Providing a "Last Word" on SBRA

The Small Business Reorganization Act of 2019 (SBRA) took effect on Feb. 19. Signed into law on Aug. 23, 2019, it adds a new subchapter V to chapter 11, providing a better path for small businesses to successfully restructure, reduce liquidations, save jobs and increase recoveries to creditors, while recognizing the value provided by entrepreneurs. It adopts the current definition of a "small business debtor" as a person in commercial or business activity with aggregate or noncontingent liquidated secured and unsecured debts as of its bankruptcy filing date of not more than $2,725,625.

On Feb. 11, ABI held a special abiLIVE webinar titled, "What's the Last Word on SBRA?," presented by the following members of ABI's Commission to Study the Reform of Chapter 11, federal judiciary and U.S. Trustee Program:


Hon. Michelle Harner

• Hon. **Michelle M. Harner** is a U.S. Bankruptcy Judge for the District of Maryland (Baltimore). Prior to her appointment to the bench in 2017, she served as the Francis King Carey Professor of Law and the director of the Business Law Program at the University of Maryland Francis King Carey School of Law. From 2012-14, Judge Harner served as the official Reporter to the ABI Commission to Study the Reform of Chapter 11.


Hon. Benjamin Kahn

• Hon. **Benjamin A. Kahn** is a U.S. Bankruptcy Judge for the Middle District of North Carolina (Greensboro). Prior to his appointment, he was a member of Nexsen Pruet PLLC and previously clerked for Hon. Jerry G. Tart, U.S. Bankruptcy Judge for the Middle District of North Carolina. Judge Kahn was recognized as among the Top 10 *North Carolina Super Lawyers* across all practice areas for the two years immediately preceding his appointment to the bench.


Daniel Casamatta

• **Daniel J. Casamatta** is the Acting U.S. Trustee for Region 13 in Kansas City, Mo., which includes the judicial districts in Arkansas, Missouri and Nebraska. He was sworn in on Jan. 1, 2015. Mr. Casamatta has served as the Assistant U.S. Trustee in the Kansas City office of the U.S. Trustee Program (USTP) since 2008. Prior to that appointment, he served as Assistant U.S. Trustee in Grand Rapids, Mich., for 18 years, was an attorney advisor in the Cleveland USTP office for three years, and for periods of time was also the Acting Assistant U.S. Trustee in Indianapolis and the Acting Chief of the USTP's National Bankruptcy Training Institute, located in the Department of Justice's National Advocacy Center in Columbia, S.C.


Robert Keach

• **Robert J. Keach** is a shareholder at Bernstein, Shur, Sawyer & Nelson in Portland, Maine. He is a Fellow of the American College of Bankruptcy and a Past ABI President (2009-10). He is also the co-chair of ABI's Commission to Study the Reform of Chapter 11. Mr. Keach testified on ABI's behalf in support of the SBRA before the House Judiciary Committee's Subcommittee on Antitrust, Commercial and Administrative Law on June 25.


Amy A. Quackenboss

ABI Executive Director **Amy A. Quackenboss** moderated the discussion. Please note that Judges Harner and Kahn participated on the panel for educational purposes only, and nothing they discussed on the panel should be used or be attempted to be used in their respective courtrooms. The panelists discussed key provisions of the SBRA that practitioners would need to know before the law took effect, and going forward. Below are excerpts of the key points raised on the webinar. If you would like to listen to the webinar and view additional analysis and information on the SBRA, be sure to visit ABI's SBRA Resources page at abi.org/sbra.

Who Qualifies as a Small Business Debtor Under the SBRA?

Judge Harner: A small business debtor [under the SBRA] is an entity or an individual engaged in commercial or business activity with aggregate noncontingent liquidated debts of not more than $2,725,625. At least 50 percent of that debt has to be commercial or business.

When you're thinking about the cap and who qualifies as a small business debtor, the definition is mandatory to be a small business debtor in a traditional chapter 11 case … note that the debtor has to elect into subchapter V. So, the new [SBRA] provisions, the majority of them that apply only as sub-V cases, are not automatic. They are not mandatory. It's optional, so a debtor has to elect in, and under the proposed national interim rules, the debtor has 14 days from the petition date to opt in to the subchapter.

Judge Kahn: It's important for folks to remember and recognize that a debtor either is or is not a small business

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debtor. There's no election to that. There certainly could be a debate about that, and Rule 1020 provides the mechanism.

Judge Harner: The "small business" definition, which applies in all chapter 11 cases, is the exclusion, which was previously fairly broad for commercial real estate activities … so now it's just a single-asset real estate debtor who is excluded from the definition of "small business." That opens the door for debtors who have commercial real estate businesses in operation.

