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“Engaged In”: The Rocky Marriage Between Commercial and Business Activity and Subchapter V Eligibility

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“ENGAGED IN”: THE ROCKY MARRIAGE BETWEEN COMMERCIAL AND BUSINESS ACTIVITY AND SUBCHAPTER V ELIGIBILITY

ABSTRACT

The Small Business Reorganization Act of 2019, which created subchapter V bankruptcy relief for eligible small business debtors, is a step towards a small-business-friendly bankruptcy environment. The legislative history of subchapter V stated the goal of this new statute was to provide a cost-effective and streamlined path to reorganization to allow financially distressed small businesses to remain in business. To be eligible for subchapter V relief, a debtor must, among other requirements, be “engaged in commercial or business activities.” However, courts have continuously disagreed on the meaning of “engaged in commercial or business activities.” Courts have taken different stances on whether the debtor must be presently engaged in commercial or business activities, and what conduct satisfies the “activities” prong.

This Comment proposes a revision to subchapter V’s eligibility requirements to alleviate the confusion caused by inconsistent judicial interpretation, correct legislative drafting mistakes, and harmonize legislative intent and application, and proposes that the phrase “engaged in commercial or business activities” should be replaced with “presently engaged in the operation of, as of the petition date, a trade or business.” The term “trade or business” is a term of art commonly used in the Tax Code. The test set out by the Supreme Court in Commissioner v. Groetzinger should be used to determine if unregistered business forms, like sole proprietorships, are engaged in a trade or business. However, registered business forms are inherently a trade or business. These changes will remedy existing confusion by implementing a clear framework that accurately reflects legislative intent.

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INTRODUCTION

The “engaged in commercial or business activities” requirement for subchapter V eligibility should be revised to better reflect legislative intent and narrow the scope of debtor eligibility. Congress passed the Small Business Reorganization Act of 2019 (“SBRA”), creating subchapter V, which established a new avenue of relief for eligible small business debtors to reorganize under chapter 11. A small business debtor is defined as:

a person *engaged in commercial or business activities* (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than \$7,500,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor.¹

Representative Ben Cline of Virginia, the SBRA’s sponsor, spoke during a hearing held by the Subcommittee on Antitrust, Commercial, and Administrative Law on June 25, 2019, at which the House version of the SBRA was considered.² During the hearing, Cline stated the legislation was intended to allow these debtors “to file bankruptcy in a timely, cost-effective manner, and hopefully allow them to *remain in business*” which “not only benefits the owners, but employees, suppliers, customers, and others who rely on that business.”³ Proceeding under subchapter V offers unique advantages not typically afforded to standard chapter 11 debtors. However, the Bankruptcy Code fails to define “engaged in commercial or business activities,” which has led to inconsistent rulings on eligibility among bankruptcy courts. The conflicting directives from bankruptcy courts have caused confusion among

¹ 11 U.S.C. § 1182(1)(a)–(b) (emphasis added). The SBRA took effect on February 19, 2020. Small Business Reorganization Act (SBRA) of 2019, Pub. L. No. 116-54, 133 Stat. 1079 (codified primarily at 11 U.S.C. §§ 1181-1195). It has undergone slight modifications since. See Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, § 1113(a)(1), 134 Stat. 281, 310–11 (2020) (codified as amended at 11 U.S.C. § 1182) (increasing the limit for aggregate noncontingent liquidated secured and unsecured debts as of the petition date from \$2,725,625 to \$7,500,000); COVID-19 Bankruptcy Relief Extension Act of 2021, Pub. L. No. 117-5, sec. 2, § 1113, 135 Stat. 249 (amending the CARES Act by extending its increased debt threshold through March 22, 2022).

² *Oversight of Bankruptcy Law and Legislative Proposals: Hearing Before the Subcomm. on Antitrust, Com. & Admin. L. of the H. Comm. on the Judiciary*, 116th Cong. 19–22 (2019) (statement of Rep. Ben Cline, Member, H. Comm. on the Judiciary) [hereinafter *Cline Statement*].

³ *Id.* at 19 (emphasis added).

debtors, lawyers, and scholars. This Comment navigates and diagrams this uncertainty on eligibility and ultimately proposes a revision to 11 U.S.C. § 1182 that will better reflect legislative intent and permit easier application.

This Comment begins by highlighting key advantages uniquely afforded to subchapter V debtors to illustrate the importance of eligibility. Next, this Comment explores the seminal eligibility cases in early subchapter V jurisprudence. Ashley Champion has sorted the prevailing interpretations of “engaged in commercial or business activity” into three distinct schools of thought, each characterized by a few notable opinions.⁴ After discussing and expanding on her framework, I provide an overview of the inconsistencies between the different schools of thought. Before suggesting a proposed revision to subchapter V’s eligibility requirements, this Comment examines the SBRA’s legislative history and the usage of “engaged in” throughout the Bankruptcy Code and other federal statutes, such as the Tax Code. My proposed revision to subchapter V’s eligibility requirements better captures legislative intent by requiring debtors to be actively operating a trade or business on the petition date. The term “trade or business” is a term of art commonly used in the Tax Code, and its established definition will be adopted in this context.

I. ADVANTAGES AFFORDED TO SUBCHAPTER V DEBTORS

The SBRA and subchapter V provide a reasonable avenue for financially distressed small businesses to seek reorganization and avoid both the harsh realities of chapter 7 liquidation and the costs and complexities associated with traditional chapter 11 relief. Before the SBRA, small businesses had few choices for relief and often resorted to chapter 7 bankruptcy, which ends the debtor’s business via liquidation.⁵ Although a successful chapter 11 case would allow continued operations, chapter 11’s costs and procedural obligations are often too demanding for small businesses to satisfy.⁶ The significant procedural and reporting requirements can quickly accumulate substantial attorney’s fees for the chapter 11 debtor.⁷ In addition to their own attorney’s fees, chapter 11 debtors are also responsible for the attorney’s fees of the unsecured creditors’

⁴ Ashley D. Champion, *Analyzing a Gatekeeper to Subchapter V Eligibility: What Does It Mean to Be “Engaged in Commercial or Business Activities”?*, 2021 NORTON ANN. SURV. BANKR. L. 3 (2021).

⁵ Nika Aldrich & Lawrence Ream, *Chapter 11 Bankruptcy is Expensive; The Small Business Reorganization Act Provides a Realistic Opportunity for Small Businesses to Reorganize*, SCHWABE, WILLIAMSON & WYATT: NEWSROOM (July 2, 2020), <https://www.schwabe.com/newsroom-publications-chapter-11-bankruptcy-is-expensive-the-small-business-reorganization-act-provides-a-realistic-opportunity>.

⁶ *Id.*

⁷ *Id.*

committee, creating even more financial stress for already struggling small businesses.⁸ The SBRA aims to alleviate some of these concerns by implementing a streamlined and more affordable process which provides small businesses a previously unavailable opportunity to quickly reorganize.⁹

A. *Reduced Cost to Debtors*

Subchapter V provides several cost advantages to eligible debtors that are not otherwise available under chapter 11. Reorganization under subchapter V is typically less expensive than a traditional chapter 11 case because the debtor is not required to pay quarterly fees to the United States trustee.¹⁰ In a standard chapter 11 case, debtors must pay a quarterly fee to the United States trustee System Fund, which can range from \$250 to \$250,000, based on the amount of the debtor’s total quarterly disbursements.¹¹ However, the statute outlining quarterly United States trustee fees explicitly excludes small business cases under subchapter V.¹² Although subchapter V debtors are not required to pay quarterly United States trustee fees, a “subchapter V trustee” is typically appointed to assist the reorganization process by handling many of the typical chapter 11 obligations.¹³ The subchapter V trustee does not assume management of the debtor’s business but rather assists in creating a reorganization plan and examining proofs of claim from creditors.¹⁴ The termination of the subchapter V trustee’s appointment is based on whether the plan is consensual or non-consensual.¹⁵ If the plan is consensual, the subchapter V trustee is relieved of their duties when the plan is “substantially consummated” under 11 U.S.C. § 1183(c)(1) and notice of substantial consummation is provided to the subchapter V trustee, the United States trustee, and all interested parties.¹⁶ If the plan is non-consensual, then the subchapter V trustee remains in place until the end of the plan to make distributions pursuant to the terms of the plan.¹⁷ Though the debtor is required to pay fees to the subchapter V trustee, those fees are included as part

⁸ *Id.*

⁹ *Id.*

¹⁰ William L. Norton III & James B. Bailey, *The Pros and Cons of the Small Business Reorganization Act of 2019*, 36 EMORY BANKR. DEV. J. 383, 383 (2020) (citing 28 U.S.C. § 1930(a)(6)(A)).

¹¹ 28 U.S.C. § 1930(a)(6)(A).

¹² *Id.*

¹³ See Aldrich & Ream, *supra* note 5.

¹⁴ Norton & Bailey, *supra* note 10, at 389.

¹⁵ *Id.*

¹⁶ *Id.* (citing 11 U.S.C. § 1183(c)(1)–(2)).

¹⁷ *Id.* (citing 11 U.S.C. § 1194(b)) (noting that the court or the plan may allow for the subchapter V trustee to be relieved of their duties in a non-consensual plan prior to the completion of the plan).

of the reorganization plan rather than paid quarterly like United States trustee fees.¹⁸

Under subchapter V, a debtor may be allowed to spread administrative expenses over the life of the plan if that plan is confirmed pursuant to the cramdown provisions.¹⁹ The cramdown provisions of 11 U.S.C. § 1191(b) state that notwithstanding 11 U.S.C. § 510(a) (“Subordination of claims”), and assuming the proposed plan meets the requirements in 11 U.S.C. § 1129(a) (“Confirmation of plan”), the court may, at the debtor’s request, confirm their proposed plan if “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.”²⁰ Essentially, the cramdown provision allows the court to accept the debtor’s proposed plan despite objections from creditors that may not receive the full value of their claims under that plan.

Although spreading administrative expenses throughout the duration of the plan is standard practice in chapter 12 and 13 cases, it is only available to subchapter V debtors when the plan is approved pursuant to the cramdown provisions.²¹ However, this is still an improvement over a typical chapter 11 case, which requires the administrative expenses to be paid in full on the effective date of the plan.²² While debtors usually prefer a consensual plan to avoid the hassle of preparing motions and arguing for approval of the plan under the cramdown provisions, a subchapter V debtor may prefer the plan be contested, so administrative expenses can be allocated over the life of the plan.²³ An already financially distressed small business may be unable to afford a lump sum payment of the administrative fees on the effective date of the plan, so the ability to spread the expenses over the term of the plan may be extremely valuable in the business’s recovery.

In a traditional chapter 11 case, the creation of a creditors’ committee is usually standard practice. However, in subchapter V, a creditors’ committee is

¹⁸ Aldrich & Ream, *supra* note 5.

¹⁹ Champion, *supra* note 4 (citing 11 U.S.C. §§ 1129(a)(9)(A), 1191(e)).

²⁰ 11 U.S.C. § 1191(b); *see also* 11 U.S.C. § 510(a); 11 U.S.C. § 1129(a).

