

NEWS ALERT

BANKRUPTCY & CREDITORS' RIGHTS



Chapter 11 Reforms Provide Small Business Owners a Faster and Cheaper Way to Keep Control and Reorganize in Troubling Times

By Robert E. Kaelin, Taruna Garg and Jonathan M. Horne | June 16, 2020

The Small Business Reorganization Act ("SBRA") took effect on February 19, 2020 to little fanfare. The new law was years in the making and intended to address a disconnect in the Chapter 11 process: small businesses that could benefit most from bankruptcy were reluctant to file, and when they did the cases often failed and the businesses shuttered. Failure was not the business owners' fault, but rather the result of a Chapter 11 process that had become too costly, time consuming and risky to be a viable restructuring alternative for most small businesses. The SBRA changes this calculus by providing small businesses access to a new "Subchapter V" Chapter 11 process that is designed to be cheaper, faster and pose far less risk that owners might lose control of their businesses. With a global pandemic and resulting economic fallout now posing an existential threat to many small businesses, the changes brought on by the SBRA, and recently enhanced under the Coronavirus Aid, Relief and Economic Security (CARES) Act, could not have arrived at a more opportune time, and are now available to provide small business owners the ability to restructure their debts while saving their businesses and many jobs.

1. Is Your Business Eligible?

While any business that has the majority of its debts arise from commercial activities can file Chapter 11, currently only small businesses with aggregate debts of \$7.5 million or less can access the enhanced protections under Subchapter V. However, this limit excludes debts owed to insiders or affiliates, or debts that are unliquidated or contingent. Examples of unliquidated or contingent debts include debts for which an amount is not yet fixed (like when a lawsuit is first filed) or debts which have not yet come due.

2. How is Subchapter V Faster?

Time is money, and this is especially true in bankruptcy. Generally, the longer a case lasts, the costlier it becomes. Subchapter V aims to reduce expense by streamlining the reorganization process. To this end, Subchapter V provides that:

- the court must hold a status conference within 60 days of filing at which the debtor provides a detailed overview of the status of its reorganization efforts and negotiations;
- the debtor must file a proposed plan of reorganization within 90 days of filing; and
- equity owners are provided greater flexibility to "cram down" their plan of reorganization on dissenting creditors, making it less likely there will be lengthy (and costly) plan confirmation litigation.

3. How is Subchapter V Cheaper?

In addition to saving small businesses money by reducing the time they are in bankruptcy, Subchapter V also reduces costs by eliminating certain direct expenses that are otherwise paid by Chapter 11 debtors. For example,

- Subchapter V debtors do not pay United States Trustee fees, which are paid quarterly and generally equal 1% of all disbursements made during the case (including all payments for wages, inventory, rent, etc.);

- no Creditor's Committee is formed in Subchapter V cases, eliminating an additional layer of professional fees that are otherwise paid by Chapter 11 debtors; and
- Subchapter V debtors are not required to file a disclosure statement with their plan of reorganization, a lengthy document often requiring significant attorney time to prepare, further reducing professional fees otherwise paid by Chapter 11 debtors.

4. How is Subchapter V Safer?

The speed and cost saving measures outlined above mean nothing for small business owners if filing bankruptcy presents a significant risk that the business could ultimately be taken over by creditors or be forced to liquidate. In that regard, Subchapter V provides enhanced protections to ensure that owners can successfully reorganize their small businesses, while retaining control, including the following:

- only a debtor may file and confirm a plan of reorganization, eliminating the risk that creditors will propose a competing plan that wrests control from ownership;
- Subchapter V eases the bankruptcy absolute priority rule, making it easier for owners to retain equity in the reorganized company even when unsecured creditors object to the proposed plan;
- plan payments, including unsecured claims and certain bankruptcy administrative claims, can be made over time from business earnings, reducing the need to make substantial payments to creditors upon confirmation, and making a successful reorganization more feasible; and
- a trustee is appointed in every Subchapter V case to facilitate and work with the debtor in presenting a confirmable Chapter 11 plan.

5. Other Issues

These are just some of the notable provisions that could allow small businesses and individuals to go through the bankruptcy process in a more streamlined and effective way, and it may become an attractive alternative should the economic fallout from this crisis deepen. However, certain restrictions apply if small businesses have applied or intend to apply for the Paycheck Protection Program (PPP), which is part of the CARES Act. The Small Business Administration, in charge of administering the PPP, released an interim rule restricting eligibility for PPP loans if the companies file bankruptcy. This issue has been considered by bankruptcy courts around the country. *Hidalgo Cty. Emergency Serv. Found. v. Carranza* (*In re Hidalgo Cty. Emergency Serv. Found.*), 2020 Bankr. LEXIS 1174 (Bankr. S.D. Tex. Apr. 25, 2020); *Cosi Inc. v. Small Business Administration et al.*, Case No. 1:20-ap-50591 (Bankr. D. Del. Apr. 28, 2020).

For more information, please contact:

Robert E. Kaelin at 860.240.6036 or rkaelin@murthalaw.com

Taruna Garg at 203.653.5410 or tgarg@murthalaw.com

Jonathan M. Horne at 617.457.4085 or jhorne@murthalaw.com

Robert E. Kaelin, Co-Chair

860.240.6036

rkaelin@murthalaw.com

Thomas S. Vangel, Co-Chair

617.457.4072

tvangel@murthalaw.com

Matthew A. Ciarleglio

203.772.7712

mcialeglio@murthalaw.com

Daniel C. Cohn

617.457.4155

dcohn@murthalaw.com

Michael P. Connolly

617.457.4078

mconnolly@murthalaw.com

Mark G. DeGiacomo

617.457.4039

mdegiacomo@murthalaw.com

Taruna Garg

203.653.5410

tgarg@murthalaw.com

Olga L. Gordon

617.457.4030

ogordon@murthalaw.com

Jonathan M. Horne

617.457.4085

jhorne@murthalaw.com

Anthony R. Leone

617.457.4117

aleone@murthalaw.com

Benjamin H. Nissim

203.653.5419

bnissim@murthalaw.com

Robert A. White

860.240.6031

rwhite@murthalaw.com

With more than 100 attorneys in six offices throughout Connecticut, Massachusetts and New York, Murtha Cullina LLP offers a full range of legal services to meet the local, regional and national needs of our clients. Our practice encompasses litigation, regulatory and transactional representation of businesses, governmental units, non-profit organizations and individuals.

CONNECTICUT + MASSACHUSETTS + NEW YORK

© Copyright Murtha Cullina LLP. | This material is intended for general information purposes only

**MURTHA
CULLINA**
ATTORNEYS AT LAW

MURTHALAW.COM