New Jersey Law Journal
STATEWIDE LEGAL AUTHORITY SINCE 1878
An ALM Publication
APRIL 22, 2020
NJLJ.COM

How the SBRA Can Help Small Businesses Recover from the COVID-19 Crisis

The Small Business Reorganization Act adds Subchapter V to Chapter 11 of the Bankruptcy Code, and creates a more efficient and less costly process for small businesses to reorganize.

By Bruce H. Levitt

Businesses have often used Chapter 11 of the Bankruptcy Code as a means to restructure debt. Due to the cost and onerous statutory requirements to successfully complete the bankruptcy process, many businesses, especially small businesses, have been deterred from seeking Chapter 11 relief.

On Aug. 23, 2019, Congress passed the Small Business Reorganization Act (SBRA) into law, which became effective on Feb. 19, 2020. 11 U.S.C. §1181 et seq. The SBRA adds Subchapter V to Chapter 11 of the Bankruptcy Code, which created a more efficient and less costly process for small businesses to reorganize. While it wasn't enacted in response to the economic consequences of the Coronavirus (COVID-19), for the reasons discussed in this article its provisions will help many small businesses recover.

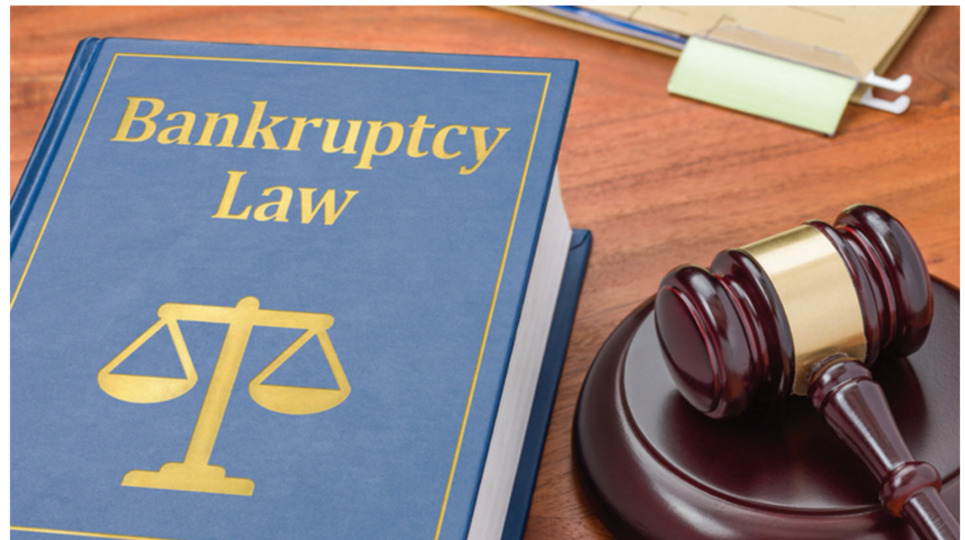
A Chapter 11 bankruptcy is intended to help financially distressed businesses and, in certain cases, individuals, restructure debt and emerge with a Court approved Plan which addresses their financial obligations and allows them to continue to operate. As discussed herein, the process and procedural requirements of Chapter 11 often make it impractical for small businesses to pursue.

There are many reasons for this reality. Chief among them is the cost involved. Given the numerous pleadings and other documentation necessary to move a Chapter 11 case through the courts, a significant amount of attorney time is required and, hence, expensive attorney fees accrue. For many small businesses the retainers to counsel alone are more than they can afford. Chapter 11 debtors often have to retain accountants and other professionals to assist with reporting requirements and to guide them through the process. Additionally, in some Chapter 11 cases creditor committees are formed. Those committees also retain professionals which must ultimately be compensated by the small business. By streamlining the process, the SBRA will significantly

lessen the counsel and other professional fees. The SBRA also eliminates the need for creditor committees, unless otherwise directed by the court.

The "absolute priority rule" is another provision of the Bankruptcy Code which makes the non-SBRA Chapter 11 process unfavorable to small businesses. Under this rule, unless a Chapter 11 Plan is approved by all classes of creditors, the business owners cannot retain their ownership interest. 11 U.S.C. §1129(b)(2)(B)(i). While the courts have recognized a "new value" exception to the absolute priority rule, it generally requires the owners to essentially

purchase back their shares or interest. *See Bank of America National Trust and Savings Assn v. 203 North LaSalle Street Partnership,* 436 U.S. 434 (1999). Most small business owners struggling to survive do not have the available funds to buy back their interest and therefore cannot even attempt a Chapter 11 reorganization. The SBRA eliminates the absolute priority rule. 11 U.S.C. §§1181, 1191(b).



Copyright: Zerbor

As discussed more fully in this article, there are numerous provisions in the SBRA which make it easier and more affordable for a small business to successfully use Chapter 11 to restructure. The SBRA, however, is just one part of the Bankruptcy Code that governs small business cases. The automatic stay, which immediately takes effect when a bankruptcy is filed, will preclude landlords, lenders and other creditors from taking any legal action, or any debt collection actions while the small business bankruptcy proceeds. 11 U.S.C. §362. This will be extremely helpful to small businesses facing the competing pressures of rebuilding their business and, concurrently, addressing the demands of creditors.

