



# RECENT CHANGES IN THE BANKRUPTCY CODE FOR SMALL BUSINESSES IN THE ERA OF COVID-19

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## Today's Panelists:

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# SUBMIT QUESTIONS

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# THE BANKRUPTCY CODE

- Title 11 of the United States Code is the Bankruptcy Code
- Bankruptcy Code is divided into numerous chapters and subchapters

# AGENDA

- Chapter 11 Bankruptcy Basics
- Obstacles to Chapter 11 Bankruptcy for Small Businesses
- Recent Changes to Bankruptcy Code under SBRA and CARES Act
- Statistics of Bankruptcy Filings During 2008 Recession.
- Key Considerations
- Frequently Asked Questions

# CHAPTER 11 BANKRUPTCY BASICS

## OVERVIEW

- Purpose: Allows a debtor to reorganize itself by restructuring its debts and emerge from bankruptcy as a more financially-viable going concern
- A debtor continues to operate its business during its Chapter 11 bankruptcy proceedings
- What distinguishes a Chapter 11 reorganization from Chapter 7?
  - Chapter 7 is a liquidation – a trustee is appointed to liquidate the debtor’s assets and pay any net proceeds to creditors
  - In a Chapter 7, the debtor ceases operations; it never emerges from bankruptcy
  - Chapter 7 for individuals gives them a “fresh start” by discharging most of their prepetition debts

# CHAPTER 11 BANKRUPTCY BASICS (cont'd)

## KEY FEATURES OF CHAPTER 11 BANKRUPTCY

- The heart of Chapter 11 is the “Plan” of reorganization modifying terms of debts that must be approved.
- No liquidation of most or all assets
- Generally no trustee is appointed
  - Debtor’s existing management/ownership retains control of the business
- More costly, complex and time-consuming than Chapter 7 liquidation
- Creditors retain significant leverage.

# CHAPTER 11 BANKRUPTCY BASICS (cont'd)

## PROCEDURE

- Participants in Chapter 11 Proceedings:
  - Bankruptcy Judge
  - “Debtor in Possession” (“DIP”)
  - Chapter 11 Trustee (*if appointed*)
  - U.S. Trustee
  - Official Committee of Unsecured Creditors
- File Petition for Relief
- Automatic Stay
- First Day Motions
- Disclosure Statement
- Chapter 11 Plan of Reorganization
- Creditor Voting on Plan
- Confirmation of Plan by Bankruptcy Court
- Possible Conversion to Chapter 7

# OBSTACLES TO CHAPTER 11 BANKRUPTCY FOR SMALL BUSINESSES

- Small businesses make up the vast majority of all U.S. businesses, so they have a significant impact on U.S. economy.
- High costs and time consumption associated with Chapter 11 has historically placed small businesses at disadvantage relative to larger businesses.
  - Larger business are historically more likely to have the resources to bear the expense and burden of Chapter 11
- For distressed small businesses, Chapter 7 may seem like the only option because of the greater cost and complexity of Chapter 11



# RECENT CHANGES TO BANKRUPTCY CODE

## OVERVIEW

- Makes Chapter 11 a more viable option for distressed small businesses.
- Attempts to address many of the concerns faced by small businesses by establishing new rules tailored specifically to small businesses.
- Shifts significant leverage from creditors to the small business debtor.
- Streamlines the bankruptcy process, making it more efficient and less costly for small businesses.
- Broadens the scope of businesses permitted to file under Chapter 11.

# RECENT CHANGES TO BANKRUPTCY CODE (cont'd)

## THE SMALL BUSINESS REORGANIZATION ACT (“SBRA”)

- Enacted February 2020 (pre-COVID-19), as an additional “Subchapter V” to Chapter 11 of the U.S. Bankruptcy Code.
- Establishes special rules addressing longstanding issues (*i.e.*, existing prior to COVID-19) preventing small businesses from obtaining Chapter 11 relief.
- Core provisions of SBRA make it easier for small businesses to reorganize by:
  - Increasing debtors’ ability to negotiate and confirm a reorganization Plan;
  - Increasing debtors’ ability to retain control of their business; and
  - Reducing a number of procedural burdens and costs.

