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# 2020 Central States Virtual Bankruptcy Workshop

## **Small Business Reorganization Act of 2019**

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# Small Business Reorganization Act of 2019

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**If you were representing a debtor that was eligible for a Subchapter V election, would you recommend such an election?**

- A. Yes
- B. No, because I don't like the shortened timeframes and deadline
- C. No, because I don't like the automatic appointment of a Subchapter V trustee
- D. The cost of Ch 11 is still too high
- E. No, for other reasons



## Small Business Reorganization Act of 2019

- Context
- Highlights
- Who Qualifies?
- Subchapter V Timeline
- Duties of the Debtor
- Powers of the Debtor
- Duties of the Trustee
- Plan Confirmation
- Interim Rules



## Context



## SBA Statistics: Small Businesses are a Critical Part of the US Economy

99% of American Businesses meet the SBA definition

47.5% of the US Workforce is Employed by Small Business

Small Businesses account for 64.9% of net new job creation



## Small Business have a High Rate of Failure

50% of small businesses will fail in the first 5 years

Only 1/3 of small businesses last 10 years

Remarkably similar rates of failure across industries

Not really contingent upon macroeconomic conditions



## ABI Commission Interviews: What's the Problem?

Ch 11 is Cost Prohibitive for Small Business

Huge failure rate: only 27% of Small Business Debtors confirm Ch 11 plans

Perceived Increase in Use and Speed of Asset Sales under 363

Perceived Decrease in True Reorganizations

Absolute Priority Rule & Existing Owners





## ABI Report: Recommended Changes

Reduce Barriers to Entry

Appoint an Estate Neutral to Facilitate Resolution

Eliminate Need for an Impaired Accepting Class to Cram Down

Enhance Liquidity During the Case

Eliminate UST Fees



## Highlights

11 U.S.C. §§ 1181–95 “Subchapter V of Chapter 11”

No Quarterly Trustee Payments

No Creditor Committee (“For Cause” Only)

Limited Trustee

No Disclosure Statement (“For Cause” Only)

Avoid Absolute Priority Over Impaired-Class Objections

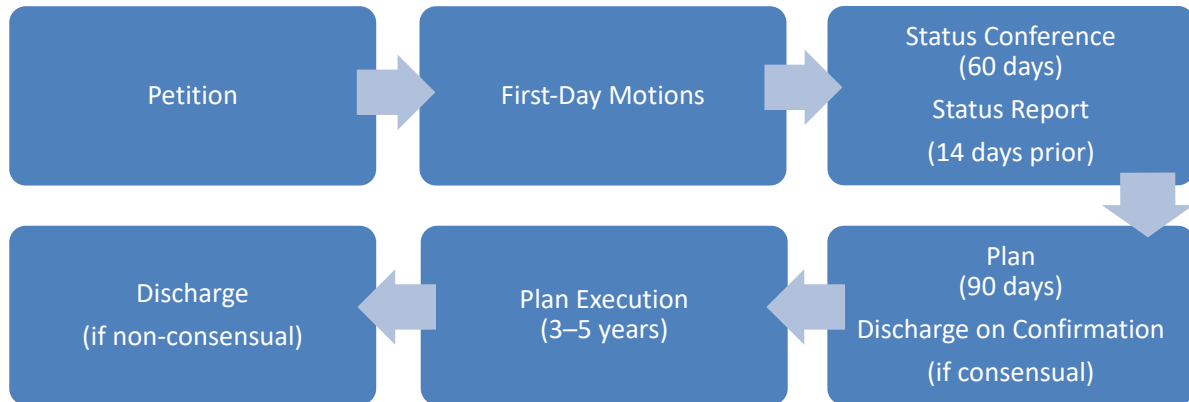
Distinction Between “small business case” and “subchapter V case” (11 U.S.C. § 101(51C))

Other (e.g. 11 U.S.C. § 547(b); 28 U.S.C. § 1409(b))



## SubV Timeline: Faster Ch 11 Cases

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## Who Qualifies?

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11 U.S.C. § 1182(1) & 11 U.S.C. § 101(51D)(A):

SubV is for "small business debtors"

- A "person" engaged in commercial or business activities
- Excludes SARE's
- Aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than \$7,500,000 (excluding debts owed to 1 or more affiliates or insiders)
- Not less than 50 percent of debt arose from the commercial or business activities of the debtor

CARES Act

- Previous debt limit: \$2,725,625
- Raised the debt limit to \$7,500,000
- Currently sunsets on March 27, 2021, unless adjusted by Congress.



