



The Small Business Reorganization Act—Coming to a Bankruptcy Court Near You in February 2020

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On August 23, 2019, the Small Business Reorganization Act of 2019 (the “Act”) was signed into law. The Act, which goes into effect in February of 2020, creates a new Subchapter V under Chapter 11 of the U.S. Bankruptcy Code.

In the past, few small businesses have been able to reorganize under Chapter 11 of the Bankruptcy Code due to the costs and administrative burdens associated with the process.

The Act is meant to eliminate and/or streamline some of the more costly and burdensome elements of traditional Chapter 11 relief. It should give small businesses greater access to the benefits that Chapter 11 affords—namely, breathing room to improve financial and operational performance, and the ability to reduce or at least restructure debts.

Some of the key elements of the Act include:

- A “small business debtor” eligible to seek relief under the Act is defined as a debtor with non-contingent, liquidated debts (secured and unsecured) totaling not more than \$2,725,625.
- The United States Trustee will be required to appoint a trustee in every Subchapter V case. The trustee will serve in a role similar to a Chapter 13 trustee and will not generally be involved in any operational aspects of the business. In this sense, the Act preserves the notion of a “debtor in possession” in small business cases. The trustee will have a role in assisting the debtor in developing a plan of reorganization, and will be responsible for disbursing payments under a plan.
- An unsecured creditors’ committee will not be appointed unless ordered by the court for cause.

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- A status conference must be held within 60 days of the date of the petition to determine how best to proceed with the case. The date of the status conference may be extended if cause is demonstrated.
- A plan of reorganization must be filed within 90 days of the petition date, although the court can extend the deadline if circumstances outside the control of the debtor merit an extension. Only a debtor may file a plan, and no disclosure statement is required. However, a plan must contain some information, such as a liquidation analysis and a projection of a debtor's ability to make payments under the plan, traditionally associated with a disclosure statement.
- A plan may modify the rights of a secured lender with a lien on the principal residence if the "new value" received from the loan was not used primarily to acquire the residence and was used primarily in connection with the small business.
- The "absolute priority" rule, which stands for the proposition, generally, that a shareholder cannot retain equity in a business unless creditors are paid in full, is eliminated for the cramdown of a plan under Subchapter V. In other words, the cramdown of a plan that includes a non-consenting class of creditors can be "fair and equitable" under the Act. Under the new provision, existing owners of a business may retain their full ownership without providing any "new value," but only if the plan provides for the debtor to distribute all of its projected disposable income over at least three years and no more than five from the date the first payment is due under the plan.
- In a typical Chapter 11 case, a debtor must pay administrative expense claims—claims incurred for goods and services during the post-petition period—on the effective date of a plan of reorganization.
- Under the Act, a small business debtor may stretch payment of administrative expense claims out over the term of the plan.
- Under the Act, a discharge is not granted until the debtor completes all payments due within the first three years of the plan or a longer period not to exceed five years as the court determines. The discharge applies to all debts addressed by the plan except for debts (1) on which the last payment is due after the first three years of the plan, or such other time fixed by the court not beyond five years, or (2) debts otherwise non-dischargeable.

The Act, which will take effect in February of 2020, gives small businesses expanded access to the Bankruptcy Code's reorganization tools. Small business owners—and the customers, suppliers, and lenders who do business with them—should prepare to exercise their rights and protect their interests under this new subchapter of the Bankruptcy Code. Foster Swift will continue to monitor and share developments related to the Act.

In the meantime, if you have any questions about how the Act may impact your business, please contact Scott Chernich at (517) 371-8133 or at schernich@fosterswift.com.