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Time to Reorganize: Changes to the Bankruptcy Code for Small Businesses

By Jeremy H. Rothstein

The Small Business Rehabilitation Act, or SBRA, takes effect on February 19, 2020, gives small business debtors new tools to restructure their debts while reducing the costs and burdens of filing for Chapter 11 bankruptcy and includes several changes that ease the path for small business owners to reduce and discharge debt while remaining in operation.



LAST AUGUST, PRESIDENT DONALD TRUMP signed the Small Business Reorganization Act of 2019 into law.¹

Known as SBRA, the Act takes effect on February 19, 2020, and will give small business debtors new tools to restructure their debts while reducing the costs and burdens of the Chapter 11 process.

The new law also includes several debtor-friendly changes that will make it easier for small business owners to reduce and discharge debt while holding onto their businesses.

Because the SBRA will make Chapter 11 a more viable, useful option for eligible debtors, all practitioners who serve small business clients and their creditors should be aware of the changes.

This article provides a general summary of key provisions of the SBRA for readers who may have limited familiarity with the Bankruptcy Code.²

Chapter 11 in a Nutshell

Business reorganizations are governed by Chapter 11 of the Bankruptcy Code. Broadly speaking, the purpose of Chapter 11 is to keep the debtor's business alive and restructure debts in a manner that protects the interests of creditors and other stakeholders. Filing a Chapter 11 petition immediately stays all collection efforts and litigation against the debtor and its property.³

The business may continue to operate, and management remains in place unless there is significant fraud or misconduct. A successful case generally culminates in the confirmation (meaning court approval) of a plan to restructure debts or the sale of the debtor's business to pay creditors.

Several aspects of traditional Chapter 11 make it all but impossible for small businesses to reorganize. In a traditional Chapter 11, owners generally cannot retain their ownership interest without paying in sufficient new money or an equivalent. While wiping out equity may make sense in a larger Chapter 11, it is not a solution for small businesses that are operated by the owners or their families. Also, many small businesses cannot afford a traditional Chapter 11 case, because the process imposes heavy costs and burdens.



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At the same time, strict deadlines often leave small businesses without enough time to restructure. As a consequence, successful small business reorganizations have been rare, and getting rarer.⁴

Designed to reduce that trend, the SBRA adds a new Subchapter V to Chapter 11 that addresses each of the above issues for small businesses that qualify.

Eligibility for a Subchapter V Small Business Reorganization

To qualify for the new Subchapter V, debtor must meet the definition of a "small business debtor." It must have not more than \$2,725,625 in non-contingent, unliquidated debt—either secured or unsecured—as of the date of filing of the bankruptcy petition, excluding debts owed to affiliates or insiders.⁵ Debts of any of the debtor's affiliate who also file for bankruptcy will count toward the \$2.7 million limit.⁶

The \$2.7 million debt maximum may exclude many businesses, particularly since companies facing trouble tend to take on more debt before they consider bankruptcy.

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Careful advance planning is critical for businesses on the brink that want to qualify for a small business reorganization. For instance, a debtor hoping to qualify for Subchapter V may be better off turning down a last-ditch loan that would put its debts over \$2.7 million.

Alternately, a business facing costly litigation might qualify at the beginning of the litigation (while the debt is contingent and unliquidated) but lose eligibility after attorney's fees pile up or judgment is entered.

In addition, fifty percent or more of a debtor's debt must have arisen from commercial or business activities, a threshold that may allow individuals with business-related debts to fit within the definition, even if their business is run as a separate entity.⁷

On the other hand, the definition excludes publicly traded companies and single asset real estate entities.⁸

Administering a Small Business Reorganization Case

In every Subchapter V case, a trustee will be appointed to supervise the case.

The trustee will be a certified public accountant or other professional with business, managerial, or consulting experience and be responsible for monitoring the case and

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the debtor's property, facilitating a consensual Chapter 11 plan, examining and objecting to claims, and appearing at most hearings, among other things.⁹ ¹⁰

If the debtor confirms a Chapter 11 plan that requires the payment of its disposable income over time, the trustee will be responsible for collecting the income and making disbursements.¹¹ And if the debtor stops participating in the case or commits fraud or gross incompetence, the trustee may be granted expanded powers, including taking control of the business and investigating misconduct.¹²

The SBRA also reduces the costs of a Subchapter V case by eliminating committees of unsecured creditors, though the court may appoint one for cause.¹³

Because fees of committee professionals would be paid from the debtor's assets, this represents a major cost savings. A Subchapter V case debtor also need not pay quarterly fees to the United States trustee, an additional savings.¹⁴

As in any bankruptcy case, the debtor will have to make several disclosures about its assets, liabilities, and financial affairs upon filing and shortly thereafter.