By making the process more affordable, eliminating some of the obstacles faced by small businesses in Chapter 11 proceedings, and utilizing other provisions of the Bankruptcy Code such as the automatic stay, the SBRA will provide an opportunity for some small businesses to survive in the post-COVID-19 world.

Who Can Be a Small Business Debtor?

As enacted, the SBRA applies to businesses and individuals engaged in commercial or business activities with noncontingent, liquidated, secured and unsecured debts of no more than $2,725,625. 11 U.S.C. §101(51D)A. The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), signed into law on March 27, 2020, amended the SBRA to increase the debt limit to $7.5 million. CARES Act, Pub.L No. 116-136, 134 Stat. 281 at §1113 (2000). This made the SBRA available to many additional businesses. This debt limit increase is temporary and will expire one year from March 27, 2020, when the debt limit will return to $2,725,625.

The SBRA specifically excludes from the definition of a small business debtor a business or individual that operates "single asset real estate." 11 U.S.C. 101(54D) A. The term "single asset real estate" debtor is defined in 11 U.S.C. 101(51B). Therefore, with the exception of single asset real estate debtors, so long as the debt limit is not exceeded, the SBRA is applicable.

How Does the SBRA Work?

When a Chapter 11 petition is filed, all of the protections and provisions of the Bankruptcy Code become effective. When the debtor elects to be treated as a small business debtor, the SBRA eliminates some of those provisions and sets forth specific procedural requirements that make a small business reorganization easier to accomplish.

The goal of the SBRA is the filing of a consensual Plan of Reorganization within 90 days of the bankruptcy filing. The 90-day period can be extended by the court upon a finding that the "extension is attributable to circumstances for which the debtor should not justly be held accountable." 11 U.S.C. §1189(b). To attain the goal of a consensual plan, a bankruptcy trustee is appointed whose principal

role is to "facilitate the development of a consensual plan of reorganization." 11 U.S.C. §1183(b)(7). In essence, the trustee is to act as a mediator between the debtor and the creditors to assist in getting a consensual plan before the court.

The SBRA requires that the court conduct a status conference within 60 days of the filing in order to keep the case on its fast track status, and also to promote the goal of a consensual plan. At least 14 days before that conference, the debtor must file a report outlining all efforts the debtor has undertaken or will undertake to attain a consensual plan of reorganization. 11 U.S.C. §1188.

Importantly, in a case proceeding under the SBRA, the small business debtor is not required to file and seek approval of a disclosure statement, which is a time consuming and expensive process. Instead, the plan itself must contain information about the history of the business operations, a liquidation analysis and projections with respect to the ability of the debtor to make plan payments. 11 U.S.C. §1190.

As in all Chapter 11 cases, the SBRA plan must provide for payment and treatment of the claims of administrative, secured, priority and general unsecured creditors. Certain creditor claims are broken down into classes. In a non-SBRA case, the Chapter 11 plan cannot be approved unless at least one impaired (negatively affected) class has voted to accept it. The SBRA eliminates that requirement for small business debtors. This means that even if the plan is not consensual, it can be approved by the court upon a finding that it does not discriminate unfairly and that it is fair and equitable. 11 U.S.C. §1191(b).

Small business debtors must fund the plan by dedicating all disposable income or property of equivalent value over a period of three to five years. 11 U.S.C. §1191(c)(2). Disposable income is that income which is available after the payment of ongoing business expenses. 11 U.S.C. §1191(d). Courts can confirm (approve) a plan upon a showing that the debtor will either be able to make the plan payments or that there is a reasonable likelihood that the debtor will be able to make plan payments. 11 U.S.C. §1191(c)(3). Upon completion of plan payments, the debtor is entitled to a discharge. 11 U.S.C. §1192.

This funding requirement is especially important to those businesses that will be struggling to rebound after the pandemic because they may not be able to show a current ability to make plan payments. Based on prior history, however, many businesses may be able to use projections to show a reasonable likelihood that payments will be made in the future.

Planning Is Important

A small business bankruptcy, like a typical Chapter 11 case, still requires planning. It is very important to have a strategy in place at the time the petition is filed as to how the small business will successfully exit from the bankruptcy. This is especially true because the time for the small business debtor to propose a plan is short. Unless a quick filing is necessary because a landlord or other creditor is taking aggressive action, no bankruptcy should be filed until it is determined that a bankruptcy can be successful.

It is also important to understand the full nature of the debt. Often, owners of small businesses that operate as a Sub-Chapter S Corporation or an LLC have personally guaranteed the business debt and/or incurred debt to operate the business on personal credit cards. A Chapter 11 filing for the business alone will not protect the owners from their personal liability. It is important to analyze the debt to determine if either a business or personal bankruptcy is appropriate, or in some cases both.

Finally, be aware that the majority of the provisions of the Bankruptcy Code are still applicable in small business cases. A thorough and working knowledge of the Code is essential to representing any debtor in the bankruptcy court.

Bruce H. Levitt *is a member of the law firm of Levitt & Slafkes in Maplewood, concentrating his practice in individual and small business bankruptcies, foreclosure defense and commercial litigation.*

Reprinted with permission from the April 22, 2020 edition of the NEW JERSEY LAW JOURNAL. © 2020 ALM Media Properties, LLC. All rights reserved. Further duplication without permission is prohibited.
For information, contact 877.257.3382, reprints@alm.com or visit www.almreprints.com. NJLJ-04242020-446693