²¹ Norton & Bailey, *supra* note 10, at 387 (citing 28 U.S.C. § 1930(a)(6)(A)) (“The ability to stretch out some payments . . . is not available in a consensual plan, probably because the drafters did not want the trustee appointed in the case to be removed until after the administrative expenses, including trustee fees, have been paid.”). The subchapter V trustee in a consensual plan is removed on the effective date of the plan, while in a non-consensual plan, the subchapter V trustee is not relieved of their duties until completion of the plan. *See id.* at 389 (discussing 11 U.S.C. § 1183(c)).

²² Champion, *supra* note 4.

²³ *Id.*; *see also* Norton & Bailey, *supra* note 10, at 387 (citing 28 U.S.C. § 1930(a)(6)(A)).

not appointed unless ordered by the bankruptcy court.²⁴ This allows the debtor to avoid paying the legal fees of the creditors’ committee, as required in a standard chapter 11 case.²⁵

B. The Reorganization Plan: Exclusivity and Discharge

Chapter 11 affords the debtor the exclusive right to file a plan of reorganization for 120 days, though the court can extend the exclusivity period up to eighteen months.²⁶ After the expiration of the exclusivity period, any interested party is allowed to file a plan on the debtor’s behalf.²⁷ However, in subchapter V, eligible debtors are granted the exclusive right to file a plan, and other interested parties are not allowed to file a plan at any point in the case.²⁸ The subchapter V debtor’s exclusive right to propose a plan lowers reorganization costs because the debtor is not forced to litigate to prevent the approval of competing plans.²⁹ Under the SBRA, debtors are also not required to file a disclosure statement as chapter 11 requires.³⁰ In subchapter V, a debtor is only required to include a brief history of the company detailing its ability to make the payments under the plan rather than the extensive and costly disclosures required under the traditional chapter 11 plan process.³¹

Once the plan is confirmed in a subchapter V case, the debtor is the only party that can modify it,³² compared to an ordinary chapter 11 case which allows the trustee, United States trustee, or unsecured claimholders to request revisions to the plan.³³ This scenario is a win-win for subchapter V debtors. In the event the debtor’s business rebounds and garners increased revenue or profits, creditors are unable to seek an increase in payments.³⁴ If the debtor’s business declines, the debtor can request that the court modify the plan.³⁵ Nevertheless,

²⁴ Aldrich & Ream, *supra* note 5.

²⁵ *Id.*

²⁶ Champion, *supra* note 4 (citing 11 U.S.C. § 1121(b), (d)) (observing that small business debtors under chapter 11 are granted the exclusive right to file a plan for 180 days, with the potential to be extended up to 300 days post-petition).

²⁷ *Id.* (citing 11 U.S.C. § 1121(c)).

²⁸ *Id.* (citing 11 U.S.C. § 1189(a)).

²⁹ Aldrich & Ream, *supra* note 5.

³⁰ *Id.*

³¹ *Id.*

³² Champion, *supra* note 4 (citing 11 U.S.C. § 1193, 1181(a)).

³³ *Id.* (citing 11 U.S.C. § 1127(e)) (alterations may be requested to change payments, extend, or reduce the payment period, or alter the distribution amount in a standard chapter 11 case).

³⁴ Norton & Bailey, *supra* note 10, at 386 (citing 11 U.S.C. § 1193(c)).

³⁵ *Id.* (citing 11 U.S.C. § 1193(c)).

there is a catch. Debtors under subchapter V must file their reorganization plan within ninety days of the petition date and are subject to stricter standards when seeking an extension.³⁶

As discussed above, contested plans enable the debtor to spread administrative costs out over a longer period. Although this may encourage debtors to hope for a contested plan, 11 U.S.C. § 1191(a) reels them back in. If a debtor's reorganization plan is consensual and was approved in accordance with 11 U.S.C. § 1191(a), then the debtor obtains a discharge on the effective date of the plan.³⁷ Section 1191(a) of the Bankruptcy Code provides that a consensual plan under subchapter V will follow the same procedures as a consensual plan in a standard chapter 11 case.³⁸ However, when a non-consensual plan is confirmed in subchapter V pursuant to 11 U.S.C. § 1191(b), the debtor is granted a discharge "as soon as practicable after completion by the debtor of all payments due within the first 3 years of the plan."³⁹

C. *Inapplicability of the Absolute Priority Rule*

Arguably the most important advantage for subchapter V debtors is the inapplicability of the absolute priority rule.⁴⁰ The absolute priority rule in 11 U.S.C. § 1129(b)(2)(B)(ii) requires that in a non-consensual plan, any "dissenting class of unsecured creditors must be paid in full before any junior class can receive or retain property under a plan of reorganization."⁴¹ Typically, when a class of unsecured creditors votes to reject a chapter 11 plan, they must be paid in full prior to equityholders receiving anything, essentially wiping out the value of equityholders' shares in the company.⁴² However, subchapter V cases are not subject to the same rules. In subchapter V, courts may "confirm a plan over the objection of unsecured creditors as long as all projected disposable income of the debtor, to be received in a three-year [to five-year] period . . . will be applied to the plan."⁴³ The inapplicability of the absolute priority rule in subchapter V strategically encourages eligible debtors to pursue relief under subchapter V because the business owners' interests are more secure. This ensures continuity of management and ownership since equityholders retain

³⁶ Champion, *supra* note 4 (citing 11 U.S.C. § 1189(b)).

³⁷ Norton & Bailey, *supra* note 10, at 386 (citing 11 U.S.C. § 1191(a)).

³⁸ *Id.*

³⁹ 11 U.S.C. § 1192.

⁴⁰ Norton & Bailey, *supra* note 10, at 384–85 (citing 11 U.S.C. § 1191(a)).

⁴¹ *Id.* at 384 (citing *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988)).

⁴² *Id.* (citing *Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 437 (1999)).

⁴³ *Id.* at 385 (citing 11 U.S.C. § 1191(b)).

incentives to participate fully in the reorganization of the company, given that they have a greater chance of retaining some value.⁴⁴

II. THREE SCHOOLS OF THOUGHT

The approaches that courts have taken in applying subchapter V’s eligibility requirements have been conceptually organized into three distinct schools of thought.⁴⁵ *Wright* and *Blanchard* represent the earliest school, followed by *Thurmon* and *Johnson*. *Offer Space*, *Ikalowych*, and *Port Arthur Steam Energy* offer the most recent approach. While the three schools of thought can be organized by their ideology and analysis, they are spread across jurisdictions throughout the country. The early *Wright* and *Blanchard* approach contends that a debtor does not need to be currently engaged in commercial or business activities as of the petition date, based on the plain language of 11 U.S.C. § 1182.⁴⁶ The *Thurmon* and *Johnson* approach alters this by requiring debtors to be actively engaged in commercial or business activities as of the petition date, but narrows the scope of conduct considered an “activit[y].”⁴⁷ Lastly, the courts in *Port Arthur Steam Energy*, *Ikalowych*, and *Offer Space* followed the *Thurmon* and *Johnson* courts by requiring that debtors be currently engaged in commercial or business activities, but take a much broader approach as to what may constitute a “commercial or business activity” by allowing non-operational tasks of defunct businesses to satisfy those requirements.⁴⁸ This Comment argues that the *Thurmon* and *Johnson* approach is the optimal approach and best captures legislative intent. My proposed revision codifies the contemporaneity requirement and strict interpretation of “commercial or business activities” imposed by *Thurmon* and *Johnson* in a manner that is unambiguous and easily applied to future debtors. The below figure visually summarizes the three approaches.

⁴⁴ *See id.*

⁴⁵ *Champion*, *supra* note 4. Ashley Champion conceptually linked *Wright* with *Blanchard*, *Johnson* with *Thurmon*, and *Offer Space* with *Blue* together in her discussion of the current subchapter V eligibility landscape.

⁴⁶ *See In re Wright*, No. 20-01035, 2020 WL 2193240, at *3 (Bankr. D.S.C. Apr. 27, 2020); *see also In re Blanchard*, No. 19-12440, 2020 WL 4032411, at * 2 (Bankr. E.D. La. July 16, 2020).

⁴⁷ *See In re Thurmon*, 625 B.R. 417, 423 (Bankr. W.D. Mo. 2020); *see also In re Johnson*, No. 19-42063, 2021 WL 825156, at *7 (Bankr. N.D. Tex. Mar. 1, 2021).

⁴⁸ *See In re Port Arthur Steam Energy, L.P.*, 629 B.R. 233, 236–37 (Bankr. S.D. Tex. 2021); *see also In re Offer Space*, 629 B.R. 299, 310 (Bankr. D. Utah 2021).

		Must filing be contemporaneous with debtor's being "engaged in commercial or business activities?"	
		Contemporaneity Required	Contemporaneity Not Required
How strictly should "commercial or business activities" be construed?	Expansive Construction	3. <i>Port Arthur Steam Energy, Offer Space, Ikalowych</i>	(none)
	Restrictive Construction	2. <i>Thurmon, Johnson</i>	1. <i>Wright, Blanchard</i>

A. *The First School of Thought: Wright and Blanchard's No Contemporaneity Requirement*⁴⁹

In re Wright was one of the earliest instances of a court having to interpret the meaning of "engaged in commercial or business activities" since the opinion was issued just a few months after subchapter V went into effect.⁵⁰ In *Wright*, the debtor was an individual and the sole member of Boiling Pot Investments, LLC, as well as a 49% owner of Carolinas Custom Clad, Inc.⁵¹ Both companies filed for bankruptcy under chapter 11 and ceased operations in 2018; however, both previous bankruptcy cases were dismissed before *Wright* filed for bankruptcy as an individual and sought relief under subchapter V.⁵² In defining "engaged in commercial or business activities," the court addressed the legislative history, which "indicates [the SBRA] was intended to improve the

⁴⁹ Champion, *supra* note 4. Champion similarly grouped *Wright* and *Blanchard* in her discussion of subchapter V eligibility.

⁵⁰ *Wright*, 2020 WL 2193240.

⁵¹ *Id.* at *1.

⁵² *Id.*

ability of small businesses to reorganize and ultimately remain in business”⁵³ However, the court stated that “nothing in 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.”⁵⁴ To support their position, the court cited to an excerpt from *Collier on Bankruptcy* stating that “the definition of a ‘small business debtor’ is not restricted to a person who at the time of the filing of the petition is presently engaged in commercial or business activities and who expects to continue in those same activities under a plan of reorganization.”⁵⁵ Relying on that excerpt, the court reasoned that the debtor was sufficiently engaged in commercial and business activities, even though his two businesses had shut their doors in 2018,⁵⁶ because he was still “addressing residual business debt” incurred by those businesses.⁵⁷

In *Blanchard*, a married couple filed for bankruptcy relief under chapter 11 in the fall of 2019.⁵⁸ In response to a motion by the United States trustee requesting that the court convert the case to chapter 7, the debtors amended their petition and sought relief under the newly-passed subchapter V.⁵⁹ The debtors were the sole owners of three companies and two rental properties; their debt largely stemmed from personal guarantees of business debts.⁶⁰ In determining whether these debtors were “engaged in commercial or business activities,” the court adopted the reasoning given by the court in *Wright*,⁶¹ emphasizing that subchapter V contained no language that would limit application to debtors *currently* engaged in commercial or business activities. The court ultimately

⁵³ *Id.* at *3 (citing H.R. REP. NO. 116-171, at 4 (2019), as reprinted in 2019 U.S.C.C.A.N. 366, 369).

