

Behind on an SBA EIDL Loan? A Subchapter V Bankruptcy May Cut What You Owe, Keep the Business Running

By David Espin, Esq.

For businesses that have fallen behind on their COVID-19 Economic Injury Disaster Loan (EIDL) from the Small Business Administration, it can feel like there are only two choices — dig deeper into the hole by continuing payments or shut the doors.

There is a third option that many business owners have never heard of. It is called Chapter 11, Subchapter V bankruptcy. For a lot of EIDL borrowers, it can cut the loan down to a small fraction of the balance, wipe out much of the rest, and let the business keep running.

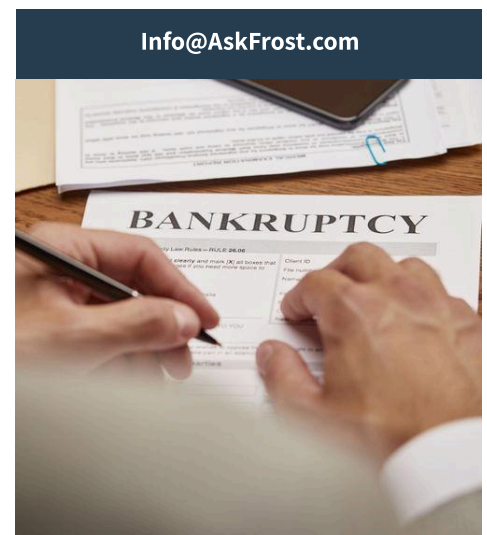
The SBA Skipped a Step, and That Can Help Struggling Businesses

When a bank makes a business loan, it wants collateral worth more than the loan itself. It orders appraisals. It asks for financial statements. It checks what your equipment and inventory are really worth before it hands over any money. That cushion protects the bank if the collateral loses value later.

But here's a twist: The SBA did not do that with COVID-19 EIDL loans. The goal was to get relief money out the door fast during the pandemic, so the agency skipped the appraisals and the financial review it would normally require. On most EIDL loans over \$25,000, the SBA simply took a blanket lien on the borrower's business property such as equipment, inventory, and accounts receivable without ever checking what any of it was worth.

That shortcut matters now because of how bankruptcy treats secured debt.

This bankruptcy option is also growing in importance because SBA has sent some 500,000 delinquent EIDL loans over to the Treasury collections apparatus. This step can add financial pressure onto a struggling business because it allows



the government to access collection tools like wage garnishment, government benefit offsets, and tax refund seizures to collect on the debt.

For people with problems with **delinquent EIDL loans** who are struggling financially and considering options like **bankruptcy**, the Frost Law team may be able to help. Contact our team to schedule a consultation at **(410) 497-5947**.

Here's a closer look at how Subchapter V bankruptcies may be able to help businesses struggling with an EIDL loan.

A Loan Is Only “Secured” Up to What the Collateral Is Worth

In a bankruptcy case, the court looks at the actual fair market value of a lender's collateral on the day the case is filed. The loan is treated as secured only up to that value. Everything above that value becomes unsecured debt, which falls into the same category as an unpaid credit card or an old vendor bill.

So the SBA may hold a lien on your business. But that lien is only as good as what your property is genuinely worth today, not what you borrowed.

Here is how that plays out. Say your business owes the SBA \$500,000. Your remaining assets are some used equipment, a modest amount of inventory, and a few receivables that are worth \$50,000 on the open market. In a Subchapter V case, that single \$500,000 claim can be split into two parts:

- A \$50,000 secured claim. This portion has to be paid, but the payments can be stretched out over many years, which makes the monthly figure far smaller – and manageable.

- A \$450,000 unsecured claim. This part of the SBA loan goes into a bucket alongside your other unsecured creditors. Under Subchapter V, this part of the debt may be paid with only pennies for each dollar owed.

The gap between the balance and the collateral value is where the savings come from. And because the SBA never appraised anything up front, that gap is unusually wide for many EIDL borrowers. If you run a service business, the effect can be even stronger because your “collateral” may be a few computers, some tools, and a work truck, while the loan is in the hundreds of thousands.

