

“Small Business Reorganization Act of 2019”

On Friday, August 23, 2019, President Donald J. Trump signed the **Small Business Reorganization Act of 2019¹ (SBRA)** into law. The SBRA ensures the ability of small businesses to reorganize and rehabilitate their financial affairs effectively under the Bankruptcy Code by loosening certain requirements.²

SBRA was adjusted in part because it no longer worked well for small size businesses. “Small Business are entities that produce job creation and a dynamic economy but are also most likely to experience financial distress”³. It has been proven that Chapter 11 does not exactly work for small and medium size businesses. These types of businesses no longer use Chapter 11 save their businesses; now, these businesses file bankruptcy knowing the business probably will not persist. “For the fiscal years of 2018-15, more than 18,000 small businesses file a chapter 11 case, and only about 27% confirmed a reorganization plan”⁴.

ABI Commission Co-Chair, Robert Keach, testified before the House Judiciary Subcommittee on Antitrust, Commercial and Administrative Law on July 25, 2019. During his testimony, he claimed that the United States Bankruptcy Code:

- a) Gives unrealistic deadlines to small and medium size businesses which do not give opportunities for these businesses to restructure,
- b) Imposes substantial and costly disclosure and reporting requirements on these companies,
- c) Does not provide any tools that can help small businesses; whose owners may be unsophisticated in finance, business plans or restructuring issues; create and implement an effective reorganizational plan,
- d) It makes it difficult for a small business owner to maintain an ownership interest in the business under the current Chapter 11⁵.

The SBRA adds a new Subchapter V to Chapter 11, providing a better path for small businesses to successfully restructure, reduce liquidations, save jobs, and increase recoveries to creditors while recognizing the value provided by the entrepreneur. This SBRA adopts from the Bankruptcy Code, the current definition of a “small business debtors”, which is defined as a person in commercial business or business activity with aggregate or non-contingent liquidated secured and unsecured debt as of its bankruptcy filing date of not more than **\$2,725,625**.⁶ Previously, one could not exceed **\$2,566,050** liquidated secured and unsecured. Even though the maximum amount increased, it is still too low to help small business since most of them have more than a \$2.7 million total debt.⁷

Despite the need for further modifications--such as the maximum total debt--it is believed that this Act will help financially troubled small businesses come out from bankruptcy in a shorter period of time than under the current statute. Unlike the current version of the Bankruptcy Code, which allows any party-in-interest to file a Chapter 11

¹ Small Business Reorganization Act of 2019, Pub. L. No. 116-54, (Codified as 11 U.S.C. §1181)

² *President Signs Small Business Reorganization Act into Law*, American Bankruptcy Institute (ABI), August 23, 2019. <https://www.abi.org/newsroom/press-releases/president-signs-small-business-reorganization-act-into-law>

³ Keach, Robert, American Bankruptcy Institute Journal, at 8, “*ABI Testifies on Family Farmers and Small Business Reorganization*”(August 2019) <https://www.abi.org/abi-journal/abi-testifies-on-family-farmers-and-small-business-reorganizations>

⁴ *Id.*, at 9.

⁵ *Id.*

⁶ *President Signs Small Business Reorganization Act into Law*, ABI, *Supra*.

⁷ Owens, Keith, *Chapter 11 For Small Businesses*, Venable, LLP, May 2, 2019, <https://www.venable.com/insights/publications/2019/05/chapter-11-for-small-businesses>

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plan once the debtor's exclusive period has expired, the SBRA **only** authorizes the small business debtor to file a Chapter 11 plan of reorganization.⁸ In fact, the SBRA requires a standing trustee to be assigned for the chapter 11 case and must remain throughout the plan of reorganization to guarantee that the small business's reorganization stays on track. How do they ensure the business reorganization is staying on track? The standing trustee has to:⁹

- report all of the property received by the company;
- examine and reject any claims made against the company;
- conduct a review of the company's financial condition and business operations;
- report any fraud or misconduct;
- appear at the status conference and significant hearings;
- write a final report of the case for the bankruptcy court;
- assist the facilitation of a plan of reorganization if necessary;
- distribute certain company property in accordance with the plan of reorganization; and
- confirm the company's adherence to the court-approved plan of reorganization during the payment period.¹⁰

According to the SBRA "an initial status conference is required in every case within 60 days of commencement 'to further the expeditious and economical resolution'." An official committee of unsecured creditors would not be appointed under the bill unless the bankruptcy court orders one. In addition, "[t]he debtor is required to file with the court and serve on the trustee and all parties in interest a report that details the efforts the debtor has undertaken and will undertake to attain a consensual plan of reorganization no later than 14 days before the date of the status conference under subsection." A disclosure statement will not be required, which further reduces the burdens and costs on small businesses. Lastly, the debtor must file a plan no later than 90 days after the order for relief under this chapter, unless the court extends the period if there is need for extension which the debtor should not justly be held accountable. The SBRA offers businesses that file Chapter 11 bankruptcies, a debtor's ability to right size their balance sheet, reduce liabilities, reject or restructure burdensome leases and executory contracts, renegotiate funded debt, and sell its assets. These benefits will now be available for smaller companies without having to incur the costs associated with larger Chapter 11 filings.¹¹

