provide a few examples of ways in which, through Subchapter V, Congress has made the Chapter 11 reorganization process easier for small business debtors. This new component of bankruptcy law will be a valuable resource for financially distressed owners of small to mid-sized hotels well into the future.

Robert W. Lannan is the Principal of Lannan Legal, PLLC, a firm specializing in hospitality industry transactions and counseling, restructuring, bankruptcy, and insolvency, and general corporate transactions. The firm advises and represents businesses, in the hospitality industry nationwide and elsewhere.
