Faster, Cost-Effective, and Streamlined Reorganization Under Subchapter V

By Ethan D. Dunn

On February 19, 2020, the newly created Small Business Reorganization Act (SBRA) became effective.[1] Sections 1181–1195 were added as Subchapter V of Chapter 11 of the Bankruptcy Code; several other sections of the code were amended to conform with these new sections.[2] The SBRA is intended to streamline an ordinarily complex Chapter 11 process and provide small businesses an opportunity to reorganize their debts more quickly and cost effectively.

As with any new law, implementation requires a practical framework for practitioners, courts, and trustees to follow. On December 5, 2019, the Advisory Committee on Bankruptcy Rules proposed Interim Amendments to the Federal Rules of Bankruptcy Procedure to address provisions of the SBRA for adoption in each judicial district by local rule or general order and the promulgation of new official forms.[3] The interim amendments were adopted by the U.S. Bankruptcy Court for the Western District of Michigan on January 23, 2020, and adopted by the U.S. Bankruptcy Court for the Eastern District of Michigan on February 3, 2020.[4]

Leveling the playing field for small business owners

According to the U.S. Small Business Association, as of 2016 more than 30 million small businesses were driving the U.S. economy. Nearly 25 million of those businesses had no employees and 6 million had paid employees. This represents roughly 99 percent of all businesses in the country and nearly 65 percent of all jobs in the U.S.[5] Although small businesses make up the vast majority of businesses in the U.S., the traditional Chapter 11 process was often not an option given the length of time, expense, and complexity of the process. Before enacting the SBRA, Congress amended the Bankruptcy Code to define certain businesses as "small business debtors," and to provide special rules and procedures for reorganization cases involving those debtors.[6]

At a Glance

Congressional enactment of the Small Business Reorganization Act of 2019 (SBRA) creates a streamlined and cost-effective approach for small businesses to successfully restructure their debts without the pitfalls of a traditional Chapter 11 bankruptcy case. This article explores several of the SBRA provisions and their impact on the cost of bankruptcy that historically hindered many small businesses that needed to reorganize their debts.

The changes, however, did not have the impact desired by Congress given the continued high costs of the Chapter 11 process. The SBRA was enacted to reduce the tremendous expense of a Chapter 11 bankruptcy for small businesses that need to reorganize their debts.

The SBRA includes six key amendments that should create the significant cost savings Congress intended and streamline the path to reorganization for small businesses under Subchapter V of Chapter 11 of the Bankruptcy Code:

(1) Shortening the length of time for filing a plan[7]

(2) Removing the disclosure statement requirement[8]

(3) Eliminating unsecured creditor committees[9]

(4) Eliminating U.S. trustee fees[10]

(5) Inapplicability of the absolute priority rule[11]

(6) Allowing plan confirmation without acceptance by an impaired class[12]

Ninety days to file a plan without a disclosure statement

The SBRA shortens the length of time to file a plan to 90 days as opposed to up to 300 days in a traditional Chapter 11 bankruptcy case. The shortened period should, theoretically, reduce the attorney fees charged in the case, but that remains to be seen. Procedurally, starting a Subchapter V bankruptcy case is similar to a traditional Chapter 11 bankruptcy case, and the debtor must take the same steps as in a Chapter 11 to ensure continued business operations during the case (e.g., first-day motions, initial debtor interview, meetings of creditors, etc.). However, significant cost savings should be found in the creditor negotiation and plan preparation stages. A Subchapter V plan is more form driven and feels more like a Chapter 13 plan.[13] Additionally, the disclosure statement requirements of 11 USC 1125 are waived under Subchapter V unless otherwise ordered by the court for cause.[14] Even if cause is shown and a disclosure statement must be prepared, the disclosure statement would be governed by the less rigorous requirements of 11 USC 1125(f). By eliminating this requirement, a small business debtor may quickly move toward plan confirmation—bypassing the potentially costly disclosure statement approval process.

Eliminating the cost of creditor's committees

The Subchapter V bankruptcy estate will not be required to bear the expense related to a creditor's committee since a committee will likely not be appointed in a Subchapter V bankruptcy case.[15] In a typical Chapter 11 case, the U.S. trustee may solicit and appoint a group of creditors to serve on a creditor's committee. The committee's role is to represent the

interests of unsecured creditors and deal with the hierarchy of claims under the Bankruptcy Code. The committee is authorized to hire counsel, and the costs of both the committee and its counsel are borne by the bankruptcy estate.[16] These costs can be significant and can mean the difference between a funded and feasible plan of reorganization and the debtor's being forced to liquidate. Subchapter V eliminates this cost center by making inapplicable sections of the code regarding the appointment, selection, and powers of official committees of creditors "unless the court for cause orders otherwise."[17]

No quarterly fees paid to the U.S. trustee

Before enactment of the SBRA, the debtor was responsible for paying quarterly fees to the U.S. trustee.[18] In a typical Chapter 11 bankruptcy case, these fees vary based on the dollar amount of disbursements made by the debtor during each quarter of the year. The quarterly U.S. trustee fee starts at $325 and increases up to a maximum quarterly fee of $250,000 based on the total cash disbursed by the debtor during the quarter.[19] Subchapter V of the Bankruptcy Code eliminates this fee entirely. Needless to say, the cost savings to a small business debtor can be significant.