## But When Can You Qualify?

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The SBRA is silent as to whether it applies to pending cases

But case law is beginning to emerge and answer this question

- See *SBRA: Case Law So Far Suggests an Enthusiastic Bench*

Fed.R.Bankr.P. 1009(a) authorizes a debtor to amend its petition as a matter of course at any time before the case is closed

Thus, a debtor with a pending case may amend its petition to elect Subchapter V treatment

- See *In re Progressive Solutions, Inc.*, 2020 WL 975464 (Bankr.C.D. Cal. Feb 21, 2020)

However, a case that was pending "for an extended period of time" before enactment of the SBRA could result in a taking of vested property rights and thereby become ineligible for Subchapter V election. Further, even if the debtor does not meet the definition of a "small business debtor" when the case was filed, as long as it meets the definition at the time of amendment and election of Subchapter V the election is appropriate

- See *In re Moore Properties of Person County, LLC*, 2020 WL 995544 (Bankr. M.D.N.C. Feb. 28, 2020)
- See also, *In re Body Transit, Inc.*, 2020 WL 1486784 (Bankr.E.D.Pa. March 24, 2020)



## But When Can You Qualify?

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Amendment of a debtor's petition to make the Subchapter V election has also been held valid after a creditor's competing plan of reorganization which would have paid all creditors in full and its attendant disclosure statement had already been approved but not yet confirmed

- *In re Ventura*, 2020 WL 1867898 (Bankr.E.D.N.Y. April 10, 2020)





## Debtor's Duties

### Most are the Same

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- Section 1187 incorporates Sections 1116 and 308
- File small business documents listed in Section 1116(1)
- Attend meetings described in Section 1116(2), e.g., IDI and 341
- File schedules and SOFA, per Section 1116(3)
- File post-petition financial reports, including MORs, per 1116(4)
- Maintain insurance, per 1116(5)
- File timely tax returns, per 1116(6)
- Allow the UST to inspect books and records, per 1116(7)



## Some Unique Debtor Duties in SubV

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- 14 days before Status Conference, file a report re Debtor's efforts to obtain consensual plan, per 1188(c)
- Attend a status conference no more than 60 days after Petition Date. Goal of status conference is to discuss "the expeditious and economical resolution of a case"
- File a plan within 90 days, per 1189(b)



## Powers of the Debtor

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All the same powers as DIP in Chapter 11 case, including:

- Sell/lease/use property under Section 363
- Obtain credit under Section 364
- Assume/reject contracts under Section 365
- Pursue preferences, fraudulent transfers, post-petition transfers under Section 547, 548, and 549
- Hire professionals – NOTE disinterestedness exception under Section 1195

Debtor has exclusive right to file a plan. Even if removed as DIP, Subchapter V trustee does not have authority to propose a plan (Sections 1189 and 1183)



## Trustee's Duties

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Facilitate the development of a consensual plan and make sure the debtor commences making timely payments

Evaluate the viability of the business by reviewing financials

Take part in the Initial Debtor Interview

Attend and participate at the meeting of creditors

Participate in status conferences and hearings such as confirmation hearings



## Trustee's Duties Continued

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Perform the duties specified in § 704(a)(2), (5)-(7) and (9)

- Be accountable for all property received
- Examine proofs of claim and object if necessary
- Furnish information upon request from a party in interest
- Oppose discharge if necessary
- Make a final report or accounting
- Send domestic support notices



## Trustee's Duties Under a Consensual Plan

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Trustee's services terminate upon substantial consummation of the plan

Debtor makes payments directly to the creditors

- Pre-confirmation, the debtor might make adequate protection payments to the trustee, which the trustee will disburse upon confirmation or return to the debtor if no plan confirmed

Debtor operates the business

Trustee files Report of No Distribution if the trustee did not handle funds

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## Trustee's Duties Under a Non-Consensual Plan

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Plan payments are made to the trustee and the trustee disburses to creditors

Trustee involved throughout the plan

Trustee files Final Report and Accounting of funds received and disbursed

Debtor operates the business

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## Trustee's Duties—When Cause

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For Cause, the court may require the trustee to perform the duties specified under § 1106(a)(3), (4) and (7)

- Investigate the conduct and financial condition of the debtor and any matter relevant to the case
- File a report on the investigation

For cause, the DIP may be removed and the trustee will operate the business § 1183(b)(5)

The trustee will report any fraud, incompetence, or gross mismanagement



## Trustee Compensation

Received under § 330 – billable instead of a percentage of disbursements

Trustee will file an initial statement of their hourly rate

File fee application for any fees requests

Paid by debtor over time



## Section 1190: Contents of a SubV Plan

- \* a brief history of the business operations of the debtor
- \* a liquidation analysis
- \* feasibility projections
- \* Debtor must commit future earnings as needed to make plan payments
- \* Debtor may modify secured claims against homestead
  - If the debt was not used to purchase the property; and
  - Loan proceeds were used for Debtor's small business





