

SMALL BUSINESS RESTRUCTURING IN CHAPTER 11

Under the Small Business Reorganization Act

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The Current State of Business Bankruptcies

Businesses are eligible to file bankruptcy under Chapters 7, 9, 11, 12, and 15 of the Bankruptcy Code

Most businesses file under Chapter 7 or Chapter 11

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Liquidation

CHAPTER

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**Liquidation or
Reorganization**

Business Bankruptcies Under Chapter 11

**Chapter 11
has several
key features:**

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- **Allows the business to remain operational as normal**
- **Allows current management to remain in place unless extenuating circumstances**
- **Allows business in Chapter 11 to negotiate a plan to pay off creditors over time**
- **Allows automatic stay that stays all collection action and related litigation once bankruptcy is filed**

Small Business Bankruptcies Under Chapter 11

2005 Amendments to Bankruptcy Code:

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- ➔ **Provided new provisions designed to help small businesses utilize Chapter 11 to reorganize**
- ➔ **Changes allowed for a somewhat more streamlined process**
- ➔ **However, it still remained expensive for a small business to actually reorganize through Chapter 11**
- ➔ **Ownership Interests Requirement Remained- the “Absolute Priority Rule”**

Ownership Interests Requirement Under Chapter 11

All creditors be paid in full for existing equity holders to keep their ownership interests



OR

Equity holders would have to put in additional capital to keep their ownership interests



Small Business Reorganization Act

Subchapter V of Chapter 11:



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- **Small Business Reorganization Act (SBRA)**
- In effect as of **Feb 20, 2020**
- **Game Changer for small businesses:**
 - **Voluntary for business to file under this new Subchapter**
 - **Has many advantages over pre-existing law**
 - **Allows for quicker & less expensive reorganization**

Who Can File Under Subchapter V?

How does a
business qualify
to proceed
under SBRA?

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➔ Total **Non-Contingent Liquidated** Debts under **\$2.725 m**

- What is **Non-Contingent**?
- What is **Liquidated**?

➔ At least **50%** of this debt has to be from **business activities**

- Because individuals can file under SBRA as well –
i.e. sole proprietorship

Who Can File Under Subchapter V?

How does a
business qualify
to proceed
under SBRA?

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- ➔ **Cannot** be a single asset real estate entity
 - i.e. – an LLC that owns one apartment building

- ➔ An individual with:
 - \$100,000 in business-related debt &
 - \$90,000 in consumer-related debt**is eligible** to file as a small business debtor & reorganize under Subchapter V



Non-contingent Liquidated Debt

Non-contingent is Not Defined by Bankruptcy Code

Definition of Contingent Debt:

“[i]f the debtor’s legal duty to pay, i.e., his liability, does not come into existence until triggered by the occurrence of a future event that was reasonably within the presumed contemplation of the parties at the time the original relationship between the parties was created.”

Non-contingent is Not Defined by Bankruptcy Code

Definition of Contingent Debt:

A contingent debt “is one which the debtor will be called upon to pay **only upon the occurrence or happening of an extrinsic event which will trigger the liability of the debtor** to the alleged creditor and if such triggering event or occurrence was one **reasonably contemplated by the debtor and creditor** at the time the event giving rise to the claim occurred.”

Source: *In re Adams*, 05-51183, 2006 WL 2846471, at *2 (Bankr. W.D. La. June 27, 2006).

Liquidated is Not Defined by Bankruptcy Code

Definition of Liquidated:

Liquidated at its simplest means that the amount of debt is known or is easily calculated

The “dollar amount”

(1) is determined, fixed, settled, adjusted and made certain mathematically and with precision,

(2) is agreed upon, or

(3) is fixed by operation of law

Source: *In re Harkness*, 189 Fed. Appx. 311, 313 (5th Cir. 2006).

Examples of Recent Filings

Vet Clinic



Trucking Co.



