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New Small Business Reorganization Act Makes It Easier For Small Businesses To Reorganize

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Chapter 11 can be a daunting and expensive process for any business to undertake, but its myriad requirements tend to have a disproportionate effect on small businesses. To the rescue for the faltering small business is the Small Business Reorganization Act of 2019 (SBRA), which was enacted into law on August 23, 2019 and became effective on February 19, 2020. This Act now makes it much easier and less burdensome and expensive for a "small business debtor" to emerge from Chapter 11.

Preliminarily, the following requirements must be met in order to qualify for treatment under the SBRA:

- the debtor must be an individual or entity engaged in commercial or business activities
- the debtor must not have as its principal activity the ownership and operation of "single asset real estate," defined generally as a single property or project, other than residential property with fewer than four units, which generates substantially all of the debtor's income and on which no substantial business is conducted by the debtor other than operating the property
- the total amount of the debtor's debts (secured and unsecured) must not exceed $2,725,625, and
- not less than 50% of the debts must arise from commercial or business activities

Once qualified under the SBRA, it provides substantial advantages for a debtor that do not exist in a classic Chapter 11. Chief among them are:

- There is no absolute priority rule. In classic Chapter 11, the debtor cannot confirm a plan if the equity holders retain their interests, or in the case of an individual, if the debtor retains property, ***unless*** either the unsecured creditors are paid in full, they agree to accept less than the amount they are owed by a super-majority vote on the plan (of those creditors who actually vote), or the equityholders contribute substantial "new value" to the plan
- In place of the absolute priority rule, and in a case where the creditors do not accept a plan that pays them less than the full amount of their claims, the debtor is required to contribute its projected disposable income to creditors for a period of three to five years or must distribute property to creditors with a value that is not less than the debtor's projected disposable income for that period. "Disposable income" is liberally defined as income that is not reasonably necessary for: (i) the support of an individual debtor or dependents of the debtor, (ii) payment of certain domestic relations obligations, or (iii) payment of expenses that are necessary to maintain the debtor's business
- The ability to confirm a plan even if no creditors vote to accept it
- No appointment of a creditors' committee unless the court orders otherwise
- Only the debtor may file a plan, which may be limited to containing a brief history of the debtor's business, a liquidation analysis, projections, and a provision that submits all or a portion of future income as is necessary for execution of the plan
- No requirement of a disclosure statement, which typically would accompany a plan, unless the court orders otherwise
- The debtor is exempt from paying United States trustee fees, which are based on the amount of quarterly cash outlays made by the debtor and which in smaller cases would typically range from $325 per quarter for disbursements of less than $15,000 to $4,875 per quarter for disbursements of between $300,000 and $1 million
- Administrative expenses do not have to be paid in full on the effective date of the plan, but can be paid over the term of the plan
- For individuals, the ability to modify certain residential mortgages if the underlying loan was not used to acquire the residence but was instead used in connection with the debtor's business

The timeline of a small business Chapter 11 is designed to be abbreviated. For example, a status conference must be held before the court within 60 days of the Chapter 11 filing, and within 14 days of the status conference, the debtor must file a statement that details the efforts that have been undertaken to achieve a plan with the consent of creditors. The debtor is also required to file a plan within 90 days of the Chapter 11 filing, unless the court extends that time based on extenuating circumstances. Another new feature is the automatic appointment of a standing trustee, who will have a monitoring role in the case that includes facilitating the development of a consensual plan.

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There is little question that the SBRA introduces groundbreaking changes that provide small businesses with a greater opportunity to reorganize. As with any legal process, it is important for a small business to have experienced and capable counsel to make sure it can take full advantage of the SBRA while also complying with its provisions.

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