

New Bankruptcy Law May Help Small Cos. Weather COVID-19

By **Andrew Zaron**

(March 24, 2020, 3:15 PM EDT) -- COVID-19, the novel coronavirus disease, is affecting not just people's health but the health of the economy. Local governments have ordered the shutdown of "nonessential" commercial and retail establishments. Schools have closed. Travel has come to a halt. And the phrases "social distancing" and "self-quarantine" are suddenly commonplace.

In this unprecedented time, businesses across all industries are reporting cash shortages, leading many, including their vulnerable employees, to fear they will fail. While businesses of all sizes will suffer from the economic downturn, small businesses may have a more difficult time surviving because there is less room to downsize and there are fewer assets available to negotiate with creditors.



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Given that so many companies are confronting the same problems, the universal hope is that debtors and creditors can work together to find solutions that allow struggling small businesses to weather the crisis. While hope springs eternal, debtors and creditors cannot always agree on solutions. Small businesses will need to consider alternatives to avert disaster.

Almost miraculously for small businesses, in August 2019, President Donald Trump signed into law a bipartisan bill introduced by Reps. Ben Cline, R-Va.; David Cicilline, D-R.I.; Doug Collins, R-Ga.; and Steve Cohen, D-Tenn. — the Small Business Reorganization Act, or SBRA, of 2019, also known as Subchapter V of Chapter 11 of the Bankruptcy Code. The new law, which was supported by the American Bankruptcy Institute, became effective in February this year, just as U.S. small businesses started to feel the effects of the economic downturn resulting from the novel coronavirus pandemic.

The SBRA addresses many of the issues that made it difficult over the last two decades for a small business to take advantage of the traditional provisions of Chapter 11 of the Bankruptcy Code. Under the law, a small business is defined as having no more than about \$2,725,625 in secured and unsecured debts.

Bankruptcy practitioners should focus on whether their clients fall within this threshold. If so, they can immediately use the new law as leverage in prebankruptcy negotiations with creditors. If a bankruptcy filing is necessary, the Official Bankruptcy Petition Form has been amended to include a box that should be checked if a company elects to proceed under Subchapter V of Chapter 11. In preparation for a

possible filing, practitioners should gather financial statements from their clients. These will be needed to verify their client is a “small business” as defined by the Bankruptcy Code.

The three key issues that the SBRA addresses are as follows.

1. Simpler Plan Process

A debtor’s goal in Chapter 11 is to obtain approval of a plan that restructures and, in many instances, eliminates debt. Under the traditional provisions of Chapter 11, a debtor is required to file and obtain court approval of a disclosure statement to confirm a plan of reorganization. The process is time-consuming and expensive, and often provides leverage to creditors who can object to the adequacy of the disclosure statement. Under the SBRA, a debtor is not required to file or obtain approval of a disclosure statement.

Also under the traditional provisions of Chapter 11, a debtor is required to solicit acceptances of its plan. If all classes of creditors do not vote in favor of the plan, the debtor must win approval of at least one class of impaired creditors. Although creditors can object to a plan under the SBRA, a debtor does not need to obtain the affirmative votes of creditors to confirm its plan.

By eliminating the requirements that a debtor obtain approval of a disclosure statement and solicit creditor votes, the SBRA makes Chapter 11 cheaper, more manageable, and more likely to succeed.

2. Easier for Existing Owners to Retain Equity

Before the “small business” amendments to Chapter 11, existing owners of the debtor could only retain their equity over the objection of a class of unsecured creditors if unsecured creditors were paid in full — or, in certain instances, if existing owners injected sufficient “new value” into the company. The resulting lack of leverage, and the risk owners would not retain their equity, were major disincentives to small businesses contemplating Chapter 11.

Under the SBRA, existing owners of the debtor can retain their equity over the objection of a class of unsecured creditors so long as they commit all of the disposable income of the debtor to pay creditors over a three- to five-year period. The knowledge of what it will take for owners to retain equity renders Chapter 11 more predictable and palatable for small businesses.

3. Faster and Cheaper

Under the traditional provisions of Chapter 11, a debtor has 120 days to propose a plan. Under the SBRA, a debtor has 90 days to file a plan. Also, before the rule change, the Office of the U.S. Trustee frequently appointed a committee of unsecured creditors that were paid by the debtor. Under the SBRA, there are no committees of unsecured creditors, thereby removing leverage in favor of creditors who could join forces against the debtor at the debtor’s expense.

Perhaps equally fortuitous for small businesses facing distress as a result of COVID-19, the SBRA is brand-new. There are few, if any, reported cases interpreting the law. Courts will therefore have considerable discretion to construe the new provisions in a manner favorable to small businesses, which may prove particularly helpful to debtors in the current economic environment. Armed with this

knowledge, small businesses facing distress will have additional leverage to negotiate with creditors before and, if necessary, in the course of an ongoing bankruptcy case.

Now is a time fraught with uncertainty for everyone. While the medical community continues to search for the means to address the health consequences of the coronavirus, the small-business community already has the means to obtain relief from the economic effects of the virus: the Small Business Reorganization Act of 2019.

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