# RECENT CHANGES TO BANKRUPTCY CODE (cont'd)

## THE CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY ACT (“CARES ACT”)

- Enacted March 2020 in response to COVID-19 pandemic.
- As a whole, intended to provide broad range of relief to individuals and businesses affected by COVID-19.
- Core provisions pertaining to Chapter 11 Bankruptcy include **temporary** amendments to SBRA specifically geared to small business debtors.
  - Designed to alleviate burdens faced by small businesses that may file Chapter 11 in the wake of COVID-19.
  - Amendments are only temporary, terminating 1 year from enactment of CARES Act.

# RECENT CHANGES TO BANKRUPTCY CODE (cont'd)

## KEY FEATURES OF SBRA

- Debtor has exclusive right to file Plan.
- Permits court to approve Plan without creditor support if “fair and equitable.”
- Removes disclosure statement requirement.
- No creditors’ committee.
- Eliminates quarterly fees to U.S. Trustee.
- Modification of rights of creditors with security interest in debtor’s residence.
- Shortens time period for filing Plan to 90 days (previously 120 days).
- Court must appoint a “Standing Trustee” for general oversight.

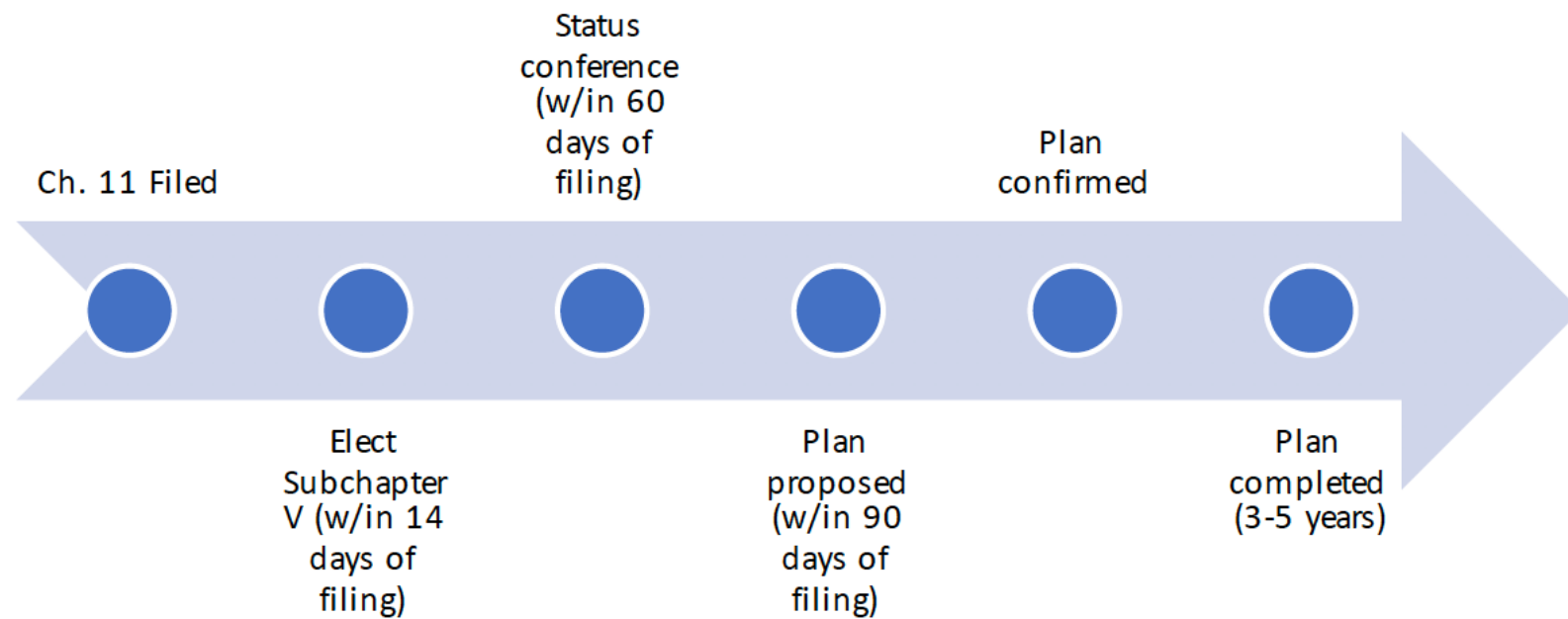
# RECENT CHANGES TO BANKRUPTCY CODE (cont'd)

## KEY FEATURES OF CARES ACT

- Expands access to Chapter 11 bankruptcy relief.
- Temporarily broadens Chapter 11 eligibility by increasing debt limit from \$2,725,625 to \$7,500,000 until 3/21/2021.