⁵⁴ See *id.* (quoting 2 COLLIER ON BANKRUPTCY ¶ 101.51D (16th ed. 2020)); see also *In re Bonert*, 619 B.R. 248, 255–56 (Bankr. C.D. Cal. 2020); *In re Blanchard*, No. 19-12440, 2020 WL 4032411, at *2 (Bankr. E.D. La. July 16, 2020).

⁵⁵ *Wright*, No. 2020 WL 2193240, at *3 (quoting 2 COLLIER ON BANKRUPTCY ¶ 101.51D (16th ed. 2020)). But see *In re Ikalowych*, 629 B.R. 261, 282–83 (Bankr. D. Colo. 2021) (noting that the section of *Collier* relied upon by the court in *Wright* was subsequently removed). The *Wright* court also cited to a portion of *Collier* that gave a hypothetical scenario in which a small business debtor might be unjustly excluded from subchapter V.

That [potential debtor] may have incurred \$2,725,625 in noncontingent, liquidated, secured and unsecured debts that arose from business activities before the date of the filing of the case, but as of the petition date may have discontinued those business activities. There is nothing in the legislative history to suggest that in this latter instance, the small business amendments should not apply to that person.

Wright, 2020 WL 2193240, at *3 (quoting 2 COLLIER ON BANKRUPTCY ¶ 101.51D (16th ed. 2020)).

⁵⁶ *Wright*, 2020 WL 2193240, at *3

⁵⁷ *Id.*

⁵⁸ *Blanchard*, 2020 WL 4032411, at *1.

⁵⁹ *Id.*

⁶⁰ *Id.* at *2.

⁶¹ *Id.*

allowed the debtors to proceed under subchapter V.⁶² The court reasoned that because “a majority of the Debtors’ debts stem[med] from the operation of both currently operating businesses and non-operating businesses,” the debtors were sufficiently engaged in commercial or business activity to allow them to proceed under subchapter V.⁶³ This Comment later argues that this first line of reasoning is obsolete;⁶⁴ both subsequent schools impose some sort of contemporaneity requirement, but diverge on what types of actions the debtor must be engaged in at time of filing.

*B. The Second School of Thought: Thurmon and Johnson’s Narrow Stance on “Activities”*⁶⁵

Departing from the *Wright-Blanchard* approach, the bankruptcy courts deciding *In re Thurmon* and *In re Johnson* determined that a debtor was not eligible to proceed under subchapter V unless engaged in business or commercial activities as of the time of the petition.⁶⁶ The court’s decision in *Thurmon* best exemplifies the inconsistent application of the subchapter V eligibility requirements.⁶⁷ In *Thurmon*, a married couple who owned a limited liability company sought relief under subchapter V three months after the LLC ceased operations and sold its assets.⁶⁸ While the company did not have any employees, customers, vendors, or any other indicators of its intention to resume business activities on the petition date, it retained outstanding accounts receivable and two company vehicles.⁶⁹ The United States trustee objected to the debtors’ subchapter V election on the basis that the debtors had ceased business operations prior to the petition date and had no intent to resume.⁷⁰ The court ultimately agreed with the United States trustee, and prohibited the debtors from proceeding under subchapter V.⁷¹ The debtors presented three grounds as to why they should be allowed to proceed under subchapter V. First, “the

⁶² *Id.*; see also *In re Bonert*, 619 B.R. 248, 255–56, 258 (Bankr. C.D. Cal. 2020) (allowing a debtor to proceed under subchapter V based on residual business debts incurred by bakery business that ceased operations prior to the petition date).

⁶³ *Blanchard*, 2020 WL 4032411, at *2.

⁶⁴ See *infra* text accompanying notes 161, 165–69.

⁶⁵ Ashley Champion grouped *Johnson* with *Thurmon* in her discussion of subchapter V eligibility. See Champion, *supra* note 4 (text accompanying nn.50–67).

⁶⁶ See generally *In re Thurmon*, 625 B.R. 417, 419–24 (Bankr. W.D. Mo. 2020); *In re Johnson*, No. 19-42063, 2021 WL 825156, at *1–10 (Bankr N.D. Tex., Mar. 1, 2021).

⁶⁷ See generally *Thurmon*, 625 B.R. at 419–24.

⁶⁸ *Id.* at 420.

⁶⁹ *Id.*

⁷⁰ See *id.* at 420–21.

⁷¹ See *id.*

statutory definition of a small business debtor does not say that debtors must be ‘currently’ engaged in business.”⁷² Second, the debtors argued that even if current engagement were required, they met that requirement since their LLC was “still an entity in good standing.”⁷³ Finally, citing to *Wright* and *Blanchard*, the debtors noted that “all the cases thus far unanimously agree that debtors do not have to be ‘currently’ engaged in business to qualify for subchapter V small business relief.”⁷⁴ The court acknowledged that the debtors “are correct that since February 19, 2020 when subchapter V relief first became available, the only cases to decide the issue have agreed with [debtors’] interpretation.”⁷⁵ But the court in *Thurmon* declined to follow suit. The court supported its departure from earlier cases by stating that “if Congress had intended to make all debtors with business debts below the debt cap eligible for subchapter V small business relief regardless of whether the business was still operating, it could have done so.”⁷⁶

In *Johnson*, a married couple sought to convert their chapter 7 bankruptcy case to a subchapter V case.⁷⁷ The court held that because the companies had permanently ceased operations, with no intention to resume, and because the debtors were not carrying out any business or commercial activities related to the defunct company, the debtors were not presently engaged in commercial or business activities.⁷⁸ The debtors owned and operated seven oil and gas companies that had ceased operations prior to the petition date in summer of 2019.⁷⁹ On the petition date, the debtors did not own or hold an ownership interest in any functioning businesses.⁸⁰ However, the debtor husband actively managed an LLC owned by his parents, unrelated to the defunct companies he owned with his wife.⁸¹ The United States trustee objected to the conversion to subchapter V by arguing the debtors were no longer “engaged in commercial or business activities,” and the statute required active engagement in such activities on the petition date.⁸² The debtors argued that the statute refers to both current

⁷² See *id.* at 421.

⁷³ See *id.*

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *Id.* at 423.

⁷⁷ *In re Johnson*, No. 19-42063, 2021 WL 825156, at *1 (Bankr. N.D. Tex. Mar. 1, 2021).

⁷⁸ *Id.* at *7.

⁷⁹ *Id.* at *2. Two companies ceased operations in 2017, four ceased operations in 2018, and the remaining company ceased operations in the winter of 2019. *Id.*

⁸⁰ *Id.* at *3.

⁸¹ *Id.*

⁸² *Id.* at *1, *5.

and former commercial or business activities and their prior ownership of the oil and gas companies and resulting business debt satisfied the statutory requirement.⁸³ The court disagreed, first reasoning that the husband debtor's role within his family LLC was not sufficient to allow subchapter V eligibility because he did not hold any ownership interest and was merely a W-2 employee.⁸⁴ The court also deemed the debtors ineligible to proceed under subchapter V by virtue of their interest in their seven defunct businesses, because subchapter V's purpose as articulated by its congressional proponents was to permit small businesses "to file bankruptcy in a timely, cost-effective manner, and hopefully allow them to *remain in business*."⁸⁵

C. *The Third School of Thought: Port Arthur Steam Energy, Offer Space, and Ikalowych's Lenient Construction of "Activities"*

In re Offer Space, *In re Port Arthur Steam Energy*, and *In re Ikalowych* are recent interpretations of the subchapter V eligibility requirements. The courts in *Port Arthur Steam Energy* and *Offer Space* eased the requirements of subchapter V eligibility by construing "commercial or business activities" as an extremely broad term that can be satisfied by non-operational tasks carried out on behalf of defunct businesses, such as maintaining accounts receivable or upkeeping facilities.⁸⁶ The court in *Ikalowych* determined that "commercial or business activity" for an individual debtor could include non-passive entity ownership, managing or directing a limited liability company, wind down activities, or serving as a salaried employee.⁸⁷

In *Port Arthur Steam Energy*, a limited partnership debtor owned and operated a waste heat facility in Texas.⁸⁸ On the petition date, the debtor was not actively selling steam or electricity services, as it had previously.⁸⁹ The debtor's facility was continually maintained by a contracted employee and employees of the debtor's limited partner pursuant to a management agreement.⁹⁰ The debtor

⁸³ *Id.* at *5.

⁸⁴ *Id.* at *8.

⁸⁵ *Id.* at *6 (quoting H.R. REP. NO. 116-171, at 4 (2019), as reprinted in 2019 U.S.C.C.A.N. 366, 369) (emphasis added by court).

⁸⁶ See *In re Port Arthur Steam Energy, L.P.* 629 B.R. 233, 237 (Bankr. S.D. Tex. 2021); see also *In re Offer Space*, 629 B.R. 299, 306 (Bankr. D. Utah 2021).

⁸⁷ *In re Ikalowych*, 629 B.R. 261, 283–86 (Bankr. D. Colo. 2021).

⁸⁸ *Port Arthur Steam Energy*, 629 B.R. at 234.

⁸⁹ *Id.* at 234, 236.

⁹⁰ *Id.* at 236.

sought relief under subchapter V in April 2021.⁹¹ A creditor and the United States trustee challenged the debtor’s eligibility under subchapter V, arguing that the debtor was not “engaged in commercial or business activities.”⁹² In analyzing the debtor’s subchapter V eligibility, the court began by looking at the plain language definition of each word to piece together a comprehensive definition.⁹³ It first defined “engaged in” as “involved in activity” and specified that this, in the context of 11 U.S.C. § 1182, means that a debtor is presently participating in commercial or business activities on the petition date.⁹⁴ The court defined “commercial” as “of or relating to commerce” and “viewed with regard to profit”;⁹⁵ it further defined “commerce” as “the exchange or buying and selling of commodities on a large scale involving transportation from place to place.”⁹⁶ Additionally, the *Port Arthur Steam Energy* court defined “business” as “a usually commercial or mercantile activity engaged in as a means of livelihood.”⁹⁷ Lastly, the court defined “activity” as “the quality or state of being active: behavior or actions of a particular kind.”⁹⁸ The court ultimately held the debtor was engaged in commercial or business activities.⁹⁹ The court cited several examples of conduct that indicates commercial or

⁹¹ *Id.* at 235.

⁹² *Id.* If the debtor’s eligibility under subchapter V is challenged, the debtor is responsible for proving eligibility.

⁹³ *Id.* at 236.

⁹⁴ *Id.*; see also *In re Blue*, 630 B.R. 179, 188 (Bankr. M.D.N.C. 2021); *In re Offer Space*, 629 B.R. 299, 305 (Bankr. D. Utah 2021); *In re Johnson*, No. 19-42063, 2021 WL 825156, at *6 (Bankr. N.D. Tex. Mar. 1, 2021); *In re Vertical Mac Constr.*, No. 6:21-bk-01520, 2021 WL 3668037, at *2 (Bankr. M.D. Fla. July 23, 2021).

