When a Lawsuit Becomes "Business Debt:" What a New Subchapter V Ruling Means for Small Businesses

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A federal bankruptcy court in Texas took a broad view of which debts count toward Subchapter V eligibility. Here is what that means for businesses in Maryland, Washington, D.C., and Virginia.

For many small and mid-sized companies, the biggest financial threat is not a slow quarter. It is a lawsuit.

A single judgment, sanction, or fee award can turn a healthy business into one that cannot pay its bills. Owners in that position tend to ask the same question: Does my business still qualify for Subchapter V; the faster and less expensive form of Chapter 11 bankruptcy designed for smaller companies?

A recent decision from the United States Bankruptcy Court for the Eastern District of Texas offers a helpful answer. In I*n re JSCo Enterprises, Inc*. from Sept. 30, 2026, the court held that a multimillion-dollar award that grew out of hard-fought business litigation still counted as business debt for eligibility purposes, even though the award was imposed as a penalty for misconduct.

A Quick Refresher on Subchapter V

Congress created the Subchapter V category in 2019 so smaller businesses could reorganize without the cost and delay of a traditional Chapter 11 case. A Subchapter V business usually:

1. Does not need to file a separate disclosure statement.
2. Works alongside a trustee whose job includes helping the parties reach a deal, and
3. Can keep its ownership in place even if a class of creditors votes against the plan, as long as the plan commits the business's projected disposable income to creditors for three to five years.

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To qualify, a business must pass two money tests measured on the day it files. First, its total debts must fall under a dollar limit set by Congress. These are fixed in amount and not dependent on some future events, leaving out debts owed to insiders and affiliates. Second, at least half of those debts must have arisen from the company's commercial or business activities. The JSCo case in Texas turned on that second test.

What Happened in JSCo

JSCo began as a consulting company formed by a former practice-group leader at the national accounting firm BDO. BDO sued, claiming its former partner had breached the firm's partnership agreement, and the dispute grew bitter. A Delaware court later found that JSCo had destroyed evidence and engaged in other litigation misconduct. As a penalty, the court entered a default judgment against JSCo and ordered it to pay about $5.2 million of BDO's attorneys' fees. A separate damages award of about $1.9 million followed in 2025, after JSCo had already filed for bankruptcy.

While the litigation was pending, JSCo also transferred its operating business to a newly formed trust in exchange for a promise of monthly payments over nine years. When JSCo filed its Subchapter V case in November 2023, it held little more than the right to receive those payments.

BDO, now JSCo's largest creditor, argued that JSCo never qualified for Subchapter V. In BDO's view, the $5.2 million fee award came from courtroom misconduct, not from running a business, so it should not count toward the 50 percent business-debt test. Without that award, BDO said JSCo would fall short of the Subchapter V requirements.

The Court's Answer: Business Debt Is Read Broadly

The court disagreed. It noted that courts read the phrase "commercial or business activities" broadly, and that the statute does not limit qualifying debt to loans, vendor bills, or the costs of day-to-day operations. The question is simply whether the debt arose from the company's commercial or business activities. Because the Delaware litigation grew out of a business dispute, the sanction that came out of that litigation did too. Calling the award a penalty did not cut that connection. The fee award counted, and JSCo was eligible.

The court then confirmed JSCo's liquidating plan over BDO's objections. An important part of that result happened earlier in the case: At BDO's request, the court expanded the Subchapter V trustee's duties so the trustee could investigate the transfer of the operating business. The trustee concluded the transfer was likely fraudulent and negotiated a settlement that shortened the payment stream to 48 months and added collateral and personal guaranties from the owners.

Relying on that court-approved settlement, the court found the plan was proposed in good faith, was workable, and gave creditors meaningful remedies if payments stopped. BDO's appeal of the settlement order remains pending.

Does This Ruling Apply in Maryland, D.C., and Virginia?

Not directly, but the Court's review could be persuasive. JSCo is a decision of a single bankruptcy court in Texas. Bankruptcy courts in Maryland and Virginia sit within the Fourth Circuit, and Washington, D.C. sits within the D.C. Circuit. Neither set of courts is bound by JSCo. Frost Law's research has not located a decision from either court of



appeals that decides whether litigation-based debt counts toward the 50 percent test, so JSCo is likely to be cited as persuasive authority. Its reasoning tracks the broad reading of "business activities" that the Eleventh Circuit adopted in 2025.

Bankruptcy courts within the Fourth Circuit have, however, given owners some practical guidance on eligibility:

1. **Long-term leases can push a business over the limit.** In Virginia's Eastern District *In re Macedon Consulting, Inc.* from June 14, 2023 the court counted all future rent owed under a signed lease toward the debt limit. That pushed the company out of Subchapter V, although it was allowed to continue in a traditional Chapter 11 case.
2. **Eligibility is a snapshot taken on the filing date.** In Virginia's Western District *In re Dobson* in 2023), the court held that eligibility is measured as of the petition date, and that a later event did not take it away. JSCo reflects the same timing principle: BDO's $1.9 million damages award came long after the filing.

Where the Debt Limit Stands

The Subchapter V debt limit has changed several times since 2020. JSCo filed in 2023, when the limit was $7.5 million. H.R. 7730, signed into law by President Trump on Nov. 10, 2026, permanently increased the debt limit to $7.5 million.

Key Takeaways for Business Owners

1. Judgments, sanctions, and fee awards that grow out of a business dispute may count as business debt for Subchapter V purposes.
2. Eligibility is measured on the day you file. Only debts that are fixed in amount count toward the limit, and long-term lease obligations can add up quickly.

If a lawsuit, judgment, or aggressive creditor is putting pressure on your business, the timing and structure of a filing can make a significant difference. An experienced business bankruptcy attorney can review your debts, test your eligibility, and help you choose the path that best protects your company.

If you have bankruptcy questions, we can help. Contact Frost Law at **(410) 497-5947** or **schedule a confidential consultation.** Our **bankruptcy resources center** covers what each type of filing means for your company, your creditors, and you personally.

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