Mechanics of a Subchapter V Case

Judge Harner: When a debtor elects into the subchapter, a number of things happen rather quickly:

- There's a mandatory status conference before the court that the court must hold no later than 60 days after the filing. So, within the first 60 days of the case, you're going to see the court, and at least 14 days prior to that status conference, the debtor needs to file a report with the court. Now the language of section 1188 (B) of the new subchapter focuses the report on the debtor's intentions with respect to a consensual plan.
- Under Section 1189 of the new Act, the plan of reorganization must be filed on or before the 90th day after the petition date.
- Only the debtor can file a plan. Only a debtor may modify a plan, and the debtor can modify a plan after it's filed any time up through confirmation. The other thing I will note because it's in the statutory language: There isn't an exception to the 90-day rule.
- No disclosure statement unless ordered by the court.
- No quarterly U.S. Trustee fees.

Oftentimes in small business cases, the small business debtor is either locked with the secured creditor because it has no choice or it's not talking to the secured creditor because relations have broken down. The subchapter and the intervention of the sub-V trustee are meant to work out those wrinkles and help the case move forward consensually if possible, and if not, just quicker and more effectively.

Debtor Requirements, Role of the U.S. Trustee's Office and New Subchapter V Trustee

Dan Casamatta: The U.S. Trustees Program is dedicated to making this new legislation work. There is still the requirement as before for the subchapter V debtor to file a copy of the most recent balance sheet for the business, statement of operations, a cash-flow statement and income tax returns. That was in § 1116 before for small businesses and remains effective for subchapter V debtors.

Under the interim rule that the Judicial Conference enacted, Bankruptcy Rule 1020, the election must be made on the petition for a voluntary case or within days after the order for relief in an involuntary case.

Bob Keach: There are no official rules and forms because it takes too long, frankly, to get that done. In most cases, the rules and forms won't actually be even local rules and forms, again because of a timing issue. The rules and forms … are recommended rules and forms. I believe in most districts around the country, if not all, those rules and forms will be adopted.

> **Judge Kahn: Folks need to understand the speed at which these cases are going to move. It's much less like a big chapter 11 than it is more like a chapter 12 or a chapter 13.**

Dan Casamatta: There are no creditors' committees in subchapter V cases. Interestingly, the change to the statute also made creditors' committees not applicable in small business cases unless the court orders that to be done. That's intended to be a cost-saving measure for the debtor.

There's still a requirement to file periodic reports, and that is based in section 1187 (B), but it refers to section 308, which says that a debtor's report must contain information about debtor profitability, reasonable approximation of the debtor to projected cash receipts and cash disbursements, and a comparison of the cash receipts.

We [the U.S Trustee] will be setting initial debtor interviews in cases like we do now; the 341 meeting will have to be attended. The court schedules conferences, and that's something that the debtor's management and counsel have to attend as well. In addition to that, as before, [debtors will have to]:

- File loss schedules and statements of financial affairs;
- File post-petition financial and other reports;
- Maintain insurance;
- File tax returns and other government filings;
- Make sure to pay all taxes during the case again as small business debtors now are required [to do];
- Allow the U.S. Trustee to inspect the debtor's premises, books and records. It doesn't happen often, but it's something that we can do and we certainly would include the trustee if it's something that's appropriate to do; and
- Perform all the duties of a trustee under § 1106 except for conducting an investigation of the debtor.

We [the U.S. Trustees] have all these duties; our intention is to work with the subchapter V trustee…. There's two ways we could appoint subchapter V trustees: either standing trustees or case-by-case trustees. We've decided that in the U.S. Trustee jurisdictions, and I believe the bankruptcy administrators are doing this as well, to start off with a case-by-case trustee.

The key to making this work, we think, is to have the right trustee in the case. These are not trustees that will be operating businesses unless the court orders it.

So, we focused on trustee candidates that had some business acumen. There's a lot of people that we selected that have mediation backgrounds, negotiators, people that understand what businesses are worth and about cash flow. The way the pools of trustees are set up in the U.S. Trustee Program, some regions have one pool for the whole region. Some have different ones per district.

A subchapter V trustee is similar to trustees under chapters 12 and 13. Mechanically, the way that we're going to select trustees from our pools in the U.S. Trustee jurisdictions is we're going to look at the case when it gets filed, make sure that it's properly elected to be subchapter V, and then we've agreed with the Administrative Office of U.S. Courts that we will make our appointment within 24 to 48 hours of filing.

They [subchapter V trustees] are going to say in that affidavit what they plan to charge for these cases and ensure that they don't have any conflicts, but these are not operating trustees. Some people call them a supervisory trustee. People should not be concerned that the trustee is going to become debtor's counsel. I think how the trustee will work in the case will really depend on the facts of the case and in the communications with debtor's counsel.

