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Bankruptcy Code Revised

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Some Financial Help for the Little Guy: President Trump Does Something Uncontroversial for a Change and Signs Four New Bankruptcy Bills into Law[1]

President Trump signed four bipartisan bankruptcy bills into law this past Friday, effecting the most significant changes to the Bankruptcy Code since 2005. The four bills, except the SBRA (defined below) became effective as soon as President Trump's tiny hand signed them into law. The SBRA will become effective 180 days later. The new laws are:

- **The Family Farmer Relief Act of 2019 ("FFRA")** (H.R. 2336) - This is the shortest of the new laws. The text reads: "Section 101(18) of title 11, United States Code, is amended by striking "$3,237,000" each place that term appears and inserting "$10,000,000". Its purpose and impact will be to enable many more farmers to file bankruptcy under chapter 12 of the Bankruptcy Code.[2]
- **The Honoring American Veterans in Extreme Need Act of 2019 (the "HAVEN Act")** (H.R. 2938) - The HAVEN Act exempts certain benefits paid by the Department of Veterans Affairs and the Department of Defense from the calculation of monthly income. Its purpose and impact will be to enable more veterans to file chapter 7 bankruptcy rather than chapter 13 bankruptcy, by making it easier to pass the means-test presumption.[3]
- **The National Guard and Reservists Debt Relief Extension Act of 2019** (H.R. 3304) - This law extends (for four years, through December 18, 2023) the exemption from the means test presumption provided to

qualifying members of reserve components of the Armed Forces and members of the National Guard who, after September 11, 2001, are called to active duty or to perform a homeland defense activity for not less than 90 days. Like the HAVEN Act, it will continue to enable more people to file chapter 7 rather than having to seek bankruptcy relief under chapter 13.

- **The Small Business Reorganization Act of 2019 (the "SBRA")** (H.R. 3311) - The SBRA is designed to do two basic things.

    1. First, and more easily summarized, it is intended to cut down on preference cases. It will do this in two ways:

        a) It will require the plaintiff to consider a preference recipient's potential affirmative defenses under Bankruptcy Code §547(c) before filing a preference action.

        b) It will increase the dollar limitation in Bankruptcy Code §1409(b) is raised from $13,650 to $25,000. Some context: Bankruptcy Code §1409(b) already limits venue for a preference lawsuit to the district in which the defendant resides for proceedings to recover money or property from a non-insider if the amount at issue is less than of less than $13,650. So, the law increases nearly doubles this amount.

    2. Second, it adds an entirely new Subchapter V to chapter 11 of the Bankruptcy Code, with the goal of making it much easier for "small business debtors" (as defined by the Bankruptcy Code) to use chapter 11 to reorganize., Subchapter V cannot be properly summarized in bullet points. Don't worry, we have your back…

More About the SBRA

Chapter 11 often "…(a) places unrealistic and artificial deadlines on [small businesses], which do not give these companies an opportunity to restructure; (b) imposes substantial and costly disclosure and reporting requirements on these companies; (c) does not provide any tools that can help small businesses … create and implement an effective reorganization plan; and (d) makes it difficult for a small business owner to maintain an ownership interest in the business under the current Chapter 11."[4] For the small business debtor, the

Bankruptcy Code has not offered a reasonable pathway for financial recovery in many years.

Drawing support from a handful of bipartisan legislators, and drafted in consultation with the American Bankruptcy Institute (ABI) and the National Conference of Bankruptcy Judges, the SBRA is intended to alter the bankruptcy playing field and give the "little guy" a chance at rehabilitation by way of chapter 11.[5]

Effective February 1, 2020, SBRA will (i) streamline and simplify existing bankruptcy procedures and provide new tools to increase a small business' ability to achieve a successful restructuring, and (ii) mitigate some of the difficulties currently experienced by small business debtors in a traditional chapter 11 bankruptcy. SBRA is breakthrough legislation for "mom and pop" businesses to finally obtain the restructuring tools now available only to large business entities.

Need for the Enactment of SBRA

Although mega bankruptcy cases like Toys 'R' Us and Sears grab all the headlines, the reality is that the majority of commercial bankruptcy cases filed in the United States involve debtors with less than $2.1 million in assets. As it currently stands, chapter 11 makes it difficult for small businesses to reorganize and forces them to use alternatives that often result in liquidation like federal and state receiverships or assignments for the benefit of creditors (ABCs).

Chapter 11 bankruptcy was initially designed for administering complex business reorganizations involving multi-million-dollar companies. Despite containing several provisions specifically focused on small business debtors, chapter 11 still creates difficulties for small businesses, including high administrative costs, monitoring shortfalls, and procedural roadblocks.