You Keep the Business You Built

In a regular Chapter 11 bankruptcy case, something called the absolute priority rule usually stops owners from keeping their business ownership unless creditors are paid in full or agree to let them stay. Subchapter V removed that barrier.

Under Subchapter V, you can keep 100 percent of your company even though your unsecured creditors are not paid in full. But there are some important conditions. The court must find that your bankruptcy plan is fair, that you can actually perform it, and that you are putting your projected disposable income toward creditors for the required period, which is usually three to five years.

That is the part owners tend to underestimate. The real value of a business is rarely the equipment. It is the customer list, the reputation and name you spent years building, along with the trained employees, the licenses, and the contracts already in place. Close the doors and all of that disappears, and your assets sell for scrap. Reorganize the business under Subchapter V instead, and the value stays where it belongs — with you.



You Do Not Need a Single Creditor to Vote Yes

There's a surprise for most business owners, and it is one of the strongest features of Subchapter V.

In a standard Chapter 11 case, at least one class of affected creditors normally has to vote in favor of your plan before a judge can approve it. That gives a large creditor real leverage to block you or force worse terms.

Subchapter V works differently. A judge can approve your plan even if not one creditor votes for it. The SBA can object, argue, and vote no, but the plan can still be confirmed as long as it meets the legal standards. You do not have to negotiate your way with creditors to get to a "yes." This is critical. That removes the single biggest source of delay, expense, and pressure in a traditional business reorganization.

Other Ways Subchapter V Is Easier Than a Regular Chapter 11

Subchapter V was created by the Small Business Reorganization Act of 2019 to make reorganizing realistic for small businesses that could never absorb the cost of a full Chapter 11 case. A few of the practical differences:

- There is a size limit. Subchapter V is open to businesses whose qualifying debts fall under a cap, currently \$3,424,000. Not every dollar you owe counts toward that number. The cap counts only debts that are already fixed and certain in amount, and it leaves out money the business owes to its own owners or to affiliated companies. At least half of the debt also has to come from your business activity. Plenty of owners assume

they are over that line, but a closer look shows they are not.

- No creditors' committee. Standard Chapter 11 cases often have an official committee of unsecured creditors that hires its own lawyers and financial advisors — and bills the cost to you. Subchapter V does away with that in most cases.
- No disclosure statement. A regular Chapter 11 requires a long, formal document explaining your plan to creditors before they vote. Subchapter V debtors generally do not have to prepare one, which saves both time and legal fees.
- No quarterly government fees. Chapter 11 debtors owe recurring quarterly fees to the U.S. Trustee's office that grow with the size of the business, which can add up during a long case. Subchapter V debtors do not pay them.
- A fast timeline. You must file your Subchapter V plan within 90 days of filing the case. That deadline is there on purpose, to move businesses in and out of bankruptcy quickly instead of letting a case drag on for years.

Subchapter V cases do have a trustee assigned, but the trustee does not take over or run your business. You stay in control of day-to-day operations. The trustee's job is to help move negotiations along and keep an eye on the case. The Subchapter V trustee does get paid for their services in this case.

The Bottom Line

Subchapter V was built to give small businesses a real path to reduce their debt and stay open, instead of being pushed into closing because a traditional Chapter 11 costs too much and takes too long. For business owners carrying a defaulted COVID-19 EIDL loan that is far larger than anything



the SBA actually took a lien on, it can be a powerful tool.

Every business is different, and whether Subchapter V is the right move depends on your numbers, your assets, and your loan documents. If you are behind on an EIDL loan, talk to an experienced bankruptcy attorney about what a Subchapter V case could do for you before the SBA's collection efforts go any further.

For people struggling with delinquent SBA EIDL loans or considering bankruptcy, the Frost Law team may be able to help. Contact the experienced team at Frost Law by calling **(410) 497-5947** or **[schedule a free consultation](#)**. Our website also has more information on **[EIDL loans](#)** and **[bankruptcy issues](#)**.

[More News Articles](#)