⁹⁵ *Port Arthur Steam Energy*, 629 B.R. at 236 (quoting *Commercial*, MERRIAM-WEBSTER ONLINE DICTIONARY, www.merriam-webster.com/dictionary/commercial (last visited Feb. 11, 2023)); see also *Offer Space*, 629 B.R. at 305; *Blue*, 630 B.R. at 188–89. *But see Johnson*, 2021 WL 825156, at *8 (“[C]ommercial or business activities” in the context of subchapter V means a person “engaged in the exchange or buying and selling of economic goods or services for profit.”). However, the bankruptcy court in *Ellingsworth Residential* held that a nonprofit corporation qualified as a small business debtor under subchapter V because 11 U.S.C. § 1182 does not explicitly require a profit motive to be “engaged in commercial or business activity,” essentially expanding eligibility to non-profits involved in commerce. *In re Ellingsworth Residential Cmty. Ass’n*, 619 B.R. 519, 521 (Bankr. M.D. Fla. 2020) (reasoning that the plain language of the statute does not require a profit motive for subchapter V eligibility).

⁹⁶ *Port Arthur Steam Energy*, 629 B.R. at 236 (quoting *Commerce*, MERRIAM-WEBSTER ONLINE DICTIONARY, www.merriam-webster.com/dictionary/commerce (last visited Feb. 11, 2023)); see also *Offer Space*, 629 B.R. at 305; *Blue*, 630 B.R. at 189.

⁹⁷ *Port Arthur Steam Energy*, 629 B.R. at 236 (quoting *Business*, MERRIAM-WEBSTER ONLINE DICTIONARY, www.merriam-webster.com/dictionary/business (last visited Feb. 11, 2023)); see also *Offer Space*, 629 B.R. at 305; *Blue*, 630 B.R. at 188–89.

⁹⁸ *Port Arthur Steam Energy*, 629 B.R. at 236 (quoting *Activity*, MERRIAM-WEBSTER ONLINE DICTIONARY, www.merriam-webster.com/dictionary/activity (last visited Feb. 11, 2023)); see also *Offer Space*, 629 B.R. at 305; *Blue*, 630 B.R. at 189.

⁹⁹ *Port Arthur Steam Energy*, 629 B.R. at 236.

business activities, regardless of whether the debtor is operating on the petition date.¹⁰⁰ Specifically, the court stated that “actively pursuing litigation against a third party, seeking to collect on outstanding accounts receivable, selling an asset, preserving asset value and having managers oversee the company while an independent contractor maintained the [debtor’s] facility are all commercial and business activities.”¹⁰¹ Therefore, under this broad definition of “activities,” the debtor was held eligible to proceed under subchapter V.

The court in *Offer Space* employed similar logic. In *Offer Space*, the debtor, a limited liability company, was involved in the marketing industry prior to ceasing operations several months before filing for relief under subchapter V.¹⁰² As of the petition date, the debtor had no employees, was conducting no business, and did not intend to resume operations.¹⁰³ The debtor’s only assets were “a bank account, accounts receivable, claims in a lawsuit against a third-party [company], and [shares of a different company’s] Stock.”¹⁰⁴

The United States trustee objected to the subchapter V election, arguing the debtor was not engaged in commercial or business activities because its operations had ceased.¹⁰⁵ However, the court determined that the debtor was eligible for subchapter V because maintaining bank accounts, having accounts receivable, being involved in litigation, managing stock, winding down its business, and selling assets all constituted “commercial or business activity.”¹⁰⁶ It was these activities that led the court to permit the debtor to proceed under subchapter V. The court, however, rejected the debtor’s argument that merely preparing for a bankruptcy filing (and undertaking the activities a filing entails) is enough to satisfy the eligibility requirements.¹⁰⁷ The court also emphasized the need to refrain from conflating “activities” with “operations” because the statute only requires “activities,” a much broader phrase, and the two terms are not interchangeable.¹⁰⁸ The court defined “operation” as “the quality or state of being functional or operative.”¹⁰⁹ Therefore, “operation” would require the debtor to be actively operating as a functional business on the petition date,

¹⁰⁰ *See id.* at 237.

¹⁰¹ *Id.*

¹⁰² *Offer Space*, 629 B.R. at 302.

¹⁰³ *Id.* at 303.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 302.

¹⁰⁶ *See id.* at 306.

¹⁰⁷ *See id.* at 307.

¹⁰⁸ *See id.* at 306.

¹⁰⁹ *Id.* (quoting *Operation*, MERRIAM-WEBSTER ONLINE DICTIONARY, www.merriam-webster.com/dictionary/operation (last visited Feb. 11, 2023)).

whereas “activities” can be satisfied by non-operational actions like pursuing litigation or winding down a business.¹¹⁰

In addition to assisting in the successful reorganization of operational small businesses, the court in *Offer Space* reasoned that the SBRA may have other purposes, such as providing “relief for small business debtors who intend to liquidate their businesses without the cumbersome structure that otherwise exists in chapter 11.”¹¹¹ To support its argument, the court noted that chapter 11 allows for debtors to propose and the court to confirm plans ultimately resulting in liquidation of the debtor’s assets, and as a result, subchapter V is not solely for businesses seeking to remain in operation.¹¹² This parallels the reasoning in *Port Arthur Steam Energy*, where the court noted that subchapter V affords companies the option to liquidate through the subchapter V plan of reorganization.¹¹³

Section 1181 of the Bankruptcy Code lists sections of the Code that do not apply in subchapter V cases. It does not exclude section 1123(b)(4), which provides that a chapter 11 plan may provide for the sale of all or substantially all of the property of the estate and the distribution of proceeds to creditors and equity interest holders.¹¹⁴

The ability to liquidate within chapter 11 is also mentioned in section 1129(a)(11), which requires that a confirmable plan be reasonably unlikely to be followed by liquidation (unless such liquidation is part of the plan). This section is also not excluded from application in subchapter V.¹¹⁵ Therefore, if the drafters of the SBRA intended for subchapter V to be exclusively for operating businesses, with the goal of keeping them in operation, debtors would not have the ability to liquidate in a subchapter V plan since liquidation ceases operations.

Like *Offer Space* and *Port Arthur Steam Energy*, the court in *Ikalowych* took an extremely expansive view on the tasks that are sufficiently “commercial or business activities.” In *Ikalowych*, the United States trustee objected to an individual debtor’s subchapter V eligibility, claiming that the debtor was not “engaged in commercial or business activities.”¹¹⁶ The debtor presented three separate arguments to establish he was engaged in commercial or business

¹¹⁰ *Id.* at 306–07.

¹¹¹ *Id.* at 308.

¹¹² *See id.*

¹¹³ *See In re Port Arthur Steam Energy, L.P.*, 629 B.R. 233, 237 (Bankr. S.D. Tex. 2021).

¹¹⁴ *Id.* at 237 (citing 11 U.S.C. §§ 1181, 1123(b)(4)).

¹¹⁵ *Id.* (citing 11 U.S.C. § 1129(a)(11)); *see also* 11 U.S.C. § 1181.

¹¹⁶ *In re Ikalowych*, 629 B.R. 261, 267 (Bankr. D. Colo. 2021).

activities, and the court agreed with each contention.¹¹⁷ First, the debtor argued his whole ownership of JMI Management, LLC, which was used primarily as a pass-through entity for the debtor's business interests and received income from the debtor serving on the board of directors of an unrelated entity, was "commercial or business activity" within the meaning of the statute.¹¹⁸ The court determined that the debtor's non-passive ownership of JMI Management, LLC, was indeed "commercial or business activity" because JMI was an operating business managed and directed by the debtor.¹¹⁹

Next, the debtor argued that he was engaged in commercial or business activity through his indirect minority interest in a second LLC,¹²⁰ in which he served as an employee and manager before the company ceased operations a month prior to the petition date.¹²¹ After the company ceased operations, the debtor assisted in wind down activities before and after the petition date, including "interacting with lenders and a landlord; helping cleanup and turnover lease premises; assisting with payroll; dealing with tax accountants and tax issues; [and] organizing and storing business records."¹²² The court determined these wind down activities constituted "commercial or business activities."¹²³

Lastly, and most notably, the debtor argued, and the court agreed, that the debtor's role as a salaried salesman at a commercial insurance company was within the scope of "commercial or business activities."¹²⁴ The court reasoned that "his role is selling a product in the private marketplace in order to make money for himself and his employer. That is what 'commercial activity' and 'business activity' means."¹²⁵

The *Ikalowych* court took what may be the broadest stance possible on what activities could satisfy "commercial or business activity." The court continued by stating "employees flipping burgers at fast food restaurants are 'engaged in commercial or business activities' There is no reason that 'commercial or business activities' are somehow reserved only for business titans, company

¹¹⁷ *Id.* at 287.

¹¹⁸ *Id.* at 268, 273.

¹¹⁹ *Id.* at 284.

¹²⁰ *Id.* at 270. JMI Management, LLC, the debtor's wholly-owned LLC, owned a 30% interest in the second LLC. *Id.*

¹²¹ *Id.* at 284.

¹²² *Id.*

¹²³ *Id.* at 285.

¹²⁴ *Id.* at 286.

¹²⁵ *Id.* at 287.

owners, or management.”¹²⁶ However, the court pointed out that the subchapter V requirement that at least half the debtor’s debts arose from their commercial or business activities would filter out most wage earners.¹²⁷

III. HIGHLIGHTING THE INCONSISTENCIES: THE THIRD SCHOOL’S TAKE ON THE SECOND SCHOOL

A. *Broadening the Definition of “Activities”*

Similar to the debtors in *Port Arthur Steam Energy* and *Offer Space*, the debtors in *Thurmon* owned an LLC that had ceased operations; though the business had accounts receivable, the debtors had no intent to resume the LLC’s operations.¹²⁸ In *Thurmon*, the court determined the debtors were not engaged in commercial or business activities.¹²⁹ However, the courts in *Offer Space* and *Port Arthur Steam Energy* used accounts receivable as evidence of commercial or business activity and neglected the cessation of operations and the lack of intention to resume.¹³⁰ This shows that the second school adopts a much narrower view of “activity” than the third.

The court in *Offer Space* made several unpersuasive attempts to distinguish the facts in *Thurmon* from those in *Offer Space* and minimize its departure from *Thurmon*.¹³¹ The court began by noting that because the *Thurmon* debtors had already completed the winding down process prior to the petition date, they could not be “engaged in commercial or business activities” despite the business’s good standing under state law.¹³² In its discussion attempting to distinguish the facts of *Thurmon*, the *Offer Space* court conveniently failed to mention that the debtors in *Thurmon* still possessed accounts receivable, even though the *Offer Space* court had earlier stated that the possession of accounts receivable constituted a qualifying activity.¹³³ Specifically, the court in *Offer Space* stated “the debtor [in *Offer Space*] was actively engaged in commercial or business activities by . . . having accounts receivable.”¹³⁴ On these grounds,

¹²⁶ *Id.* at 286.

¹²⁷ *Id.* at 287.

