CONSUMER BANKRUPTCY

New Subchapter V Bankruptcy for Small Business Reorganizations

By Craig D. Robins

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For years, bankruptcy practice has focused on the big three types of bankruptcy filings: Chapters 7, 11 and 13. As of Feb. 19, 2020, we have a new one: Chapter 5. Technically it is a Roman numeral V and it is a subchapter.

The Small Business Reorganization Act of 2019, signed into law this past August, creates a new Subchapter V under Chapter 11 of the U.S. Bankruptcy Code, designed to be a simpler, more streamlined version of Chapter 11, which involves a plan of business reorganization. It will be available for both businesses and individuals.

Many smaller businesses who badly needed to obtain Chapter 11 relief were unable to do so because of the substantial costs involved. Due to the complexities and requirements to complete a Chapter 11 case, debtor's counsel typically does the same legal work whether the amount of debt is just a few hundred thousand dollars or in the many millions. The new SBRA Act eliminates some of the more involved procedures required by traditional Chapter 11 filings, such as disclosure statements, and provides some of the expedited procedures utilized by consumers in Chapter 13 cases, which is centered around a payment plan.

Eligibility requires that debt be less than $2.7 million. Whereas Chapter 11 provides that the debtor will be a debtor in possession of its financial affairs without an outside trustee, Subchapter V provides for a designated trustee to be responsible for the bankruptcy estate.

The trustee will monitor the reorganization but will have neither possession of the debtor's assets nor the ability to sell them. Similar to the trustee in a Chapter 13 case, the trustee will not run the business, but instead make sure the debtor complies with legal requirements. As such, the debtor will be subject to increased oversight to ensure that the reorganization stays on track. The trustee's duties will be to facilitate the development of a consensual plan of reorganization, appear at significant hearings in the case, and ensure that the debtor commences making timely payments under the plan.

Unlike Chapter 11, there won't be any unsecured creditors' committees, unless ordered for cause. In Chapter 11, debtors are required to satisfy administrative expense claims at the time of confirmation. Now debtors will be able to spread the payments over the term of the plan. Debtors will stand to save significant amounts in cases where there would have been an unsecured creditors' committee, as it is the debtor who is responsible for those costs.

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With Chapter 11 cases, there can often be protracted hearings concerning the disclosure statement — the highly detailed document designed to provide adequate information about the debtor's financial affairs, so that creditors can make an informed decision about whether to accept or reject the plan. The SBRA Act provides that debtors do not have to prepare a separate disclosure statement. Instead, the information that customarily goes into one, such as a history of the debtor and information about its financial affairs, a liquidation analysis, and financial projections, will now appear as part of the plan.

With the current law, debtors are under tremendous pressure to file their plans within a certain period of time; otherwise, creditors may file a plan. Under the SBRA Act, only the debtor is permitted to file the plan, but must do so within 90 days, although extensions may be obtained under limited circumstances. Like Chapter 13 cases, Subchapter V plans will customarily be three to five years in length.

It will now be much easier for small businesses to confirm plans. Debtors will be able to confirm plans and retain ownership interests provided that the plan does not "discriminate unfairly" and is "fair and equitable." Whereas Chapter 11 involved a complex voting system involving impaired classes, under SBRA, a plan can be confirmed without the vote of an impaired accepting class. Thus, a plan can be confirmed as long as it does not discriminate unfairly and is deemed fair and equitable as to each class of claims and provides for all of the debtor's projected disposable income be paid into the plan — a period of three to five years. Also, the contents of the plan are less stringent than those required in Chapter 11 cases.

A potentially very important provision for consumers who own businesses and seek Subchapter V relief is that they may have the ability to modify their first mortgage, something that is currently not permitted in any chapter. Under the new Act, if the consumer used the proceeds of the mortgage to finance the debtor's business, the mortgage may be modified.

The Central Islip Bankruptcy Court hosted a brown-bag breakfast seminar on this new bankruptcy on Jan. 27, 2020, which was organized by the Court's Consumer Lawyers Advisory Committee. Panelists Christine Black, Matt Spero, Rachel Blumenfeld, Dawn Kirby and Brian Ryniker presented.

Being brand new, with absolutely no precedents to follow, even our most experienced counsel was uncertain as to how various aspects would be addressed. In true competitive form, one of the panelists hoped to be the first in the district to file such a case.

The general feeling of the attending attorneys was reminiscent of the anxiety practitioners experienced in October 2005 when BAPCPA — the Bankruptcy Amendment Act — overhauled the way we practice bankruptcy by imposing a host of new requirements, such as the means test and mandatory credit counseling. At that time, the new forms and procedures were new for all of us and there was great uncertainty as to how to proceed.

Initially, Subchapter V cases may involve extra work for the pioneering attorneys who file those cases. However, once there is a clearer understanding as to the practices and procedures involved, these cases should offer an easier, less expensive, and more viable alternative to more complex Chapter 11 proceedings that many smaller businesses and consumers were unable to afford.

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