Fitness Centers



Benefits of Subchapter V



Significant Benefits of Filing Chapter 11 under SBRA:



Owners Stay in Control



Faster & Cheaper Process



Trustee is an Ally

Cost Savings Under Subchapter V



Significant Cost Savings over typical Chapter 11: **No Creditors' Committee**

Typical Chapter 11:
the U.S. Trustee will usually form a committee to represent the interests of unsecured creditors

- ▶ That committee has the statutory right to hire its own counsel & financial advisor
- ▶ The debtor has to pay the costs & expenses of the committee's professionals
- ▶ **In a case under Sub V – no committee unless judge orders it**

Cost Savings Under Subchapter V



Significant Cost Savings over typical Chapter 11: **No U.S. Trustees Fees**

➔ In a Chapter 11 not under SBRA, a debtor must pay fees to U.S. Trustee on a quarterly basis

➔ These fees are based on disbursements from the debtor during the period covered

Cost Savings Under Subchapter V



Significant Cost Savings over typical Chapter 11: **No U.S. Trustees Fees**

➔ The fees are at a minimum of \$325 per quarter and increase as the amount of disbursements increase

➔ For example, if the debtor disburses \$300,000 in a quarter, the U.S. Trustee fee is \$4,875 for the quarter

➔ Filing under SBRA provides significant savings by eliminating the U.S. Trustee fees

Cost Savings Under Subchapter V



Significant Cost Savings over typical Chapter 11: **Fewer Filing Requirements**

➔ The Plan of Reorganization does **not** have to be as complex as a plan in a larger case

➔ There are forms to use that can cut down costs

➔ **No requirement** of a separate Disclosure Statement

Cost Savings Under Subchapter V



Significant Cost Savings over typical Chapter 11: **Fewer Filing Requirements**

➔ The Plan must contain some information traditionally addressed in disclosure statements, such as a brief history of the business operations, a liquidation analysis, & a projection of the debtor's ability to make payments under the proposed plan

➔ Debtors still have to file monthly operating reports & standard "first day" motions

A Faster Reorganization Process: SBRA



More Streamlined Process

➔ Reorganization plan must be filed withing 90 days of filing bankruptcy

➔ An initial status conference will be set by the Court to occur within 60 days of filing - *although some have been continued because of COVID-19*

➔ Initial status report is due at least 14 days before initial status conference

➔ During this time, debtor is to work with SBRA Trustee to negotiate with creditors on reorganization plan

A Faster Reorganization Process: SBRA



Speed

First SBRA case file at 12:08AM CST on Feb 19, 2020 in the Middle District of Tenn:

LLC had gross revenues of \$400,000 in 2019; the debts are less than \$500,000

Debtors moved to pay the filing fee in installments

Debtors' counsel came into the case, after having received \$1,000 in fees, with \$2,065 in unpaid pre-petition fees, an unpaid balance that is not disqualifying under the SBRA's employment exception for unpaid pre-petition fees up to \$10,000

A Faster Reorganization Process: SBRA



Speed

First SBRA case file at **12:08AM CST** on **Feb 19, 2020** in the Middle District of Tenn:

9:05 AM: the US Trustee had filed his Notice of Appointment of the Sub V Trustee who proposed to bill at \$295 per hour

Initial Debtor Interview was set for **Feb 25, 2020**

341 was set for **Mar 19, 2020**

By 3:00 PM, Judge had set the mandatory status conference for **Apr 14, 2020**

Trustee as an Ally



Subchapter V Trustee

Appointed by U.S. Trustee from a pool of pre-approved Subchapter V trustees
– Goal to match expertise of trustee with Debtor’s business operations

Role of the trustee is to supervise and monitor the case & to participate in the development and confirmation of the plan

Unlike all other trustees, a Sub V trustee has the duty to “facilitate the development of a consensual plan of reorganization.” § 1183(b)(7)

- Although Chapter 13 trustee has the duty to “advise, other than on legal matters, and assist the debtor in performance under the plan.”