¹²⁸ *In re Thurmon*, 625 B.R. 417, 420 (Bankr. W.D. Mo. 2020); *see also In re Port Arthur Steam Energy, L.P.*, 629 B.R. 233, 234 (Bankr. S.D. Tex. 2021); *In re Offer Space*, 629 B.R. 299, 304 (Bankr. D. Utah 2021).

¹²⁹ *Thurmon*, 625 B.R. at 420.

¹³⁰ *Offer Space*, 629 B.R. at 306; *see also Port Arthur Steam Energy*, 629 B.R. at 236.

¹³¹ *Offer Space*, 629 B.R. at 309.

¹³² *Id.*

¹³³ *Id.* at 306, 309.

¹³⁴ *Id.* at 306.

the *Offer Space* court would have reached the opposite conclusion from the *Thurmon* court on *Thurmon*'s facts—but the court in *Offer Space* failed to address this inconsistency.¹³⁵ Though the court in *Thurmon* claims to be analyzing the definition of “engaged in,” it ultimately narrowed the definition of “activities” to require debtors to be operating on the petition date.¹³⁶ Even though the court in *Thurmon* discusses the “engaged in” portion of the subchapter V requirements in great detail, the court’s decision comes down to what the court considers to be “commercial or business activity.”¹³⁷ As noted, the debtors in *Thurmon* actively carried out similar activities to the eligible debtors in *Port Arthur Steam Energy* and *Offer Space*; however, the *Thurmon* debtors were not eligible for subchapter V relief.¹³⁸

B. Drawing a Distinction between Individuals and Entities: “Bridging the Gap”

Next, the court in *Offer Space* manufactured a new factor weighing against subchapter V eligibility, one the court admitted was absent from the text of the SBRA, by emphasizing that the debtors in *Thurmon* and *Johnson* were individuals rather than businesses.¹³⁹ However, the text of the SBRA does not distinguish between individual and business debtors: it only requires a “person” to be engaged in commercial or business activities.¹⁴⁰ It is unclear why the court would take this approach when such a distinction is not grounded in the text of the SBRA. The court in *Offer Space* took the novel analytic step of distinguishing its entity debtor from the individual debtors in *Thurmon* and *Johnson* by stating that the *Thurmon* and *Johnson* debtors “faced the challenge of bridging the gap between their commercial or business activities and their businesses’ commercial or business activities.”¹⁴¹ The court’s decision in *Offer Space* appears to have simultaneously broadened and narrowed the scope of subchapter V eligibility. While the court emphasized the broad nature of

¹³⁵ *Id.* at 309.

¹³⁶ *See In re Thurmon*, 625 B.R. 417, 423 (Bankr. W.D. Mo. 2020).

¹³⁷ *See id.* at 417.

¹³⁸ *Id.* at 423.

¹³⁹ *Offer Space*, 629 B.R. at 310. *But see In re Ikalowych*, 629 B.R. 261, 286 & n.72 (Bankr. D. Colo. 2021) (explaining that “employees can engage in ‘commercial or business activities’ in the broad sense of section 1182(1)(A) [and that] the statute does not impose any additional requirement of ownership or control of an entity”).

¹⁴⁰ 11 U.S.C. § 1182. Under the Code, the term “person” includes individuals, partnerships, and corporations (including limited liability companies), but does not include governmental entities. 11 U.S.C. § 101(41).

¹⁴¹ *In re Offer Space*, 629 B.R. at 311.

“activities” and pointed out several non-operating activities that satisfy 11 U.S.C. § 1182, the court also narrowed the scope of eligibility for individual debtors by requiring them to “bridg[e] the gap” between business activities of the individual and the activities of the business entity itself because individual debtors “were a level removed from the businesses themselves.”¹⁴² Not only that, the court failed to provide any insight as to what conduct could bridge the gap it alluded to.¹⁴³ Thus, not only is the court’s reasoning in *Offer Space* not grounded in the plain text of the statute, its imposition on individual debtors to “bridg[e] the gap”¹⁴⁴ wrongly disadvantages individual debtors seeking relief under subchapter V. The court in *Offer Space* found that the debtor was engaged in commercial or business activities by maintaining bank accounts, winding down the business, and having accounts receivable.¹⁴⁵

In *Johnson*, the court ultimately ruled the individual debtor’s role as an El Reno Energy, LLC, employee and officer with management responsibilities did not satisfy the requirements of 11 U.S.C. § 1182 because he was merely a W-2 employee and did not have an ownership interest in the entity.¹⁴⁶ However, the court in *Ikalowych* expressly disagreed with that conclusion.¹⁴⁷ In support of their disagreement with the court in *Johnson*, the court explained that “employees can engage in ‘commercial or business activities’ in the broad sense of section 1182(1)(A). Furthermore, the statute does not impose any additional requirement of ownership or control of an entity.”¹⁴⁸ The court in *Ikalowych* ultimately determined the debtor’s position as a salaried employee selling commercial insurance products constituted “commercial or business activities.”¹⁴⁹ The *Ikalowych* court recognized that its conclusion “suggests that virtually all private sector wage earners may be considered as ‘engaged in commercial or business activities,’” which is diametrically opposed to the *Johnson* court’s reasoning.¹⁵⁰

¹⁴² *Id.*

¹⁴³ Compare *id.* (holding that the debtors in *Thurmon* and *Johnson* “faced the challenge of bridging the gap between their commercial or business activities and their businesses’ commercial or business activities”), with 11 U.S.C. § 1182(1)(A) (requiring only that the debtor be a “person engaged in commercial or business activities”).

¹⁴⁴ *Offer Space*, 629 B.R. at 311.

¹⁴⁵ *Id.* at 306.

¹⁴⁶ *In re Johnson*, No. 19-42063, 2021 WL 825156, at *8 (Bankr. N.D. Tex. Mar. 1, 2021).

¹⁴⁷ *In re Ikalowych*, 629 B.R. 261, 286 & n.72 (Bankr. D. Colo. 2021).

¹⁴⁸ *Id.*

¹⁴⁹ *Id.* at 286.

¹⁵⁰ See *id.* at 286–87. But see *Johnson*, 2021 WL 825156, at *8.

Ultimately, the inconsistency of section 1182(1)(A) is characterized by contrasting applications of law to similar factual scenarios. In analyzing non-operating businesses in *Offer Space*, *Port Arthur Steam Energy*, and *Thurmon*, the courts reached reasonable, but contrasting, conclusions on whether the debtors could satisfy the eligibility requirements. An unambiguous statute should provide for a consistent outcome when applied to similar fact scenarios. The inconsistent application is on display in the *Ikalowych* and *Johnson* courts' discussion on whether a debtor's position as a salaried employee can constitute a "commercial or business activit[y]." A reading of these opinions demonstrates the need for clarity in subchapter V eligibility.

IV. USAGE OF "ENGAGED IN" THROUGHOUT THE BANKRUPTCY CODE AND OTHER STATUTES

Although the phrase "engaged in commercial or business activity" is not used in its entirety anywhere else in the Bankruptcy Code, the sub-phrase "engaged in" appears in a few other places, which helps provide context when trying to define it. The court in *In re Johnson* outlined how "engaged in" has been used in other sections of the Code;¹⁵¹ other courts, however, have been reluctant to look beyond the plain language of the statute. In its analysis, the court in *Johnson* pointed out that "in the broader context of the Bankruptcy Code as a whole, it is also significant to note that Congress did not write on a blank slate when utilizing the language 'engaged in' in the definition of a 'small business debtor.'"¹⁵² The language has also been used in subchapter IV of chapter 11, which relates to debtors operating a railroad, and chapter 12 relief for family farmers.¹⁵³

The Code defines "railroad" as a "common carrier 'engaged in' the transportation by railroad of individuals or property or the owner of trackage facilities leased by such a common carrier."¹⁵⁴ The *Johnson* court noted that, in the case of railroad debtors, the Third Circuit held

the "engaged in" inquiry to be inherently contemporary instead of retrospective in focus, explaining that, contrary to the language "spin" efforts of the appellants to apply subchapter IV to *former* railroads, the definition of "railroad" "us[es] the present-tense 'engaged'" such that

¹⁵¹ *Johnson*, 2021 WL 825156, at *7.

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ *Id.* (quoting 11 U.S.C. § 101(44)).

subchapter IV is confined to “bankruptcy petitioners who are railroads at the time of petition or thereafter.”¹⁵⁵

In the Third Circuit’s case, the court was tasked with determining if a railroad, which had ceased operations prior to filing for chapter 11 bankruptcy under subchapter IV, was sufficiently a “railroad” on the petition date.¹⁵⁶ Holding that the debtors were a “railroad” within the meaning of the Code would have given priority to claims from individuals with injuries arising out of the debtor’s operation.¹⁵⁷

Courts have taken a similar stance on the contemporary nature of “engaged in” regarding family farmers under chapter 12.¹⁵⁸ The Bankruptcy Code defines a “family farmer” as “an individual or individual and spouse ‘engaged in’ a farming operation (subject to debt limits and requirements).”¹⁵⁹ Although farming is seasonal and subject to periods of inactivity,

a majority of courts, continuing to focus on the debtor’s current state of affairs, has framed the analysis as “whether, in view of the totality of the circumstances, the debtor intends to continue to engage in a ‘farming operation’ even though he or she was not engaged in the physical activity of farming at the time the petition was filed.”¹⁶⁰

The usage throughout the Code supports the notion that “engaged in” is contemporary in nature and requires the debtor to be actively “engaged in commercial or business activities” on the petition date to be eligible for subchapter V relief, contradicting the analysis espoused by *Wright* and *Blanchard* as proponents of the first school of thought.¹⁶¹

The phrase “engaged in” has not only appeared in other sections of the Bankruptcy Code, it also appears in several other federal statutes.¹⁶² The court in *In re Ikalowych* pointed out that Congress has “utilized the same type of

¹⁵⁵ *Id.* (emphasis in original) (quoting *Hileman v. Pittsburgh & Lake Erie Props., Inc.* (*In re Pittsburgh & Lake Erie Props., Inc.*), 290 F.3d 516, 519 (3d Cir. 2002)).

¹⁵⁶ *Hileman v. Pittsburgh & Lake Erie Props., Inc.* (*In re Pittsburgh & Lake Erie Props., Inc.*), 290 F.3d 516, 518 (3d Cir. 2002).

¹⁵⁷ *Id.*

¹⁵⁸ *Johnson*, 2021 WL 825156, at *7.

¹⁵⁹ *Id.* (quoting 11 U.S.C. § 101(18)).

¹⁶⁰ *Id.* (quoting *Watford v. Fed. Land Bank of Columbia* (*In re Watford*), 898 F.2d 1525, 1528 (11th Cir. 1990)).

¹⁶¹ See *supra* note 64 and accompanying text.