# RECENT CHANGES TO BANKRUPTCY CODE

## TIMELINE UNDER SBRA & CARES ACT



# STATISTICS – WHAT DOES THE PAST TELL US?

- Financial fallout from government-mandated lockdowns may spur increased bankruptcy filings.
- The 2008 Financial Crisis:
  - Resulted in dramatic increase in Chapter 11 filings, nearly tripling from 2006 to 2009.
  - 2006 → 5,163 Chapter 11 cases filed (33% small businesses)
  - 2007 → 6,353 Chapter 11 cases filed (32.5% small businesses)
  - 2008 → 10,160 Chapter 11 cases filed (25.7% small businesses)
  - 2009 → 15,189 Chapter 11 cases filed.

# KEY CONSIDERATIONS

- The lack of legal precedent interpreting or applying new laws under SBRA and CARES Act.
- While many changes under the SBRA and CARES Act provide more leverage to debtor small business, there are limitations, (e.g., mandatory appointment of a trustee to each small business debtor filing under Chapter 11).
  - So the price for all the advantages includes somewhat more oversight.
- Changes under CARES Act are temporary, and terminate after one year.
- What are the benefits to a small business filing chapter 11 versus chapter 7?



# FREQUENTLY ASKED QUESTIONS

## ■ What constitutes a “small business?”

### ■ A “debtor” is defined under Subchapter V as:

- “...a **person engaged in commercial or business activities** (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an **amount not more than \$7,500,000** (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor...”

### ■ Exclusions:

- Landlords
- Group of affiliated debtors with aggregate noncontingent liquidated secured and unsecured greater than \$7,500,000 (excluding debt owed to 1 or more affiliates or insiders);
- Corporation subject to reporting requirements under Securities Exchange Act of 1934; and
- Affiliate of an issuer, as defined in the Securities Exchange Act of 1934.

# FREQUENTLY ASKED QUESTIONS

- **Does SBRA's Subchapter V automatically apply to any small business who files under Chapter 11?**
  - No – Small business debtors must “opt-in” to Subchapter V.

# FREQUENTLY ASKED QUESTIONS

- **What are the requirements for confirmation of Chapter 11 Plan under SBRA and CARES Act without obtaining creditor approval?**
  - The Plan must not “discriminate unfairly” and must be “fair and equitable,” as modified under the SBRA.
    - 1) All debtor’s projected disposable income received during 3-5 year Plan will be applied to payments to creditor; *or*
    - 2) Value of property to be distributed under the 3-5 year plan, from the date first payment is due under the Plan, is not less than the projected disposable income of the debtor.
  - Court must find that:
    - 1) Debtor will be able to make all payments under Plan; **OR**
    - 2) “Reasonable likelihood” debtor will be able to make all payments under Plan **and** Plan provides remedies to creditors for failure to make payments.

# FREQUENTLY ASKED QUESTIONS

- **Can non-profit corporations file Chapter 11 Bankruptcy?**
  - Generally, yes.
  - However, their reliance on speculative future donations (*i.e.*, the lack of recurring income) has historically made it more difficult for non-profit debtors to make a Chapter 11 Plan.

# FREQUENTLY ASKED QUESTIONS

- **Do the changes established under the SBRA and CARES Act apply to sole proprietorships?**
  - Sole proprietorship is a business owned by one person (or married couple) where no separate legal entity is formed.
    - *i.e.*, Business is not separate from personal assets or debts because no entity is created.
  - Sole proprietors may file under Chapter 11, but their personal assets are included in the debtor's bankruptcy estate.
  - Given the ability to file under general Chapter 11 rules, SBRA and CARES Act presumably apply to sole proprietorships.

ADDITIONAL QUESTIONS?