Written Statement of ICSC
Before the Subcommittee on the Administrative State, Regulatory Reform, and Antitrust

Hearing:
Bankruptcy Law: Overview and Legislative Reforms
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INTRODUCTION

Founded in 1957, ICSC is the member organization for industry advancement, promoting and elevating the marketplaces and spaces where people shop, dine, work, play, and gather as foundational and vital ingredients of communities and economies. In 2024 there were over 114,000 marketplaces and 1.9 million tenants. ICSC has nearly 60,000 members in North America that represent every facet of retail real estate - owner/developers, retailers, brokers, academics, financiers and lawyers. ICSC monitors industry developments related to commercial real estate and has been involved in numerous bankruptcy issues, including Subchapter V bankruptcies.

COMMERCIAL REAL ESTATE AND SUBCHAPTER V

As the Subcommittee knows, Subchapter V is a fast-track bankruptcy process for businesses that carry debt below a statutorily specified level. Notably, the Subchapter V debt limit *excludes* insider debt. In general, Subchapter V achieves speed and efficiency by significantly restricting the typical oversight and accountability guardrails in a business bankruptcy case. Subchapter V reorganization plans may be confirmed over creditors' objections, there is no committee of creditors to examine Subchapter V debtor transactions, and pre-bankruptcy owners may retain full ownership even where the business does not satisfy the "absolute priority rule," a bedrock policy of bankruptcy law for over a century. The ability of creditors, including commercial landlords, to seek protection against misuse of the Subchapter V bankruptcy laws are severely curtailed. As originally enacted, the risks associated with the absence of meaningful oversight were mitigated because the statute was narrowly focused on debtors with less than $2 million in debt, adjusted for inflation.[1] According to data from the Federal Reserve, the original (and current law) debt limit easily permits any small business to use Subchapter V. In 2024, the

[1] Subchapter V was originally enacted under the Small Business Reorganization Act (SBRA) of 2019 (Pub. L .No. 116-54), it was amended and extended under Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (Pub. L. No. 116-136) (2020), and was further amended by Pub. L. No. 117-5 (2021) and Pub. L. No. 117-151 (2022).

Federal Reserve released a report on debt loads for small businesses in 2023. Of note, the vast majority of small businesses (92 percent) reported owing less than $1 million in debt.[2] Clearly, Subchapter V as originally enacted was more than sufficient to accommodate small businesses seeking relief under the Bankruptcy Code.

With the CARES Act, Congress temporarily increased the Subchapter V debt limit to $7.5 million. This policy decision, while perhaps justified during the COVID-19 pandemic, fundamentally increased the risk for landlords that tenants owned by sophisticated investors could evade oversight and manipulate the bankruptcy process in ways that ICSC believes are contrary to Congressional intent. The temporary, higher debt limit expired in 2024 and the policy question now facing Congress is whether it should be revived. If Members of Congress are inclined to raise the limit once again, then ICSC strongly urges Congress to do so in a way that ensures that Subchapter V is only available to genuine small businesses.

Importantly, commercial landlords occupy a unique position in bankruptcy cases. Practically, tenants continue to use shopping center space even where rent has not been paid for a significant period of time. All the while, landlords continue to provide maintenance and upkeep for all tenants – including those with significant unpaid rent. This can be a particular burden for smaller, family-run shopping centers which depend on cash flow from rental payments to service debt and service the common areas of the center. Subchapter V magnifies the risk by effectively shutting the landlord out of the reorganization process.

INSIDER DEBT

In the brief time that Congress increased Subchapter V debt limit, some ICSC members encountered blatant abuses of the small business reorganization process. Specifically, debtors with significant debts above the threshold used the insider debt loophole (*i.e.*, the exclusion of insider debt) to avail themselves of Subchapter V and thus avoid scrutiny and accountability. Subchapter V does not require debtors to calculate debt owed to related parties when calculating the debt total that determines if a debtor qualifies for Subchapter V fast track procedures. When the debt limit was significantly higher than current law, the failure to count all debt opened the door to misuse of Subchapter V. There have been several cases where larger businesses, some associated with private equity investors, used deception and financial engineering to place subsidiaries and corporate affiliates into Subchapter V.

For instance, an office space lessor placed one corporate entity into Subchapter V, even though that entity owed *over $400 million* in total debt when considering "insider debt" (*In re RGN-Group Holdings*). A private equity-owned clothing retailer filed to use Subchapter V even though

[2] https://www.fedsmallbusiness.org/reports/survey/2024/2024-report-on-employer-firms, page 6.

it owed in excess of $10 million (*In re Escada*). Most recently, a Delaware bankruptcy court determined that the deliberate manipulation of insider debt on the eve of bankruptcy, specifically designed to recharacterize debt to qualify for Subchapter V, was permissible (*In re Qless Inc.*). In addition, law firms that advise private equity investors have identified Subchapter V as a financial tool for investors.[33] In some cases, landlords with the financial resources have successfully contested the misuse of Subchapter V. However, as a practical matter, small landlords, such as family owners, will simply lack the financial ability to mount such challenges. Subchapter V was not designed for well-heeled, sophisticated investors who use financial engineering to avoid scrutiny at the expense of small landlords.

CONCLUSION

ICSC supports Subchapter V, including the debt limit structure under current law, as a tool for small businesses to accelerate reorganizations. However, should Congress decide to revive a higher debt limit for Subchapter V, the statute should be amended to *include* insider debt when calculating the debtor's eligibility for Subchapter V. This is especially true if the automatic inflation adjustment is retained – the debt limit will progressively increase over time. A lower final debt limit will produce fewer opportunities to abuse the bankruptcy system in a way that is contrary to Congressional intent and imposes unfair burdens on small creditors. Thank you for considering ICSC's recommendation.

[3] https://www.eisneramper.com/insights/financial-services/subchater-v-managed-distress-ea-1222