Trustee as an Ally



Subchapter V Trustee

Subchapter V trustee **must** appear & be heard at the 60 day status conference

Subchapter V trustee **must** appear & be heard at any hearing concerning:

- (1) the value of property subject to a lien;
- (2) confirmation of the plan;
- (3) modification of the plan after confirmation; and
- (4) sale of property of the estate

*Chapter 12 Trustee has same 4 duties; Chapter 13 Trustee only has duties 1-3



Trustee as an Ally



Subchapter V Trustee Fees

Subchapter V Trustee's fees are limited

Sub V Trustee likely discharged upon plan confirmation & the Debtor making its first payment pursuant to the Plan



Owners Stay in Control

Easier to maintain equity interests even if no creditor agrees with reorganization plan

Non-consensual “cram-down” plan

Has to be “Fair and Equitable”



Owners Stay in Control

 **Only** the Debtor can propose the Plan

➔ The plan length may be **no less** than three years & **no more** than five years – all disposable income must be dedicated to the plan

➔ The plan may be approved if it is feasible, does not unfairly discriminate, & is fair and equitable as to nonconsenting, impaired classes of creditors

Owners Stay in Control



Only the Debtor can propose the Plan

Can enter into “consensual plan” where creditors agree with re-payment proposal

Can also “cram-down” a “non-consensual plan” if all creditors do not agree with re-payment proposal

No time period for confirmation of a plan and no mechanism for votes

Owners Stay in Control



Elimination of the Absolute Party Rule

Under the Absolute Priority Rule, an owner of a bankrupt business generally cannot retain his or her equity interest unless all creditor classes vote to accept the plan of reorganization or are otherwise paid in full

Consequently, equity holders wishing to “retain” an equity stake in the reorganized business typically need to provide “new value” (almost always, additional capital) into the business

The rapidly deteriorating & uncertain economic environment may discourage or inhibit equity holders from investing new capital into their businesses



Owners Stay in Control



Elimination of the Absolute Party Rule

The SBRA eliminates the Absolute Priority Rule

Instead, the debtor may retain ownership of the business even if unsecured creditors are not paid in full, so long as the plan provides for the payment of all of the business's projected "disposable income" over a three-year period or "such longer period not to exceed five years as the court may fix..."



Owners Stay in Control: “Fair and Equitable”

1

All secured creditors retain their liens in their collateral and receive payments through the plan equal to the value of the secured creditor’s interest in the debtor’s property as of the effective date of the plan,

2

that the plan provides either (i) that all of the debtor’s projected disposable income for a minimum of three years up to a maximum of five years as fixed by the Bankruptcy Court (the “Applicable Commitment Period”) will be applied to payments under the plan or (ii) for distribution to creditors of property equal in value to the projected disposable income of the debtor for the Applicable Commitment Period, and

3

that the debtor will be able to make the required plan payments (or that there is a reasonable likelihood that the debtor will be able to make the required plan payments).

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Other Points to Consider



Subchapter V Trustees in Region V

Subchapter V Trustees: Region V Louisiana



Louisiana
Trustees

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Subchapter V



Greta Brouphy
New Orleans



Leo Congeni
New Orleans



Ryan Richmond
Baton Rouge



Dwayne Murray
Baton Rouge



Lucy Sikes
Shreveport



Thomas "Rocky" Willson
Alexandria



Armistead Long
Lafayette

Subchapter V Trustees: Region V Mississippi



Mississippi
Trustees

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Subchapter V



Craig Reno
Ridgeland



Robert Byrd
Biloxi



David Lynch
Jackson



Kimberly Strong
Ridgeland

Subchapter V and the CARES ACT

Enacted in response to COVID-19 pandemic



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Subchapter V



CARES Act
Coronavirus Aid,
Relief, and Economic
Security Act

Raises debt limit to \$7.5 m for one year from Mar 27, 2020

Only applies to cases filed **AFTER** Mar 28, 2020

This will allow many more small to medium sized companies to take advantage of the law

Questions?



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