¹⁶² See, e.g., 7 U.S.C. § 229b(a)(1), (2) (“Right to discuss terms of contract”); 7 U.S.C. § 6002(8) (defining “Grower”); 7 U.S.C. § 6804(b)(2)(B)(ii)(I)(aa), (iii)(II)(aa) (discussing certain occupational qualifications); 15 U.S.C. § 78c(a)(4) (defining “Broker”).

definitional formula (i.e., _____ ‘means’ a person or entity ‘engaged in’ [an activity])” in many other federal statutes and has always used the phrase to regulate present conduct.¹⁶³ The *Ikalowych* court highlighted several examples, including

7 U.S.C. § 229b(a)(1) and (2) (“The term ‘producer’ means any person *engaged in* the raising and caring for livestock or poultry”; “The term ‘processor’ means any person *engaged in* the business of obtaining livestock or poultry”); 7 U.S.C. § 6002 (“The term ‘grower’ means any person *engaged in* the production and sale of pecans”); 7 U.S.C. § 6804 (“The term “floral supplier” means a person *engaged in* acquiring cut flowers or cut greens”); 15 U.S.C. § 78c(a)(4) (“The term ‘broker’ means any person *engaged in* the business of effecting transactions in securities for the account of others.”); 21 U.S.C. § 453(aa) (“The term ‘renderer’ means any person *engaged in* the business of rendering carcasses “); 33 U.S.C. § 1202 (““towing vessel’ means any commercial vessel *engaged in* towing another vessel astern, alongside, or by pushing ahead”); 49 U.S.C. § 21101(5) (““train employee’ means an individual *engaged in* or connected with the movement of a train, including a hostler.”); 49 U.S.C. § 30501(3) and (5) (“ ‘insurance carrier’ means an individual or entity *engaged in* the business of underwriting automobile insurance.”; “‘Junk yard’ means an individual or entity *engaged in* the business of acquiring or owning junk automobiles”).¹⁶⁴

However, the court in *Ikalowych* recognized that looking at other statutes for meaning should not be used as a dispositive method because, unlike the SBRA, other statutes may have a definition section that defines the term for that particular statute. Nonetheless, usage of the term in other places may still provide helpful clues.¹⁶⁵ The usage throughout other federal statutes,¹⁶⁶ subsequent case law from other jurisdictions,¹⁶⁷ and the grammatical construction of “engaged in” (using a “past participle used as an adjective to describe the present state of the noun ‘person’”¹⁶⁸) can definitively dispose of the *Wright* and *Blanchard* school of thought, which posits that nothing in the

¹⁶³ *In re Ikalowych*, 629 B.R. 261, 281 n.70 (Bankr. D. Colo. 2021) (emphasis added).

¹⁶⁴ *Id.* (emphases added).

¹⁶⁵ *Id.* at 278 n.68.

¹⁶⁶ *Id.* at 281 n.70.

¹⁶⁷ *In re Port Arthur Steam Energy, L.P.*, 629 B.R. 233, 236 (Bankr. S.D. Tex. 2021); *see also In re Blue*, 630 B.R. 179, 189–90 (Bankr. M.D.N.C. 2021); *In re Offer Space*, 629 B.R. 299, 305–06 (Bankr. D. Utah 2021); *In re Johnson*, No. 19-42063, 2021 WL 825156, at *6–7 (Bankr. N.D. Tex. Mar. 1, 2021); *In re Vertical Mac Constr.*, No. 6:21-bk-01520, 2021 WL 3668037, at *2 (Bankr. M.D. Fla. July 23, 2021).

¹⁶⁸ *Ikalowych*, 629 B.R. at 282.

statute requires the debtor to be currently “engaged in” commercial or business activity.¹⁶⁹

V. LEGISLATIVE HISTORY

When the language of a statute is ambiguous, as it is here, legislative history may be used to give context to the statute and elucidate the legislature’s intent in drafting the bill.¹⁷⁰ Courts have reasoned that the statutory language is clear and unambiguous,¹⁷¹ and that looking beyond the text of the statute is therefore unnecessary. Given that bankruptcy courts have ruled on this issue with varying results, the clear and unambiguous language conclusion is likely without merit. The legislative process is a valuable tool in deciphering the meaning of ambiguous text, and analyzing congressional materials published throughout the process can illustrate the purpose of the statute.¹⁷²

Though the legislative history of the SBRA provides crucial information regarding the purpose of subchapter V, which would ease application and interpretation of its language, many courts have decided against looking to legislative intent when interpreting subchapter V eligibility requirements. For example, the court in *Ikalowych* seemingly took the stance that looking to legislative history generally and in the context of subchapter V is not a worthy exercise.¹⁷³ In its opinion, the court stated that it

should not decide “what the legislature meant . . . [but] only what the statute means.” In fact, the exercise of trying to divine intent from legislative statements (whether from floor speeches, debates, or committee reports) is a sort of fiction. But, in this case, even if the Court wanted to seek fiction, it would be even more impossible because there is no helpful legislative history really explaining section 1182(1)(A). Instead, the legislative history is essentially generic.¹⁷⁴

But just because the legislative history of the SBRA is general does not mean it is as useless as the court in *Ikalowych* suggests. That legislative history, although

¹⁶⁹ See *In re Wright*, No. 20-01035, 2020 WL 2193240, at *3 (Bankr. D.S.C. Apr. 27, 2020); see also *In re Blanchard*, No. 19-12440, 2020 WL 4032411, at *2 (Bankr E.D. La. July 16, 2020).

¹⁷⁰ E.g., VALERIE C. BRANNON, CONG. RSCH. SERV., R45153, STATUTORY INTERPRETATION: THEORIES, TOOLS, AND TRENDS 39 (2022).

¹⁷¹ *Vertical Mac Constr.*, 2021 WL 3668037, at *2; see also *Port Arthur Steam Energy*, 629 B.R. at 236; *Blue*, 630 B.R. at 188; *Offer Space*, 629 B.R. at 305; *Johnson*, 2021 WL 825156, at *6.

¹⁷² BRANNON, *supra* note 170, at 40–41.

¹⁷³ *Ikalowych*, 629 B.R. at 283 n.71.

¹⁷⁴ *Id.* (citations omitted) (quoting Oliver Wendell Holmes, *The Theory of Legal Interpretation*, 12 HARV. L. REV. 417, 419 (1899)).

brief, advances a different vision of the purposes of subchapter V than that seen in the more permissive cases of the first and third schools. Statements from the SBRA's cosponsors illustrate the type of debtor the drafters hoped to aid through the streamlined and cost-effective processes available in subchapter V.¹⁷⁵ This inconsistency highlights the need for revisions to 11 U.S.C. § 1182.

The aim of the SBRA is to help operating businesses, rather than those that have already ceased operations prior to commencing a bankruptcy case. In July 2019, the House Judiciary Committee published a report on the proposed SBRA.¹⁷⁶ In the "Background and Need for Legislation" section, the report notes that a significant portion of chapter 11 business cases are comprised of small business debtors, and that these debtors are often the "least likely to reorganize successfully," frequently converting to chapter 7 liquidation if they are unable to reorganize.¹⁷⁷ The SBRA's sponsor, Representative Ben Cline, stated the purpose of the legislation is to help small business debtors "file bankruptcy in a timely, cost-effective manner, and hopefully allow them to remain in business, which not only benefits the owners, but the employees, suppliers, customers, and others who rely on the business."¹⁷⁸ This insight from the SBRA's sponsor supports the notion that the primary purpose of subchapter V is to help operating businesses. The legislature previously tried to ease the bankruptcy process for small business debtors in 2005, primarily by making the United States trustee a more active participant in small business cases, but was largely unsuccessful.¹⁷⁹ Even post-BAPCPA, "small business chapter 11 cases continue[d] to encounter difficulty in successfully reorganizing."¹⁸⁰ Throughout the legislative history, the SBRA's sponsors and supporters have continuously emphasized the primary goal of keeping financially distressed small businesses in business.¹⁸¹

During a Judiciary Hearing for the Antitrust, Commercial, and Administrative Law Subcommittee on June 25, 2019, Representative Ben Cline provided crucial testimony shedding light on the challenges for small businesses in traditional chapter 11 cases:¹⁸²

Chapter 11 of the Bankruptcy Code was primarily designed to allow a business to restructure its debt obligations while maintaining

¹⁷⁵ *Cline Statement*, *supra* note 2, at 19–22.

¹⁷⁶ H.R. REP. NO. 116-171 (2019), as reprinted in 2019 U.S.C.C.A.N. 366.

¹⁷⁷ *Id.* at 2.

¹⁷⁸ See *Cline Statement*, *supra* note 2, at 19.

¹⁷⁹ See H.R. REP. NO. 116-171, at 3–4.

¹⁸⁰ *Id.* at 4.

¹⁸¹ See *Cline Statement*, *supra* note 2, at 19; see also H.R. REP. NO. 116-171, at 2.

¹⁸² See *Cline Statement*, *supra* note 2, at 19–22.

operations, with the underlying principle being that a business in its entirety is more valuable than assets valued independently. The point of chapter 11 is that preservation of the business benefits both the creditor, who should receive a higher recovery because of the debtor’s restructuring than they would otherwise obtain through a liquidation, *and* the debtor, who can remain in business. Unfortunately, the current Bankruptcy Code makes it difficult for small businesses to reorganize and forces them to use alternatives that often lead to liquidation. When the choice is between a process that is time consuming and needlessly expensive, or the “simpler” route of negotiating with creditors or liquidation under state law, many small businesses, overwhelmed by their situation, choose the latter.¹⁸³

Congress intended the SBRA to alleviate the challenges created by a costly, lengthy, and likely unsuccessful chapter 11 case by allowing small business debtors to proceed under a streamlined and less expensive process in subchapter V that would, ideally, prevent small businesses from liquidating and ceasing operations.¹⁸⁴

Although the House Judiciary Report and testimony previously discussed may be the entirety of the official legislative history, the court in *In re Progressive Solutions* provided a compilation of public statements from Senate cosponsors of the SBRA.¹⁸⁵ Notably, the Chairman of the Senate Committee on the Judiciary, Chuck Grassley, stated that:

Our bankruptcy system is designed to help highly complex businesses reorganize after falling on hard times, but for many small businesses going through bankruptcy, these requirements can create unnecessary burdens that stall recovery. The [SBRA] takes into account the unique needs of small businesses and streamlines existing reorganization processes. A well-functioning bankruptcy system, specifically for small businesses, allows businesses to reorganize, preserve jobs, maximize the value of assets, and ensure the proper allocation of resources.¹⁸⁶

Senator Grassley’s press release reiterates the testimony from Representative Cline during the Judiciary Hearing and emphasizes that the purpose of

¹⁸³ *Id.* at 20–21.

¹⁸⁴ *Id.* at 21.

¹⁸⁵ *In re Progressive Sols., Inc.*, 615 B.R. 894, 897–98 (Bankr. C.D. Cal. 2020).