Who Does SBRA Cover?

SBRA covers only the "small business debtor," essentially adopting the Bankruptcy Code's current definition of "small business debtor" as a person in commercial or business activity with an aggregate or noncontingent liquidated secured and unsecured debts as of its bankruptcy filing date of not more than

$2,725,625.[6] A debtor that qualifies as a small business debtor would have the option either to proceed under the new subchapter V or to stick with the existing provisions of chapter 11 applicable to small business debtors. In essence, when it goes into effect next year, SBRA will apply to the majority of commercial bankruptcies filed in the United States.

How SBRA Changes the Bankruptcy Code in Favor of Small Businesses

SBRA adds a new subchapter V to chapter 11 to the Bankruptcy Code, setting out special provisions for the small business debtor. SBRA's key provisions seek to (a) increase the debtor's ability to negotiate a successful reorganization and retain control of the business; (b) reduce unnecessary procedural burdens and costs; and (c) increase oversight and ensure a quick reorganization.

Property of the Estate

SBRA modifies the existing Bankruptcy Code definition of property of the estate to include earnings and property acquired post-petition and post-confirmation until the case is closed, dismissed, or converted.[7]

Debtor's Professionals

SBRA includes a couple of amendments that are favorable to small business debtors and chapter 11 practitioners alike. Specifically, SBRA relaxes the disinterestedness requirement under section 327(a) so that a professional is not disqualified for employment solely because the professional holds a prepetition claim, so long as the claim is less than $10,000.[8]

The Trustee

SBRA requires that U.S. Trustee appoint a trustee for every case under new subchapter V, either through one or more standing trustees in the region like chapter 13 cases or on a case-by-case basis akin to chapter 7 cases. The trustee is to be compensated by the debtor's estate by the same means as a chapter 13 trustee.

Several of the subchapter V trustee's duties will include accounting for the debtor's property, appearing at an initial status conference and all other hearings, facilitating the development of a consensual plan, supervising and controlling property and funds to be distributed under the plan (or actually making the distributions), and examining and objecting to claims. Furthermore, SBRA goes as far as reassigning to the trustee some of the debtor's duties as debtor-in-possession under sections 704(a) and 1106(a). Moreover, the subchapter V trustee will remain a key player in the debtor's bankruptcy until the plan is substantially consummated.[9]

Creditors Committee

SBRA eliminates the automatic appointment of an official committee of unsecured creditors, unless there is cause for the appointment of one. Section 1195 states "[U]nless the court for cause orders otherwise, a committee of creditors may not be appointed in a small business case or a case under subchapter V of this chapter."[10]

Plan

Subchapter V is reserved for the "small business debtor," so only the debtor can file a plan,[11] which must be filed within 90 days of the bankruptcy filing – although the court may extend the deadline if the debtor can show that it should not be held accountable.[12] The plan must at least include history of the debtor's business, projections, and liquidation analysis, but no further separate disclosure statement is required unless the court orders otherwise (and should the court so order, the existing disclosure requirements for small business cases in section 1125(f) of the Bankruptcy Code will apply).[13]

Getting the Plan Confirmed

As opposed to a traditional chapter 11 filing, subchapter V does not require an impaired consenting class of non-insider creditors for confirmation of a plan.[14] It also allows administrative expenses to be paid over a period of time through the plan, rather than having to be paid in full on the effective date. The "cramdown" requirements for treatment of secured claims under section 1129(b)(2)(A) will, however, still apply.[15]

Notably, SBRA allows the small business owner to keep a stake of the business so long as the confirmation plan does not: (a) discriminate unfairly; and (b) is fair and equitable with respect to each class of claims or interests.[16] This is a critical distinction from a traditional chapter 11 in which a debtor must comply with the "absolute priority rule," which requires that any equity holder seeking to reorganize under Chapter 11 must also contribute to the plan to maintain their equity interest. SBRA removes this constraint, giving small business debtors more flexibility to propose a plan with continuity of ownership.

In exchange for this increased flexibility, SBRA does impose other constraints not previously found in chapter 11. If a trustee or holder of an unsecured claim objects to the plan, the court cannot approve the plan unless the plan provides that all of the small business debtor's projected "disposable income" to be received during the plan will be applied to make payments under the plan for at minimum 3 to 5 years.[17] Disposable income in this context means income that is not reasonably necessary for the continuation, preservation, or operation of the business debtor.[18]

These additional requirements mimic bankruptcy burdens imposed on chapter 13 consumer debtors and chapter 12 farming debtors, potentially illustrating Congress' intent to treat small business debtors similarly to individual debtors.

