

Demystifying the Bankruptcy Process - Part Six

October 27, 2023
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Originally posted on 12/27/2020, content updated on 10/27/2023

The COVID-19 pandemic created a lot of turmoil in every industry and every company. Hundreds of companies in the energy, transportation, entertainment, health & personal care, retail, travel, lodging, and leisure industries cited COVID-19 as a factor in their decision to commence a bankruptcy proceeding. According to 2020 data compiled by Bloomberg, the pandemic battered New York City businesses, with almost 6,000 closures by late October 2020, a jump of about 40% in bankruptcy filings across the region, and shuttered storefronts in the business districts of all five boroughs.

The final summary in the series is intended to help small business owners better understand how valuable a tool Chapter 11 can be during a time of crisis. The Small Business Reorganization Act (or Subchapter V of Chapter 11 of the Bankruptcy Code), which went into effect in February 2020, offers a timely and cost-efficient solution for businesses with undisputed non-contingent liability of up to \$7.5 million.

Among the key benefits of the traditional restructuring regime under Chapter 11 of the Bankruptcy Code are:

- the management stays in control of the company and an outside trustee/administrator is not brought in unless there are extraordinary circumstances.
- the company can cherry-pick beneficial contracts and reject burdensome ones.
- the company can sell its business, selected business lines, or individual assets free and clear of any encumbrances or interests.

Subchapter V brings even more benefits to the equity owners of the company and, by all indications, seems to be working as intended.

The Small Business Reorganization Act (SBRA), incorporated in the Bankruptcy Code under Subchapter V of Chapter 11, went into effect on February 19, 2020. It provides a faster, cheaper, and simpler mechanism for reorganization of small businesses.

Who is eligible to file under subchapter V - Businesses and individuals engaged in commercial activities with no more than \$2,725,625 of liquidated and non-contingent obligations? However, businesses for which primary activity is the owning of single-asset real estate are not eligible.

The CARES Act had increased the debt ceiling to \$7,500,000 through March 27, 2021. The increased debt limit applied only to

cases filed after the effective date of the CARES Act.

There are a number of modifications of the traditional restructuring process that make a subchapter V proceeding a more straightforward and cheaper path to reorganization:

- It allows the owner of the business to preserve his or her equity even when the business is not in a position to pay in full its secured and unsecured creditors (i.e., abrogates the so-called “absolute priority rule”).
- The creditors' ability to block confirmation is significantly weakened because Subchapter V eliminates the traditional requirement that at least one impaired class of creditors accepts the reorganization plan. A reorganization plan will be deemed fair and equitable to objecting unsecured creditors if the debtor pays projected disposable income to be received over at least three years.
- A subchapter V plan may provide for later payment of administrative expenses (i.e., payment through the plan) as opposed to payment on the effective date of the plan.
- Only the debtor company can file a plan (i.e., eliminates the ability of creditors to propose their own restructuring plan).
- It eliminates U.S. Trustee quarterly fees and other procedural and reporting burdens.

The SBRA cases work on a tight schedule. Within 60 days of the filing, the bankruptcy court has to hold a status conference “to further the expeditious and economical resolution” of the case. Fourteen days prior to the conference, the debtor must file a report detailing the efforts to attain a consensual plan of reorganization.

The Debtor must file a plan 90 days after the order for relief. The SBRA debtor need not solicit plan acceptances with a separate disclosure statement. The plan must include a brief history of the business operations of the debtor, a liquidation analysis, and projections with respect to the debtors' proposed payments under the proposed plan. Confirmation of a small business debtor plan of reorganization is pursuant to the usual criteria of section 1129(a) of the Bankruptcy Code, with the critical exception that the debtor *does not* need to obtain the acceptance of even one impaired class of creditors.

Allowing only the debtor to file a reorganization plan and to preserve equity in the process while giving them the option to force a plan against the creditors' vote provides a unique opportunity for reviving a business in these challenging times.

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