Congressional Changes Meant to Encourage Small Business Chapter 11 Bankruptcy Filings Prove Timely Amid COVID-19 Outbreak

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Anyone who has ever participated in a small business Chapter 11 case knows that the existing process was not exactly designed for small businesses. The process can be long, expensive and inefficient for everyone, but especially for legitimate creditors just looking for some recovery on the obligation. On August 23, 2019, President Trump signed into law the Small Business Reorganization Act (the "SBRA") which contains a number of provisions which should streamline the Chapter 11 process for small businesses and the creditors to which they owe money. The provisions of the SBRA took effect for cases filed on or after February 19, 2020 (in the midst of the ongoing coronavirus pandemic and its inevitable financial repercussions) and require a small business debtor to opt-in to its subchapter V provisions. Once the debtor has chosen to opt-in, below are some of the changes about which creditors might want to be aware.

It is too early to predict the extent of the impact of coronavirus on the nation's economy. There can be no doubt however that some businesses will not survive the pandemic. And smaller "Mom and Pop" businesses seem even more susceptible to the current economic collapse. The SBRA contains a number of new provisions specifically designed to make the Chapter 11 process easier and more attractive for small business debtors such as these. Its drafters hoped that the new provisions would draw more small businesses into the Chapter 11 process and that the process could better address those business' needs.

Shortened Case Length

One concern often expressed by creditors in Chapter 11 cases is the sheer length of the bankruptcy process. Creditors are often forced to wait for years before even partial payments commence under a confirmed plan – assuming a debtor can navigate through the labyrinth that is getting a plan confirmed. The SBRA attempts to address this issue by setting relatively quick deadlines and

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timeframes upon the filing of the case. For example, Section 1188(a) of the SBRA requires that the court hold an initial status conference not less than 60 days after the case has been filed. Additionally, under Section 1188(c) of the SBRA, a small business debtor proceeding under its provisions must also provide the court, the trustee and all parties in interest a report detailing its efforts to resolve its bankruptcy case two weeks prior to that 60 day status conference. The setting of an automatic status conference to discuss the viability of the bankruptcy case along with the requirement to file a report on steps taken to evidence that viability should encourage small business Chapter 11 debtors to commence negotiations with all of its creditors immediately after filing its case. Perhaps it may even encourage small business Chapter 11 debtors to engage in those discussions pre-filing with the hopes of entering the bankruptcy with the broad strokes of a consensual plan. In effect, this could turn small business Chapter 11 cases under subchapter V into quasi "pre-pack" or pre-packaged bankruptcy cases in which a Chapter 11 debtor actually enters into formal agreements resolving its issues with its creditors prior to any bankruptcy case ever being filed. Either way, these new provisions should drastically shorten the time most small businesses spend in bankruptcy.

Further, under Section 1189(a) and (b) of the SBRA, only the debtor may file a plan and that debtor must do so no later than 90 days after the case is filed. And Section 1181(b) alleviates the need to file a disclosure statement along with the debtor's plan. These provisions taken together should also reduce the time and expense associated with the small business Chapter 11 process.

Automatic Trustee Oversight

Another major concern expressed by creditors involved in small business Chapter 11 cases involves the continued management of the debtor by the same individuals who presumably were involved with the debtor's poor operations pre-filing. Section 1183 of the SBRA requires the appointment of trustees in every small business Chapter 11 case. Those trustees will be charged with monitoring the debtor's activities and facilitating the debtor's compliance with its plan of reorganization. While the automatic appointment of a supervising trustee under Section 1183 does not completely strip existing management of control of the debtor, it does provide another layer of supervision on which creditors and others can rely.

No Creditor Committees

Another major drawback of the existing Chapter 11 process according to most small businesses is the potential for the appointment of an unsecured creditors' committee. Some creditors agree. Unsecured creditors committees can serve a valuable purpose, ensuring the interests of the unsecured creditors (who are often the vast majority of a debtor's creditors) are adequately represented during the bankruptcy process. However, the formation, operation and participation of an unsecured creditors committee and its retained professionals can add large

amounts of expenses to any Chapter 11 case, let alone a small business case, thereby reducing any amounts left over for the unsecured creditors themselves. Section 1181(b) of the SBRA removes the automatic appointment of an unsecured creditors committee but still allows a Court to appointment such a committee "for cause."

Easier Plan Confirmation

Finally, the process to get a plan confirmed under the existing law for Chapter 11's is a long, complex one involving adequate disclosure, possible competing plans of reorganization, extended time frames for review and discussion of the same, followed by what can become a protracted fight at the actual hearing to confirm the plan if a debtor cannot obtain sufficient creditor support. This article has already discussed the SBRA's provisions relating to timing and removing a disclosure statement requirement, but the SBRA also makes it easier for a small business Chapter 11 debtor to confirm a plan even if it cannot obtain the consent of all of its creditors. And while that might seem like a negative for creditors, Section 1191 of the SBRA allows a debtor under its provisions to confirm a plan over its creditors objections only if the debtor has dedicated three to five years of net income as payments to those creditors under the plan. And under Section 1183, the supervising trustee will be involved to review the plan, the debtor's income contributions and the actual payments to creditors under the plan. Further, the debtor's proposed plan must include an automatic enforcement mechanism in the event the debtor fails to abide by plan terms and obligations. So while creditors may not have as much ability to prevent plan confirmation, they should take some solace in the fact that the debtor's operations are being monitored, that income is being dedicated to repayment under that debtor's confirmed plan, and that they have the ability to enforce non-compliance with that plan.

Conclusion

The recent enactment of the SBRA seems eerily timed to the financial downturn in which we currently find ourselves and will most likely be tested extensively in the months to come. While it remains to be seen exactly how those businesses will fare under subchapter V's new provisions, those provisions should also afford creditors a better experience in the process. In any event, if you think you may need to employ the provisions of subchapter V or if one of your customers files a subchapter V case, please contact counsel immediately to discuss the new deadlines, timeframes, responsibilities and obligations contained in the SBRA.