Under this new Act, the Chapter 11 plan of reorganization has to provide either all the projected disposable income of the debtor to be received within a 3 to 5 year period, which begins on the date the first payment is due under the plan; or the value of property to be distributed under the 3 to 5 year plan, that is more than or equal to the projected disposable income of the debtor.¹²

In addition, the standards for confirmation of a plan have been relaxed, since under 11 U.S.C. § 1129(a)(8), it excuses the debtor's compliance with subsection (10), and (15). A debtor may still obtain confirmation of a plan if the plan is fair and equitable to each class of claims or interests even if (a) no class has accepted the plan under 1129(a)(10), or (b) if the debtor is an individual, the plan fails to pay each unsecured creditor the full value of its claim under 1129(a)(15).¹³ Thus, the traditional "cramdown" scenario under 11 U.S.C. sec 1129(a)(8) has been expended to also excuse the debtor's compliance with subsections (10) and (15) of that section. After the bankruptcy court approves the company's plan of reorganization, and so long as "the plan does not discriminate unfairly, and is fair and equitable," the company will remain in possession of "all property of the estate." "[A]ll property of the estate" includes all of the property owned by the company before it filed for bankruptcy, and any property acquired by the company after filing, including earnings received from services.

⁸ Small Business Reorganization Act of 2019, *Supra*.

⁹ Arendsen, Kyle, "The small Business Reorganization Act Reintroduced: A Way Forward for Small Business Reorganization?", Esquire Global Crossings, April 23, 2019, <https://www.esquireglobalcrossings.com/2019/04/the-small-business-reorganization-act-reintroduced-a-way-forward-for-small-business-reorganization/>

¹⁰ *Id.*

¹¹ Small Business Reorganization Act of 2019, *Id.*

¹² Small Business Reorganization Act of 2019, *Id.*

¹³ Mertz, Justin and Brydges, Joseph, "Anticipated Changes to Bankruptcy Laws will Affect Farmers & Small Businesses", Michael Best and Friedrich LLP, August 6, 2019, <https://www.michaelbest.com/Newsroom/216707/Anticipated-Changes-to-Bankruptcy-Laws-will-Affect-Farmers-Small-Businesses>

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The debtor can comply with the “fair and equitable” requirement in the SBRA, in two ways. First, the debtor must identify the company’s “disposable income,” meaning income that is not used to maintain and support the company or pay the company’s necessary expenses. In the plan of reorganization, the debtor must explain how the disposable income will be distributed to the standing trustee during a three to five-year period in order to effectuate payments to creditors under the plan of reorganization. Second, the plan may require the company to distribute some or all of its property to the standing trustee for the benefit of its creditors. The plan must demonstrate that such property “is not less” than the projected disposable income during the company’s next three to five-years. Of significance, if circumstances change for the company after the plan of reorganization is confirmed, after notice and a hearing, the plan may be modified by the company. In conclusion, the SBRA allows small business operators the ability to maintain their ownership interests, but must pay certain parties-in-interest for a period of three to five years pursuant to a court-confirmed plan of reorganization.

Finally, the SBRA eliminates the Absolute Priority Rule (the “Rule”) for small businesses. The Rule entailed that to get a Chapter 11 plan confirmed, owners of the business could not retain their ownership interest, unless unsecured creditors were being paid in full or agree to receive something less. This assured that creditors would not agree to something less while owners retain their ownership interest, absent special or unusual circumstances. The Rule prevented many small businesses from obtaining effective bankruptcy relief under Chapter 11. In other words, this is beneficial since it now offers small business owners the opportunity to retain their ownership interest in the reorganized company. Also, unlike the current version of the Bankruptcy Code, the subchapter of the SBRA states that a “person is not disqualified for employment under section 327 of this title, by a debtor solely because that person holds a claim of less than \$10,000 that arose prior to commencement of the case”.¹⁴

This law will take effect in **February 2020**, that is, 180 days after it is enacted into law.¹⁵

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¹⁴ Swanson, Donald, “*Newly-Proposed Bankruptcy Legislation (“SBRA”) Needs to be Enacted*”. “*Absolute Priority Rule Eliminated for Small Businesses*”, Mediatbankry, December 13, 2018, <https://mediatbankry.com/2018/12/13/newly-proposed-bankruptcy-legislation-small-business-reorganization-act-needs-to-be-enacted-asap/>

¹⁵ President Signs Small Business Reorganization Act into Law, ABI, *Supra*.

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