Although there are no U.S. trustee fees, Subchapter V of the Bankruptcy Code does provide for appointment of a Subchapter V trustee (standing trustee) who is compensated by the bankruptcy estate.[20] The U.S. trustee still oversees the case, but the standing trustee is responsible for examining proofs of claim; providing information concerning the estate and its administration upon request; accounting for all property received; objecting to improper filings; opposing the debtor's discharge, if advisable; preparing a final report; and filing a final account of the administration of the estate with the court and the U.S. trustee. The debtor is responsible for the cost of compensating the standing trustee; however, it is the author's understanding that the U.S. trustee will closely monitor the fees charged to the estate by the standing trustee to ensure they are reasonable.[21]

The absolute priority rule does not apply

Under the Bankruptcy Code, a plan generally cannot be confirmed if it discriminates unfairly or is not fair and equitable with respect to each non-accepting class of claims or interests impaired under the plan.[22]

For a dissenting class of impaired unsecured creditors, a plan is "fair and equitable" only if the value of the claim is to be paid in full, or if the holder of any claim or interest junior to the dissenting class of creditors will not receive or retain any property under the plan on account of such junior claim or interest.[23] This requirement is commonly referred to as the "absolute priority rule."

Under the rule, equity interest holders are not allowed to keep their equity under a plan if all senior claims are not paid in full. Application of this rule has obliterated many otherwise confirmable Chapter 11 plans. This is especially true in Chapter 11 cases of small businesses where continued ownership by the current equity holders may be critical to reorganization.

Subchapter V does away with the rule by making 11 USC 1129(b)(2) inapplicable and replacing it with a disposable-income test, feasibility finding, and remedies for creditors if plan payments are not made.[24] The debtor business may confirm a plan and retain equity even if all higher priority claimants are not receiving 100 percent of their allowed claims.

Plan confirmation is allowed without acceptance by an impaired class of creditors

If all the requirements of 11 USC 1129(a)—other than paragraphs (8), (10), and (15)—are satisfied with respect to a plan, on request of the debtor, the court will confirm the plan notwithstanding the absence of an impaired accepting class of claims as long as the plan does not discriminate unfairly and is "fair and equitable."[25]

If a plan is confirmed without acceptance by an impaired class of creditors, the code imposes additional requirements on the Subchapter V debtor, including a delay in entry of the debtors' discharge.[26] The SBRA also modifies the term "fair and equitable." For secured creditors, the plan is fair and equitable if it complies with 11 USC 1129(b)(2)(A). For all others, a plan is deemed fair and equitable if it meets the requirements of 11 USC 1191(c)(2) as summarized below:

- All of the debtor's projected disposable income to be received in the three-year period beginning on the date the first payment is due under the plan (or a longer period fixed by the court not to exceed five years) will be applied to make payments under the plan;[27] or
- The value of property to be distributed under the plan in the three- or five-year plan term is not less than the projected disposable income of the debtor.
- The debtor will be able to make all payments under the plan; or
- There is a reasonable likelihood that the debtor will be able to make all payments under the plan and the plan provides appropriate remedies, which may include the liquidation of non-exempt assets, to protect the holders of claims or interests in the event that the payments are not made.

Of all the amendments to the code enacted by the SBRA, this provision will likely be one of the most valuable tools available to small business debtors. In many small business cases, ballot

solicitation can seem like an exercise in futility. This is especially true when the value of the allowed claim held by a creditor is relatively small. Many creditors will elect not to spend the time or money to vote on the proposed plan. This SBRA provision creates a path to confirmation for small business debtors even without obtaining the necessary accepting votes required for confirmation in a traditional Chapter 11 case.

Subchapter V has been temporarily amended by the CARES Act

The Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law on March 27, 2020.[28] The CARES Act amends the definition of "debtor" in the SBRA to specifically include language that increases the debt limit for a debtor wishing to file a Subchapter V bankruptcy.[29] The limit has been temporarily raised from $2,725,625 to $7,500,000 to allow a greater number of small businesses to access the Subchapter V bankruptcy option, albeit temporarily. The debt limit returns to $2,725,625 on March 27, 2021.