¹⁸⁶ *Id.* at 897 (quoting Press Release, Chuck Grassley, Member, Senate Judiciary Committee, Grassley, Bipartisan Colleagues Introduce Legislation to Help Small Businesses Restructure Debt (Apr. 9, 2019), available at <https://www.grassley.senate.gov/news/news-releases/grassley-bipartisan-colleagues-introduce-legislation-help-small-businesses-0>).

subchapter V is to help small businesses maintain operations. The court also captured input from senators across the country advocating for subchapter V.¹⁸⁷ Senator Richard Blumenthal, for instance, stated that “[w]hen a small business owner requires relief from overwhelming debt, bankruptcy should offer a path forward to preserve jobs—not an endless, money-draining process. Our bipartisan legislation implements thoughtful, commonsense reforms to make our bankruptcy system work for small businesses instead of against them.”¹⁸⁸ The *Thurmon* and *Johnson* school of thought best reflects legislative intent by requiring debtors to be currently engaged in commercial or business activities but narrowly construing “activities” to essentially require operation and denying eligibility to the debtors because of the cessation of their respective business operations.¹⁸⁹

However, two of the schools of thought outlined above have failed to reflect the legislative history, which emphasizes the need for congressional action to correct the discrepancy between theory and reality. The *Wright* and *Blanchard* approach fails to reflect legislative intent by stating “nothing within the language of the SBRA requires debtors to be currently engaged in business or commercial activities,”¹⁹⁰ effectively eliminating the contemporaneity requirement. The *Port Arthur Steam Energy* and *Offer Space* school of thought maintains the contemporary nature of “engaged in” but departs from legislative intent by allowing non-operating businesses to qualify by contemporaneously carrying out tasks that qualify as “activities” but do not rise to “operations.”¹⁹¹

The legislative intent points to a requirement of active business operations on the petition date because subchapter V aims to protect small businesses from liquidation; inactive businesses do not merit the enhanced protections of subchapter V and should file standard chapter 11.

VI. THE CASE FOR REFORM TO 11 U.S.C. § 1182(1)(A)

To recap: subchapter V provides several key advantages to eligible debtors that would not otherwise be available under other chapters. Subchapter V is a

¹⁸⁷ *Id.* at 897.

¹⁸⁸ *Id.* Senator Blumenthal’s statement is also captured in Senator Grassley’s press release. *See* Press Release, Chuck Grassley, *supra* note 186.

¹⁸⁹ *See In re Thurmon*, 625 B.R. 417, 423 (Bankr. W.D. Mo. 2020); *see also In re Johnson*, No. 19-42063, 2021 WL 825156, at *5 (Bankr. N.D. Tex. Mar. 1, 2021).

¹⁹⁰ *In re Wright*, No. 20-01035, 2020 WL 2193240, at *3 (Bankr. D.S.C. Apr. 27, 2020).

¹⁹¹ *See In re Port Arthur Steam Energy, L.P.*, 629 B.R. 233, 236 (Bankr. S.D. Tex. 2021); *see also In re Offer Space*, 629 B.R. 299, 310 (Bankr. D. Utah 2021).

more streamlined and economically-friendly reorganization process than a standard chapter 11 case. It also allows debtors to remain in business and avoid chapter 7 liquidation. The benefits provided to debtors in subchapter V include a streamlined and expedited process, with several cost advantages to eligible debtors,¹⁹² reorganization plan exclusivity,¹⁹³ expedited discharge,¹⁹⁴ and freedom from the constraints of the absolute priority rule.¹⁹⁵

The inconsistent application of subchapter V eligibility requirements inevitably leads to forum shopping by debtors, uncertainty among practitioners and debtors, and inequity throughout the bankruptcy system. A savvy debtor may seek to file a bankruptcy petition in a jurisdiction that has broadly interpreted the meaning of “engaged in commercial or business activities” to avoid jurisdictions that may deem the debtor ineligible. Forum shopping induces a ripple effect that may result in increased filings that may overwhelm bankruptcy courts in favorable jurisdictions. Less savvy debtors unable to forum shop might miss out on extremely valuable benefits that are exclusive to subchapter V and that would otherwise be available to them but for an accident of geography. The inconsistent application of section 1182(1)(A) also makes the job of the United States trustee more difficult. If the eligibility requirements vary across jurisdictions, the United States trustee will face difficulty in determining when to file a motion challenging the debtor’s eligibility. Confusion among United States trustees in different jurisdictions will lead to a waste of valuable government resources that could be allocated to other meaningful purposes. While contemplating a revision to section 1182(1)(A), several pertinent factors should be considered: clarity, ease of application by courts, adherence to legislative intent, and the interests of current and future debtors.

While it is easy to criticize the decisions of the judiciary, we should not fail to recognize that much of the confusion would have been avoided if the language

¹⁹² See Norton & Bailey *supra* note 10, at 383 (citing 28 U.S.C. § 1930(a)(6)(A)); see also Aldrich & Ream *supra* note 5; Champion, *supra* note 4 (explaining that debtors under subchapter V are not required to pay quarterly U.S. trustee fees, may spread administrative expenses over the life of the plan if confirmed pursuant to the cramdown provisions, and are not responsible for the legal fees of an unsecured creditors’ committee).

¹⁹³ The debtor is the only party that can file a plan of reorganization throughout the entirety of a subchapter V case, and once the plan is confirmed, only the debtor can modify it. See Champion, *supra* note 4 (citing, in nn.11–16, 11 U.S.C. § 1121(b), (d)); see also Aldrich & Ream *supra* note 5.

¹⁹⁴ See Champion, *supra* note 4 (citing, in nn. 22–24, 11 U.S.C. § 1191(a)); see also Norton & Bailey, *supra* note 10, at 386 (noting that debtors are required to file their reorganization plan within ninety days, and if the plan is confirmed consensually, under section 1191(a), then the debtor is granted a discharge on the effective date of the plan).

¹⁹⁵ See Norton & Bailey, *supra* note 10, at 384 (“The most significant advantage for debtors in Subchapter V is the elimination of the absolute priority rule.”).

within section 1182(1)(A) had been more carefully drafted to accurately reflect legislative intentions. The court in *Offer Space* was correct in pointing out that “activities” does not mean “operations;”¹⁹⁶ Congress could have been more precise in their choice of language.¹⁹⁷ Although potentially unnecessary based on the linguistic analysis provided by the court in *Ikalowych*,¹⁹⁸ Congress’s inclusion of language to emphasize the contemporaneity requirement might have prevented the need for extensive judicial interpretation. My proposed revision aims to adequately reflect legislative intent, rectify congressional drafting mistakes, and provide a comprehensive framework for determining eligibility.

VII. PROPOSED REVISION TO SECTION 1182(1)(A)

Drafting a revision to section 1182(1)(A) that is a hard and fast, black-letter rule, free of ambiguity, is a challenging but necessary task. It is important to incorporate what we have already learned from decisions interpreting the current subchapter V eligibility requirements and use that knowledge to formulate an effective revision. In this proposed revision, this Comment remedies existing confusion by implementing an easy-to-apply framework that is faithful to legislative intent.

Presently, section 1182(1)(A) reads “the term ‘debtor’ . . . means a person engaged in commercial or business activities.”¹⁹⁹ As a proposed revision to this language, this Comment suggests that it be replaced with “the term ‘debtor’ means a person *presently* engaged in *the operation of, as of the petition date, a trade or business.*” The term “trade or business” is a term of art commonly used in the Tax Code, and its established definition will be adopted in this context. While this phrase is not statutorily defined, its meaning has been studied extensively by courts and scholars,²⁰⁰ and the term can easily be imported into the subchapter V context. I discuss the reasoning behind these revisions and any potential drawbacks in greater detail below.

¹⁹⁶ See *Offer Space*, 629 B.R. at 306 (“The terms ‘activities’ and ‘operations’ are not interchangeable.”).

¹⁹⁷ See *In re Ellingsworth Residential Cmty. Ass’n*, 619 B.R. 519, 521 (Bankr. M.D. Fla. 2020) (reasoning that Congress could have used narrower language or included exclusionary language rather than the broad language in the final version of the SBRA).

¹⁹⁸ *In re Ikalowych*, 629 B.R. 261, 282–83 (Bankr. D. Colo. 2021) (observing that “the phrase ‘engaged in’ . . . is a past participle used as an adjective to describe the present state of the noun ‘person’ and is inherently contemporary in nature).

¹⁹⁹ 11 U.S.C. § 1182(1)(A).

²⁰⁰ E.g., Paula Wolff, Annotation, *What Constitutes Trade or Business Under Internal Revenue Code (U.S.C.A. Title 26)*, 161 AM. L. REPS. FED. 245 (2000); see also *Comm’r v. Groetzing*, 480 U.S. 23 (1987).

A. “*Presently Engaged in, . . . as of the Petition Date*”

This portion of the proposed revisions puts to rest any confusion on the contemporary nature of “engaged in” that currently exists within section 1182(1)(A). While some courts perceived the interpretation of “engaged in” to be a seemingly easy task,²⁰¹ other courts had more trouble.²⁰² The legislative history supports the more restrictive interpretation of “engaged in,” as championed by the second and third schools of thought.²⁰³ Adding language to officially memorialize the contemporaneity of the “engaged in” requirement is an important exercise to lay to rest the first school of thought’s misguided understanding.

Although it is a necessary revision to require debtors to be “engaged” on the petition date, this choice is not without drawbacks. The court in *Johnson* ultimately agreed that “engaged in” refers to the debtor’s current state of affairs on the petition date and requires a fact-based assessment, rather than a retrospective inquiry.²⁰⁴ However, the court declined to adopt the objectors’ more stringent interpretation, which would have required the debtor to be “‘actively carrying out’ commercial or business activities ‘at the time of the filing of the petition.’”²⁰⁵ The court posited a scenario where a debtor must temporarily cease operations for unforeseen non-financial reasons akin to force majeure events like a pandemic or disaster.²⁰⁶ Any sort of “actively carrying out” test to determine eligibility would not account for situations like this.²⁰⁷ While the proposed revision above requires operation as of the petition date, it is important to account for situations like these where an otherwise eligible small business is forced to temporarily cease operations for reasons out of their control. Perhaps creating a statutory exception for scenarios like the ones listed

²⁰¹ See *In re Port Arthur Steam Energy, L.P.*, 629 B.R. 233, 236 (Bankr. S.D. Tex. 2021); see also *In re Blue*, 630 B.R. 179, 188 (Bankr. M.D.N.C. 2021); *Offer Space*, 629 B.R. at 305; *In re Johnson*, No. 19-42063, 2021 WL 825156, at *6 (Bankr. N.D. Tex. Mar. 1, 2021); *In re Vertical Mac Constr.*, No. 6:21-bk-01520, 2021 WL 3668037, at *2 (Bankr. M.D. Fla. July 23, 2021).

²⁰² See *In re Wright*, No. 20-01035, 2020 WL 2193240, at *3 (Bankr. D.S.C. Apr. 27, 2020) (quoting 2 COLLIER ON BANKRUPTCY ¶ 101.51D (16th ed. 2020)); see also *In re Bonert*, 619 B.R. 248, 255–56 (Bankr. C.D. Cal. 2020); *In re Blanchard*, No. 19-12440, 2020 WL 4032411, at *2 (Bankr. E.D. La. July 16, 2020).

²⁰³ See *Cline Statement*, *supra* note 2, at 19 (noting the importance of permitting a “business to restructure its debt obligations while *maintaining operations*” (emphasis added)); see also *In re Progressive Sols., Inc.*, 615 B.R. 894, 897 (2020) (citing Press Release, Chuck Grassley, *supra* note 187).

²⁰⁴ *Johnson*, 2021 WL 825156, at *5.