From there, the next major milestone in a small business reorganization is the status conference, which must be scheduled within the first 60 days of the case. That deadline, though, can be extended for "circumstances for which the debtor should not justly be held accountable."

Fourteen days before the status conference, the debtor must file a status report that details all past and future efforts to attain a consensual plan of reorganization.¹⁵ For traditional Chapter 11 cases, the Bankruptcy Code authorizes more frequent status conferences with more detailed status report requirements.¹⁶

The debtor must file a proposed plan of reorganization within the first 90 days of the case, though that deadline too can be extended for "to circumstances for which the debtor should not justly be held accountable."¹⁷ It remains to be seen how the courts will interpret that language, and how long the average small business reorganization is likely to last.

The debtor has the exclusive right to file a proposed plan throughout a Subchapter V case. In a traditional Chapter 11, creditors may file competing plans after the debtor's exclusivity period expires. And once the debtor does file a plan, there is no set deadline by which it must be confirmed by the Bankruptcy Court.

Debtor-Friendly Changes for Chapter 11 Plans

To make it easier for small businesses to survive and remain in their owners' hands, the SBRA alters many of the requirements of a traditional Chapter 11 plan.

Perhaps most importantly, the debtor may maintain ownership of the business without contributing any new value. In a traditional Chapter 11, equity holders cannot

retain any interest under a Chapter 11 plan unless they make a substantial new investment or all creditors are paid in full.¹⁸ Subchapter V lets debtors opt out of that restriction, allowing owners to keep their business so long as the Chapter 11 plan is deemed fair and equitable to all classes of secured and unsecured creditors.¹⁹

A plan is fair and equitable to unsecured creditors if they receive all of the debtor's disposable income for the following three years or property worth at least the same amount.²⁰ The Bankruptcy Court may increase that payment period to no more than five years. Secured creditors' liens are protected, and they must receive the full value of their claim up to the value of their lien, though loan terms can be modified (all subject to various caveats).²¹

In a Subchapter V case, even a loan secured by the debtor's principal residence can be modified, so long as the loan was used to fund the business, not to acquire the home (a home equity line of credit, for example).²²

Under Subchapter V, disposable income is defined as "income not reasonably necessary for the maintenance or support of the debtor or a dependent, or expenditures necessary for the continuation, preservation, or operation" of the business.²³ The debtor must submit all or a portion of its income to the trustee for the term of payments,²⁴ and the trustee will distribute it to creditors. On the date of the debtor's last payment, its debts are discharged.²⁵

The SBRA also changes the treatment of so-called administrative expenses—the costs of running the business and prosecuting the bankruptcy case incurred since the filing of the petition.

Under traditional Chapter 11, those administrative expenses must be paid on the effective date of the plan, which is often a stumbling block.²⁶ But in a Subchapter V case, they can be paid through the plan over time.²⁷ That change will make it much easier for debtors to successfully adjust their debts, but those who transact with a small business debtor should know the risk of delayed or reduced payment.

An Easier Path to Plan Confirmation

In a traditional Chapter 11 filing, a debtor must go through several steps between proposing a plan and having the court approve it.

First, the debtor must develop a detailed disclosure statement with information about the business, events of the case, and the plan. The disclosure statement must be approved by the court, and it is often challenged by creditors. Once the disclosure statement is approved, the debtor must solicit votes from one or more classes of creditors.²⁸

Not all creditors need to accept the plan, but at least one "impaired" class must approve the plan for it to be imposed on the others.²⁹ The Bankruptcy Court then holds a hearing to determine whether the plan meets the various

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requirements for confirmation. That process takes months, and the debtor must often fend off repeated creditor challenges along the way.

Under the new Subchapter V, a debtor may avoid all but the final step, the confirmation hearing. The Chapter 11 plan must include a history of the debtor's business, projections, and liquidation analysis, but there is no need for a disclosure statement, unless the bankruptcy court specifically orders it. There is also no need for the debtor to solicit votes or to obtain the approval of any class of creditors, though it has the option to do so.³⁰ Instead, the Bankruptcy Court will confirm the plan if it meets the requirements of Subchapter V, with no creditor input necessary.³¹

These streamlined confirmation procedures will remove many of the pain points of a Chapter 11 case for small businesses.

Easing the Process, With Exceptions

In short, the SBRA will make it much easier for small business debtors to hold onto their businesses, and perhaps even their homes, so long as they commit their disposable income to paying creditors for three to five years. The SBRA also provides for a streamlined Chapter 11 process that should considerably reduce the cost.