Conclusion

The SBRA has created a framework for small businesses to reorganize their debts using a cost-effective and streamlined process without many of the pitfalls that exist in a typical Chapter 11 bankruptcy case. It appears to be a step in the right direction toward ensuring that small businesses can reorganize successfully while still maintaining the governance and oversight that will provide the necessary protections for the interests of creditors. ■

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ENDNOTES

1. U.S. Trustee Program Ready to Implement the Small Business Reorganization Act of 2019, Office of Public Affairs, US Dep't of Justice (February 19, 2020) <https://www.justice.gov/opa/pr/us-trustee-program-ready-implement-small-business-reorganization-act-2019> [https://perma.cc/5TGQ-66W2]. All websites cited in this article were accessed April 23, 2020.
2. Small Business Reorganization Act of 2019, PL 116-54; 133 Stat 1079.
3. Preliminary Draft: Proposed Amendments to the Federal Rules of Bankruptcy Procedure: Request for Comment, Comm on Rules of Practice and Procedure of the Judicial Conf of the United States (October 2019), available at <https://www.uscourts.gov/sites/default/files/preliminary_draft_of_proposed_amendments_to_the_federal_rules_of_bankruptcy_procedure_-_interim_rules_and_forms_0.pdf> [https://perma.cc/3GQ3-ZY4S].
4. Administrative Order No. 2020-1, US Bankruptcy Court, Western Dist of Mich (2020), available at <https://www.miwb.uscourts.gov/sites/miwb/files/general-ordes/Administrative%20Order%202020-1.pdf> [https://perma.cc/XCR9-L73E] and Administrative Order No. 2020-01, US Bankruptcy Court, Eastern Dist of Mich (2020), available at <http://www.mieb.uscourts.gov/sites/default/files/general-ordes/Admin%20Order%20%232020-01%20%282.3.2020%29.pdf> [https://perma.cc/J2EU-F7GD].
5. Frequently Asked Questions, Office of Advocacy, US Small Business Admin (September 2019) <https://cdn.advocacy.sba.gov/wp-content/uploads/2019/09/24153946/Frequently-Asked-Questions-Small-Business-2019-1.pdf> [https://perma.cc/TAL3-KYZZ].
6. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, PL 109-8; 119 Stat 23.
7. 11 USC 1189(b). Per 11 USC 1181(a), 11 USC 1121 is inapplicable in cases under Subchapter V. As such, neither the 300-day deadline to file a plan and disclosure statement nor the requirement to obtain confirmation within 45 days of filing a plan will apply in a Subchapter V case (see 11 USC 1121(e)(2)).
8. See 11 USC 1181(b) making the provisions regarding committees in 11 USC 1102(a)(1), (2), (4), and 11 USC 1102(b) inapplicable. 11 USC 1190 simply requires that "[a] plan filed under this subchapter—(1) shall include—(A) a brief history of the business operations of the debtor; (B) a liquidation analysis; and (C) projections with respect to the ability of the debtor to make payments under the proposed plan of reorganization."
9. 11 USC 1102(a)(1), (a)(2), and (a)(4); 11 USC 1102(b); 11 USC 1103; and 11 USC 1181(b) regarding the appointment, selection, and powers of official committees of creditors, do not apply in a Subchapter V case "unless the court for cause orders otherwise."
10. The language ''other than under subchapter V'' has been added in 28 USC 1930(a)(6)(A), making quarterly U.S. trustee fees inapplicable in Subchapter V cases. See also amendment to 11 USC 326(b).
11. 11 USC 1129(b) and 11 USC 1181(a) make the prohibition on equity owners retaining their interests in the debtor without paying holders of nonconsenting impaired classes inapplicable.
12. 11 USC 1191(b).
13. Revised Official Form 425A provides a type of model framework for Subchapter V plans.
14. The 2020 Committee Note to Official Form 425 states that "...there will generally not be a disclosure statement in subchapter V cases...," available at <https://www.uscourts.gov/sites/default/files/b_425a_cn_0.pdf> [https://perma.cc/9KR6-5U8S].
15. 11 USC 1181 (making the provisions of 11 USC 1102 inapplicable).
16. 11 USC 1102 (provisions governing creditor's and equity security holders committees).
17. 11 USC 1181(b) makes 11 USC 1102(a)(1), (a)(2), (a)(4), 11 USC 1102(b), and 11 USC 1103 inapplicable in a Subchapter V case.
18. 28 USC 1930(a)(6). See also Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, PL 99-554, § 1; 100 Stat 3088.
19. Chapter 11 Quarterly Fees: Change in Chapter 11 Quarterly Fee Payment Processing Time, US Dep't of Justice (April 1, 2020) <https://www.justice.gov/ust/chapter-11-quarterly-fees> [https://perma.cc/5TM9-RB6S].
20. 11 USC 1183(a).
21. 11 USC 330 determines the standing trustee's compensation.
22. 11 USC 1129(b)(1).
23. 11 USC 1129(b)(2)(B)(ii).
24. See generally 11 USC 1191(b).
25. See 11 USC 1191(b).
26. Several additional obligations are imposed on the small business debtor if confirmation takes place under section 11 USC 1191(b) as set forth in sections 11 USC 1181(c), 11 USC 1186(a), 11 USC 1192, 11 USC 1193(c), and 11 USC 1194(b).
27. See also 11 USC 1190(2) requiring administration by the standing trustee of all payments of future earnings or income required by the plan if the plan is confirmed under 11 USC 1191(b).
28. The CARES Act Works for All Americans, US Dep't of Treasury <https://home.treasury.gov/policy-issues/cares> [https://perma.cc/FL9V-D77J].
29. CARES Act, PL 116-136.