## Section 1191: How did SBRA change the Confirmation Standard?

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Absolute priority rule d/n bar retention of equity by business owner

Confirmable w/o Impaired Accepting Class

To be fair and equitable, debtor must commit 3-5 years of “disposable income” to fund the plan



## Section 1191(d): “Disposable Income” in SubV

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DISPOSABLE INCOME.—For purposes of this section, the term ‘disposable income’ means the income that is received by the debtor and that is not reasonably necessary to be expended—

(1) for—

(A) the maintenance or support of the debtor or a dependent of the debtor; or

(B) a domestic support obligation that first becomes payable after the date of the filing of the petition; or

(2) for the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor.



## §1325(b)(2): “Disposable Income” in Ch 13

For purposes of this subsection, the term “disposable income” means current monthly income received by the debtor (other than child support payments, foster care payments, or disability payments for a dependent child made in accordance with applicable nonbankruptcy law to the extent reasonably necessary to be expended for such child) less amounts reasonably necessary to be expended--

- (A)(i) for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation, that first becomes payable after the date the petition is filed; and
- (ii) for charitable contributions (that meet the definition of “charitable contribution” under section 548(d)(3)) to a qualified religious or charitable entity or organization (as defined in section 548(d)(4)) in an amount not to exceed 15 percent of gross income of the debtor for the year in which the contributions are made; and
- (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.



## Compare with Ch. 12

### Eligibility

Subchapter V: Small business debtor

- At least 50% of debt from business activities
- Aggregate debts less than \$7,500,000
- 11 U.S.C. § 1182(1)

Ch. 12: Family Farmers/Fishermen

- Most of debt must be from farming/fishing
- Aggregate debts below \$10,000,000 (farmers)
- Aggregate debts below \$2,044,225 (fishermen)
- 11 U.S.C. § 101(18) & (19A)

### Trustee’s Duties

In BOTH: trustee performs duties in 11 U.S.C. § 704; for cause, investigates debtor/runs business

Subchapter V:

- Consensual plan: services terminate at confirmation
- Non-consensual: collects, disperses plan payments

Ch. 12:

- Conducts asset sales; ensures payments are made





## Compare with Ch. 12 (cont.)

### Confirmation Requirements

#### Subchapter V:

- Meet requirements of 11 U.S.C. § 1129(a)
- No consenting impaired class needed if:
  - No unfair discrimination
  - Plan is fair and equitable as to each impaired, nonconsenting class
    - All projected disposable income
    - Debtor can make plan payments

#### Chapter 12:

- Meet requirements of 11 U.S.C. § 1225(a)
- Feasible and in best interests of creditors
- Provide future income to trustee
  - Pay priority claims in full
  - Pay secured creditors value of collateral
  - Pay unsecured creditors value of Ch. 7 liquidation

### Plan Deadlines

#### 60 days after filing:

- Subchapter V: Status Conference
- Chapter 12: Meeting of Creditors

#### 90 days after filing:

- Plan must be filed (BOTH)
  - Can be extended
- Chapter 12: Plan must be confirmed within 45 days



## Compare with Ch. 12 (cont.)

### Discharge

#### Subchapter V:

- If consensual: discharge occurs on confirmation
- If non-consensual: discharge after all payments
- No hardship discharge

#### Chapter 12:

- Option 1: debtor completes all plan payments
- Option 2: debtor qualifies for "hardship discharge"
  - Unable to complete payments due to circumstances beyond debtor's control
  - Creditors received at least as much as in Ch. 7

### Conversion

#### Subchapter V: silent on conversion

#### Chapter 12: silent on conversion to Ch. 11/13

- Debtor can convert to Ch. 7
  - Cannot be involuntary





## Key Interim Rules

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Rule 1020(a): Small Business Debtor must elect into Subchapter V

- Involuntary cases: 14-day window to make the election
- Rule 1009: Debtor may amend a voluntary petition as a matter of course anytime prior to confirmation

Rule 1020(b): the UST or any party in interest can object to a Subchapter V designation

Rule 2009: SubV Trustee is appointed by UST, no elections

Section 1185 still applies: Subchapter V Debtors can be removed

- Rule 2012: If a Subchapter V debtor-in-possession is removed, the SubV Trustee becomes an operating trustee

Rule 2015(a)(5): No UST Fees

Rule 3010: No Distributions under §15

Rule 3014: Court must set a deadline for 1111(b) elections in SubV Cases

Rule 3016(b): Generally, no DS in SubV cases unless Court orders Debtor to file one

Rule 3017.2: If no DS, then Court should enter an order setting deadlines to disseminate plan and vote, confirmation hearing



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# Questions and Discussion

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