However, only businesses with unliquidated, non-contingent debt totaling \$2,725,625 or less are eligible. Struggling businesses with debts near that maximum will have to plan carefully if they hope to take advantage of the new law. 

¹ Pub. L. No. 116-54, 133 Stat. 1079. The provisions of the SBRA are cited as they will be codified in the United States Code.

² 11 U.S.C. § 101, et seq.

³ See id. at § 362(a).

⁴ Robert J. Keach, ABI Testifies on Family Farmers and Small Business Reorganizations, XXXVIII ABI Journal 8, 8-9, August 2019, available at <https://www.abi.org/abi-journal/abi-testifies-on-family-farmers-and-small-business-reorganizations> (subscription required).

⁵ Id. at § 101(51D)(A).

⁶ Id. at § 101(51D)(B).

⁷ Id. at § 101(51D)(A).

⁸ Id. at § 101(51D)(B)(ii).

⁹ Department of Justice, Public Notice – Solicitation of Applicants to Serve as Subchapter V Trustees, https://www.justice.gov/ust/eo/private_trustee/vacancies/11ad.

¹⁰ See id. at § 1183.

¹¹ See id. at §§ 1183, 1190(d).

¹² See id. at §§ 1183(b)(2), 1183(b)(5), 1185.

¹³ See id. at § 1102(a)(3).

¹⁴ 28 U.S.C. § 1930(a)(6)(A).

¹⁵ 11 U.S.C. § 1188.

¹⁶ See id. at § 105(d).

¹⁷ Id. at § 1189(b).

¹⁸ See id. at 1129(b)(2)(B)(ii).

¹⁹ Id. at § 1191(b).

²⁰ See id. at § 1191(c)(1).

²¹ See id. at § 1191(c)(1).

²² See id. at § 1190(3).

²³ See id. at § 1191(d).

²⁴ See id. at § 1190(d).

²⁵ See id. at § 1192.

²⁶ See id. at §§ 507(a); 1129(a)(9)(A).

²⁷ See id. at § 1191(e).

²⁸ See id. at § 1125.

²⁹ See id. at § 1129.

³⁰ See id. at § 1181(b).

³¹ See id. at § 1191(b).



Test No. 134

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1. Chapter 11 of the Bankruptcy Code governs business reorganizations.
 True False
2. SBRA is an acronym for Saving Businesses and Restoring America.
 True False
3. Unliquidated and contingent debts do not count toward the \$2,725,625 debt limit under the definition of small business debtor.
 True False
4. To fit the definition of a small business debtor, at least two-thirds of a debtor's debts must have arisen from commercial or business activities.
 True False
5. Businesses may need to plan ahead to ensure they are will fit the definition of a small business debtor when they file for Chapter 11 bankruptcy.
 True False
6. Collection efforts and litigation against a debtor's property are not stayed until it proves it meets the definition of a "small business debtor."
 True False
7. If a small business debtor files for Chapter 11 bankruptcy, existing management generally remains in place.
 True False
8. There will be no committee of unsecured creditors in a case under Subchapter V unless the Bankruptcy Court order otherwise.
 True False
9. A debtor under Subchapter V need not pay quarterly Chapter 11 fees to the United States trustee.
 True False
10. The Bankruptcy Court must hold a status conference within the first 60 days of the case unless the debtor can show "mistake, inadvertence, surprise, or excusable neglect" meriting an extension.
 True False
11. If the debtor does not file a plan within the first 90 days of the case, any creditor may file a plan.
 True False
12. A Bankruptcy Court can require a Subchapter V debtor to make payments to creditors for more than three years.
 True False
13. Liens of secured creditors are protected under both traditional Chapter 11 and Subchapter V.
 True False
14. If a debtor under Subchapter V used a mortgage to purchase a home then used personal credit card debt to finance his or her business, and the credit card debt exceeds the mortgage debt, the mortgage may be modified under Subchapter V.
 True False
15. For a Subchapter V plan to be confirmed, all of a debtor's business income must be paid to creditors for at least three years.
 True False
16. In a Subchapter V case, the Bankruptcy Court may order the debtor to file a disclosure statement.
 True False
17. In a Subchapter V case, a Chapter 11 plan must include a liquidation analysis.
 True False
18. In a traditional Chapter 11 case, at least one "impaired" class must approve the plan.
 True False
19. In a Subchapter V case, a Chapter 11 plan need not be "fair and equitable" to creditors.
 True False
20. After a Subchapter V Chapter 11 plan is confirmed, the debtor is responsible for mailing monthly plan payments to each of its unsecured creditors.
 True False

MCLE Answer Sheet No. 134

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8. True False
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10. True False
11. True False
12. True False
13. True False
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15. True False
16. True False
17. True False
18. True False
19. True False
20. True False