If you get a consensual plan, which is a plan confirmed under § 1191, then when the plan has been substantially consummated, which, as before, means the first payments are made, the subchapter V trustee will be terminated. If it's a plan under § 1191(B), which is a cramdown sort of plan, then in those cases, unless the plan or order confirming the plan provides otherwise, the trustee is going to make the payments to creditors under the plan for the duration.

They [subchapter V trustees] get paid a percentage fee under § 586 like a standing trustee would under chapters 12 or 13. If it's a case-by-case trustee, which ours will be, they'll apply for compensation under 11 U.S.C. § 330.

When we [U.S. Trustees] met with all the [subchapter V] trustee candidates, we stressed to them the fact that they should not expect to have to employ professionals. We're going to appoint, we're going to select trustees from our pools, but we've told the trustees that to the extent that cases can't work because they way overcharged, if they do that regularly we probably won't select them again in the future.

Plan Process Under Subchapter V and How It Differs from the Filing Under a Regular Chapter 11

Judge Kahn: Folks need to understand the speed at which these cases are going to move. It's much less like a big chapter 11 than it is more like a chapter 12 or a chapter 13. The confirmation requirements take some of the leverage out of the creditors' hands in the case, but [it's] always much better to have cooperative creditors in a case than it is to have uncooperative creditors in a case.

Bob Keach: You can negotiate, and I think one of the lessons that small business counsel are going to want to take away from the big cases is that it's OK to start pre-bankruptcy and start negotiating what a plan might look like. Early planning will actually really help in a subchapter V case.

Judge Kahn: The subchapter V [trustee] will help facilitate discussions between the creditor and the debtor. It doesn't say what "facilitate" means. Does that make the subchapter V trustees have some of the role of a mediator? I think that's probably potentially true that it will be some of the roles that a mediator has, but also the subchapter V trustees have the obligation to appear and be heard on many of the important issues that occur in the case.

There's no 45-day limit for confirmation that allows the court and the parties time to work toward a consensual plan, which is very important. The small business provision allowed delayed payment of administrative expense claims. You can stretch out the administrative expense claims over the life of the plan, even for § 503(b)(9) or professional fees; now the language for this refers only to plans confirmed as nonconsensual plans.

Bob Keach: For somebody who has eaten a lot of fees in 40 years in middle-market cases, it also permits your client, if you are debtor's counsel, to pay you overtime.

Judge Kahn: There is an exception to the anti-modification provision that's in individual cases in chapter 11 in the non-subchapter V chapter 11 cases, which as folks know in 13 and in chapter 11 cases: A debt secured solely by a lien on the debt of [a] residential mortgage is not modifiable. There's an exception to that in these in the subchapter V cases, and it permits those loans to be modified if two things are true. One is that it was not the purchase money. It wasn't used primarily to purchase the residence. And, if the new value given in connection with the granting of the security interest is the language that's in the Code, there it is used primarily in connection with the business.

New value is a forbearance for the business debt in which the principal gives a lien on his residence as part of that forbearance, as that new value. I'm not sure that debate has much practical impact, because I think it is highly unlikely that a business debt is not secured by other assets, and only at forbearance does it become secured by the debtor's principal residence.

Bob Keach: It does give you a pre-bankruptcy planning opportunity where it's available. In other words, a small business person, particularly one that might be a sole proprietorship, could refinance a home mortgage and take out additional funds on the refinance, invest those funds into the business, and potentially qualify the entirety of the new mortgage for modification under this provision. It is something that I think will play out as it goes forward, but it does create some opportunities that don't currently exist.

Debtor's Ability to Achieve Confirmation Under Subchapter V

Bob Keach: Subchapter V debtors have something that even mega-case debtors don't have in this era of overleveraged debtors: They have real cramdown that works. The most important benefit of having real cramdown is [that] the entire creditor community will realize that real cramdown exists. As a consequence, you'll get consensual cases in the vast number of SBRA cases filed because

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everybody will know what can happen when consensual plans don't occur.

With respect to secured claims, cramdown is the same as in a regular chapter 11 case, so you've got two options for cramdown, but that is, generally speaking, paying that creditor over time the present value equal to the collateral. You pay the creditor the total of payments equal to the face amount of the claim. Most experienced bankruptcy practitioners are used to that idea. That hasn't changed. The important aspect of subchapter V cases is that the owners of the business, the shareholders, membership interest-holders or individuals can retain their interest in the business, even if the plan does not pay unsecured claims in full and the absolute priority rule is therefore accordingly met.

You can build a sale option into the plan.… Have it built into the plan, and you won't need to go back to the court, for example, for approval of your bid procedures and other things. They'll already be approved, and that provision is not limited frankly to the prospects for a sale or doing a going-concern sale. You could have a number of creative alternatives, including providing for new equity or other alternatives, so that provision shouldn't be seen as a penalty provision; it should be seen as an opportunity provision for you to avoid conversion or dismissal by actually pre-ordaining what your alternative is. abi