²⁰⁵ *Id.* at *5–6 (emphasis omitted).

²⁰⁶ *Id.* at *6 n.28.

²⁰⁷ *Id.*

by the *Johnson* court or allowing debtors to show cause at an evidentiary hearing would remedy this potential drawback to the proposed revision.

By capturing the contemporary nature of the “engaged in” requirement, the proposed revision harmonizes the legislative intent with recent judicial interpretations to provide a clear framework for debtor eligibility.

B. “*The Operation of*”

Again, in this portion of the proposed revision, the primary goal is to remedy a discrepancy between the drafters’ intent and judicial interpretation of subchapter V. Replacing the “activities” requirement with “the operation of” will correct the congressional drafting mistake that has created confusion for courts tasked with interpreting subchapter V’s eligibility requirements. As the court in *Offer Space* pointed out, “activities” has a much broader meaning than “operations” and the terms should not be used interchangeably.²⁰⁸ While other courts have conflated the two,²⁰⁹ the terms undoubtedly have distinct meanings and implications. The court in *Offer Space* defined “operation” as “the quality or state of being functional or operative”²¹⁰ and further noted that Congress is no stranger to using “operations” in the Bankruptcy Code.²¹¹ Congress has used “operation[s]” in several definitions in section 101 of the Bankruptcy Code, including its definitions of “family farmer”²¹² and “family fisherman.”²¹³ Therefore, Congress should have known to use “operations” in subchapter V’s definition of small business debtors. This portion of the proposed revision is a relatively seamless transition due to the term’s usage in other sections of the Bankruptcy Code. By revising section 1182(1)(A) to require “operation” rather than “activities” subchapter V’s eligibility requirements will be easier to apply, more consistent with the legislative history, and able to reconcile any judicial confusion across jurisdictions.

²⁰⁸ *In re Offer Space*, 629 B.R. 299, 306 (Bankr. D. Utah 2021).

²⁰⁹ *See In re Thurmon*, 625 B.R. 417, 423 (Bankr. W.D. Mo. 2020); *see also Johnson*, 2021 WL 825156, at *4.

²¹⁰ *Offer Space*, 629 B.R. at 306 (quoting *Operation*, MERRIAM-WEBSTER ONLINE DICTIONARY, www.merriam-webster.com/dictionary/operation (last visited Feb. 11, 2023)).

²¹¹ *Id.* at 307.

²¹² *Id.* (citing 11 U.S.C. § 101(18)(A), which defines a “family farmer” as “an individual or individual and spouse engaged in a farming operation”).

²¹³ *Id.* (citing 11 U.S.C. § 101(19)(A), which defines a “family fisherman” as “an individual . . . engaged in a commercial fishing operation”).

C. A “Trade or Business.”

Finally, Congress should replace the phrase “commercial or business,” with “trade or business.” The term “trade or business” is a term of art used in several sections of the Tax Code,²¹⁴ but most notably within the section allowing for a deduction of expenses incurred in carrying on a trade or business.²¹⁵ Although the term is not statutorily defined, its longstanding use throughout the Tax Code has allowed courts and law journals to thoroughly analyze its meaning. While the definition provided by the Supreme Court to define “trade or business” in the tax context provides a starting point for a framework in subchapter V, additional factors should be included here for ease of application.

Commissioner v. Groetzinger is a seminal case defining “trade or business” within the Tax Code, specifically interpreting the meaning of the phrase within the context of 26 U.S.C. § 162(a).²¹⁶ The Supreme Court defined the term of art “trade or business” as follows: “to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer’s primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify.”²¹⁷

In *Groetzinger*, the issue was whether a taxpayer was “carrying on a trade or business” by gambling on greyhound races for 60 to 80 hours per week.²¹⁸ The taxpayer conducted research on the greyhounds, went to the track six days a week for forty-eight weeks of the year, and kept a detailed ledger of his wagers.²¹⁹ In their analysis of precedent interpreting “trade or business,” the Court recognized that previous cases “give us results, but little general guidance.”²²⁰ Determining whether a taxpayer is engaged in a “trade or business” is a fact-intensive exercise,²²¹ but the Court’s definition provides guidelines for application. The Court concluded that the taxpayer’s gambling

²¹⁴ See, e.g., 26 U.S.C. § 163(h)(2)(A) (“Interest”); see also 26 U.S.C. § 165(c)(1) (“Losses”); 26 U.S.C. § 166(d)(2)(A) (“Bad debts”); 26 U.S.C. § 167(a)(1) (“Depreciation”); 26 U.S.C. § 174(b) (“Amortization of research and experimental expenditures”); 26 U.S.C. § 179(d)(1)(C) (“Election to expense certain depreciable business assets”); 26 U.S.C. § 197(c)(1)(B) (“Amortization of goodwill and certain other intangibles”); 26 U.S.C. § 198(c)(1)(A) (“Expensing of environmental remediation costs”).

²¹⁵ 26 U.S.C. § 162(a) (“Trade or business expenses”).

²¹⁶ See *Comm’r v. Groetzinger*, 480 U.S. 23 (1987).

²¹⁷ *Id.* at 35.

²¹⁸ *Id.* at 24.

²¹⁹ *Id.* at 24–25.

²²⁰ *Id.* at 32.

²²¹ *Id.* at 36 (citing *Higgins v. Comm’r*, 312 U.S. 212, 217 (1941)).

activities qualified as a trade or business within that definition because he participated in gambling full time, with regularity, and to produce income.²²²

The general framework provided by the Supreme Court in *Groetzinger* provides a solid foundation for the use of “trade or business” within subchapter V’s eligibility requirements. However, Congress should still add a statutory definition of “trade or business” to 11 U.S.C. § 101, which contains general definitions that apply across the Bankruptcy Code. In defining “trade or business” in the definition section of the Code, the *Groetzinger* framework could be used to determine whether unregistered business entities, like sole proprietorships, are eligible for relief under subchapter V. However, additional factors could be added to the *Groetzinger* framework when determining if a sole proprietorship is sufficiently engaged in a “trade or business,” such as the source of debt or the nature of the work. It would be unnecessary to apply the *Groetzinger* framework to registered business entities like limited liability companies and corporations. These registered entities are inherently trades or businesses, whereas someone operating a sole proprietorship could be engaged in a hobby or other activity that does not rise to the level of a “trade or business.” Registered entities like limited liability companies and corporations have confirmed their status as “trades or businesses” by registering as entities, and therefore would satisfy this element of eligibility automatically, though they would have to show they are in operation as of the petition date.

The definition of “trade or business” to be included in section 101 of the Bankruptcy Code should include a carveout for non-profit entities. Whether a nonprofit entity was eligible for subchapter V relief under the current eligibility requirements was previously decided by a bankruptcy court in *Ellingsworth Residential*,²²³ which held that non-profit entities were eligible for subchapter V relief because the plain language of the statute did not require a profit motive.²²⁴ Because the proposed revision would impose a for-profit requirement by importing the *Groetzinger* framework, Congress should take preventative action and include an exception within the definition to allow eligibility for non-profit entities that are otherwise engaged in commerce.

²²² *Id.* at 35–36.

²²³ *See generally In re Ellingsworth Residential Cmty. Ass’n*, 619 B.R. 519 (Bankr. M.D. Fla. 2020).

²²⁴ *Id.* at 521.

CONCLUSION

The SBRA is a fantastic first step toward providing a reasonable alternative to chapter 11 for small business debtors. Subchapter V provides eligible debtors with a much more streamlined and cost-effective reorganization process than does a standard chapter 11 case. These benefits, like reduced cost to debtors, plan exclusivity, and faster discharge, are crucial for keeping financially distressed small businesses in business. However, as currently drafted, subchapter V’s eligibility requirements have been subject to inconsistent interpretations by courts, which creates confusion amongst debtors, practitioners, and scholars. Inconsistent rulings on debtor eligibility create inequitable results for debtors based on where they filed a bankruptcy petition. While most courts have defined “engaged in” to be contemporary in nature and based on the debtors’ circumstances on the petition date,²²⁵ others have reasoned that the plain language does not require the debtor to be currently engaged in commercial or business activities.²²⁶ The term “commercial or business” has a generally agreed-upon definition based on the phrase’s common meaning, however, the eligibility requirements raised the question of whether non-profit entities are eligible for subchapter V relief.²²⁷ The most substantial confusion has stemmed from what constitutes a “commercial or business activity” within the meaning of the statute and courts have issued conflicting directives on what conduct satisfies the requirement. However, the legislative history of the SBRA clearly shows the drafters intended subchapter V to be for operating small businesses and crafted the advantages of subchapter V with the goal of keeping them in operation.²²⁸

It is clear based on the conflict between the legislative history of the SBRA and the judicial interpretations of section 1182(1)(A), that revision is necessary. In revising subchapter V’s eligibility requirements, the overarching goals of reconciling the differences between legislative intent and judicial decisions, ease of application, and providing an equitable solution that benefits potential debtors

²²⁵ *In re Port Arthur Steam Energy, L.P.*, 629 B.R. 233, 236 (Bankr. S.D. Tex. 2021); *see also In re Blue*, 630 B.R. 179, 188 (Bankr. M.D.N.C. 2021); *In re Offer Space*, 629 B.R. 299, 305 (Bankr. D. Utah 2021); *In re Johnson*, No. 19-42063, 2021 WL 825156, at *5–6 (Bankr. N.D. Tex. Mar. 1, 2021); *In re Vertical Mac Constr.*, No. 6:21-bk-01520, 2021 WL 3668037, at *2 (Bankr. M.D. Fla. July 23, 2021).

²²⁶ *See In re Wright*, No. 20-01035, 2020 WL 2193240, at *3 (Bankr. D.S.C. Apr. 27, 2020) (quoting 2 COLLIER ON BANKRUPTCY ¶ 101.51D (16th ed. 2020)); *see also In re Bonert*, 619 B.R. 248, 255–56 (Bankr. C.D. Cal. 2020); *In re Blanchard*, No. 19-12440, 2020 WL 4032411, at *2 (Bankr. E.D. La. July 16, 2020).

²²⁷ *Ellingsworth Residential*, 619 B.R. at 521 (holding that non-profit entities are eligible for subchapter V relief because the plain language of the statute does not require a profit motive for subchapter V eligibility).

²²⁸ *See Cline Statement, supra* note 2; *In re Progressive Sols., Inc.*, 615 B.R. 894, 897 (2020).

should be at the forefront of legislators' minds. This Comment proposes that the phrase "engaged in commercial or business activities" is removed from section 1182(1)(A) and replaced with "presently engaged in, as of the petition date, the operation of a trade or business." Including "operation" as opposed to "activities" in the requirement will cure a drafting mistake, which caused significant judicial interpretation. In addition, a statutory definition of "trade or business" should be added to section 101. In the definition of "trade or business" registered entities, for profit or non-profit, in good standing should automatically satisfy the requirement. In the case of unregistered entities, like sole proprietorships, a framework based on *Groetzing*, and an analysis of the source of debt and nature of the work should be applied to determine whether the debtor is a trade or business. These proposed changes, while they are not without drawbacks, provide a clearer picture of debtor eligibility and will ease application.

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