Discharge

Debtor's discharge is not granted until the debtor completes all payments due within the first three years of the confirmation plan or such longer period, but not to exceed five years as the court may fix.[19]

Conclusion

Overall, SBRA provisions are designed to make reorganization by way of chapter 11 a more affordable and realistic process for smaller businesses. Soon, perhaps, bankruptcy may again become a viable alternative for smaller companies in financial distress.

About Jonathan Friedland

Jonathan Friedland is a partner in Sugar Felsenthal Grais & Helsinger LLP's Chicago office. He is ranked AV® Preeminent™ by Martindale.com, has been repeatedly recognized as a "SuperLawyer", by Leading Lawyers Magazine, is rated 10/10 by AVVO, and has received numerous other accolades. He has been profiled, interviewed, and/or quoted in publications such as Buyouts Magazine; Smart Business Magazine; The M&A Journal; Inside Counsel; LAW360; Business Week.com; Dow Jones LBO Wire; and The Daily Deal. Jonathan graduated from the State University of New York at Albany, magna cum laude, in 1991 and from the University of Pennsylvania Law School in 1994.

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Footnotes:

1 The authors would like to thank Elizabeth Vandesteeg for her thoughtful comments. The authors practice law at Sugar Felsenthal Grais & Helsinger LLP and would be happy to discuss this article with anyone who has questions about it.

2 More details for inquiring minds who want to know: following several years of low farm income and rising debt levels (and perhaps an irresponsible tariff war), farm loan delinquencies and bankruptcies are at an all-time high. Consequently, a bipartisan group of lawmakers introduced new legislation to help family farms reorganize after falling on hard times: the FFRA.

Some context: Chapter 12 was established in 1986, after recognizing the unique challenges that family farmers and fishers face, Congress established chapter 12 of the Bankruptcy Code, which removed certain costly reorganization requirements intended for large corporations. The singular change the FFRA made was to raise the chapter 12 operating debt cap from $4.3 million to $10 million, allowing more family farmers to seek relief under the program. See H. R. 2336, Sec. 2.

The title of our little article suggests that there was nothing controversial about any of these four new laws. We have to make one caveat: various parties – such as the ABI – have cautioned against the move as it could be detrimental to the cost of credit for farmers in the long run. See generally https://abi-press-media.s3.amazonaws.com/ABA+Letter+on+H.R.+2336.pdf. In its letter to Congress, ABI states "[r]aising the debt limit on Chapter 12 bankruptcies from $4.3 to $10 million in one fell swoop will make the cost of borrowing higher for farmers and reduce the availability of credit. In particular, to offset the additional risk imposed on creditors, interest rates for farm borrowers are likely to rise and much higher costs will be borne by financially weaker farm borrowers, either in the form of increased interest or in their inability to obtain loans at any price." Id.

3 Again more detail for you curious types: prior to the HAVEN Act, a debtor's *disposable income* under the Bankruptcy Code included disability benefits received by veterans and paid by the United States Department of Defense ("DoD") or Veterans Affairs ("VA"), thereby increasing the portion of the debtor's income that is subject to the reach of creditors. Effective as of August 23, 2019, the HAVEN Act now excludes debtor's disability payments (again paid by the DoD or VA) from disposable income calculations of an individual debtor for the bankruptcy "means" testing. The HAVEN Act does not limit this benefit to veterans – but rather extends it to their dependent survivors receiving the disability payments. *See generally* H. R. 2938, Sec. 2.

Now, the HAVEN Act allows veterans previously unable to meet the chapter 7 "means test" to do so by excluding disability payments from income. Under the HAVEN Act, a veteran's benefits will be synonymous with social security benefits, where neither will be treated as income in a bankruptcy. Thus, the HAVEN Act will serve as a relief tool for myriad military families who file for bankruptcy under the Bankruptcy Code.

4 ABI Commission Co-Chair Bob Keach when he testified before a House Judiciary Subcommittee on Antitrust, Commercial and Administrative Law hearing on June 25, 2019.

5 https://www.govtrack.us/congress/bills/116/hr3311/text

6 §1182(a) of Small Business Reorganization Act of 2019.

7 See generally §1186.

8 See generally §1195

9 See generally §1183

10 See §1195, Sec. 4 (a) (3).

11 See §1189(a).

12 See §1189(b).

13 See §1187(c).

14 See generally §1191(e).

15 See §1191(c)(1).

16 See §1191(b) and (c).

17 See §1191(c)(2)(A).

18 See §1191(d).

19 See generally §1192.