

CLIENT ALERT

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BANKRUPTCY

A REALISTIC SURVIVAL OPTION FOR SMALL BUSINESSES – RELIEF UNDER THE SMALL BUSINESS REORGANIZATION ACT

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No one can yet predict the overall effect the COVID-19 pandemic will have on the economy in the long run. However, the immediate impact on small businesses seems readily apparent. The dramatic disruption has impeded cash flow and upset daily operations to the point that some business owners question whether recovery is possible. Should a business find themselves in that unfortunate position, there is relief available under Chapter 11 of the Bankruptcy Code, but the Chapter 11 process can be unwieldy and expensive for small or even medium-sized businesses.

Interestingly, and fortuitously, in late 2019 Congress passed the Small Business Reorganization Act ("**SBRA**") designed to streamline the Chapter 11 process for qualifying businesses and eliminate some of the legal hurdles for them to reorganize quickly and cost-efficiently.

Eligibility to File Bankruptcy Under the SBRA

A small business debtor is defined as having no more than \$7,500,000 in liquidated, non-contingent secured and unsecured debt. [Note: Under the SBRA as originally passed, the debt ceiling was \$2,725,625; however, the newly passed federal stimulus package – the Coronavirus Aid, Relief and Economic Security Act – raises the ceiling to the new level for one year]. The debtor (includes an individual or a company) must be engaged in commercial or business activity with at least 50 percent of the debt arising from such activity. Single asset real estate cases are excluded.

Streamlined Process That Reduces Cost

The Debtor must file a Plan of Reorganization within 90 days of filing the case but the time can be extended "under circumstances for which the Debtor should not justly be held accountable." Only the Debtor can file a plan, thus eliminating the risk of a competing plan by a creditor. Unlike larger Chapter 11 cases: (a) the Debtor does not have to file a Disclosure Statement and can seek approval of the Plan in a single hearing; (b) the Debtor does not have to pay fees to the United States Trustee; and (c) no creditor committee is appointed thereby eliminating both pressure and cost.

The Simplified Plan

The concept of the Plan is quite simple. The Debtor pays secured creditors over time (no different from a larger Chapter 11) and commits all of its "Disposable Income" to pay creditors over a 3 to 5 year period (the "Income Commitment Period"). "Disposable Income" is defined as income that is not reasonably necessary to maintain support of the Debtor, satisfy domestic obligations, or ensure the continued preservation or operation of business.

Certain Legal Hurdles Eliminated

The Debtor remains in possession of its assets although a trustee is appointed with the essential obligation to facilitate a consensual plan. In fact, provisions of the SBRA are designed to incentivize consensus. Before the SBRA, the existing shareholders (or an individual) in a chapter 11 proceeding could not retain ownership without consent of unsecured creditors unless the shareholder(s) infused new capital, or unsecured creditors were paid in full. This requirement was a nearly impossible hurdle to overcome by the financially troubled debtor trying to discharge enough debt to survive. The SBRA eliminates this requirement so long as the Income Commitment is fulfilled as described above. In addition, unlike larger Chapter 11s, acceptance by at least one accepting impaired class is not necessary. These features reduce creditor pressure, promote consensus, and ultimately save considerable time and expense in resolving issues.

Conclusion

The financial distress many small businesses are suffering is a result of the temporary setbacks caused by the COVID-19 situation. A Chapter 11 bankruptcy under the SBRA is a tool designed to allow a business to have the breathing room necessary to recapitalize and restructure a path to future prosperity.

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