by Zach Shelomith

Small Business Debtor Reorganizations - Making Their Debut in February 2020

A new bankruptcy law for small business debtors is set to take effect on February 19, 2020. The Small Business Reorganization Act of 2019 will address many of the difficulties currently encountered by small businesses who seek to reorganize under Chapter 11. The current provisions are particularly onerous for small businesses.

In particular, a Chapter 11 is time-consuming, costly, and has substantial reporting burdens. Additionally, creditors currently have much leverage under the existing Chapter 11 provisions. The Act attempts to address these concerns by giving small businesses a better chance of successfully reorganizing, rather than simply liquidating.

The Act creates a new subchapter of Chapter 11 (Subchapter V), called a "Small Business Debtor Reorganization", or SBDR. To be eligible, a debtor must have no more than $2,725,625 of debt. Both companies and individuals are eligible to file an SBDR, so long as at least 50 percent of the pre-petition debt arose from commercial or business activities. Given this debt limitation, more than half of all debtors who file Chapter 11 would be eligible to file an SBDR. What is so special about this new bankruptcy law and why is it going to make a difference?

Streamlined Process. To start, an SBDR will be a simplified procedure compared to existing Chapter 11. Under the Act, only the debtor may file a plan, and that plan must be filed within 90 days after the petition date. In addition, there is no creditors' committee, unless ordered by the court. A disclosure statement, which is typically a long document describing the plan, is no longer necessary under the Act.

Easier Path to Reorganization. The most powerful aspect of the Act, however, is that it makes a successful reorganization more of a possibility. Currently, at least one class of creditors whose rights are being modified in the plan must vote in favor of the plan for that plan to be confirmed. Therefore, if no creditors vote to accept a plan, the plan cannot be approved by the court. The Act does away with this requirement. If all other requirements under the law are met, then a plan can be confirmed even if all creditors reject the plan, or do not vote at all.

Additionally, it is typically very difficult for a business owner to retain his or her equity interest in the reorganized Chapter 11 debtor. With certain exceptions, all creditors must be paid before a business owner can retain his or her equity interest. This is known as the "absolute priority rule". The Act does away with the "absolute priority rule". It will now be much easier for a business owner to retain his or her equity interest in the business. This rule was replaced by other, more relaxed, requirements, which essentially require that the debtor's disposable income, for a period between 3 to 5 years, be devoted to payments under the plan.

Trustee. One of the controls put in place to ensure that small business debtors comply with all of their requirements under the Act is that a trustee, with limited duties and powers, will be appointed in every case. The trustee's role is to facilitate the development of a consensual plan and make distributions under the plan while the debtor still runs the business.

The Act will now give small businesses a much better chance of succeeding and allows access to the bankruptcy system to a much larger percentage of the population. It is very important for small business debtors to have experienced bankruptcy counsel who can navigate this new law and bring about a successful reorganization.

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