

**Report of the ABI Commission to  
Study the Reform of Chapter 11 (2012-14)**

**Summary of Recommendations for  
Small or Medium Sized Enterprise Cases**

Mark S. Melickian  
Sugar Felsenthal Grais & Hammer LLP  
Chicago, Illinois

8<sup>th</sup> Circuit Federal Bar Association Program  
Des Moines, Iowa  
October 2015

**Overview**

The Report of the ABI Commission to Study the Reform of Chapter 11, published earlier this year after three years of study, took up the challenge of reviewing the impact of the existing “small business case” provisions of the Bankruptcy Code and Rules, and made a series of recommendations they deemed “recommended principles.” The overall theme of the proposed changes are:

- to substantially increase the economic boundaries of small business cases by increasing the monetary thresholds from \$2.3 million to \$10 million, and provide (for cause shown) the ability of a business enterprise with assets or liabilities of up to \$50 million to move for SME treatment
- eliminate most of the unique and sometimes onerous reporting and administrative requirements for small business filers under the existing rules,
- align most (but not all) of the timelines with existing chapter 11 practice, and
- provide both clarity and flexibility to the ability of small businesses to propose new value plans through a new concept the Commission calls the “SME Equity Retention Plan.”

The Commission further recommended that the “principles” it has recommended for reforming chapter 11 generally should apply to SME cases except to the extent such principles directly conflict with the specific principles recommended for SMEs.

## I. Definition of Small or Medium Sized Enterprise

### Recommended Principles

- A “*small or medium-sized enterprise*” (“*SME*”) means a business debtor with —
  - No publicly traded securities in its capital structure or in the capital structure of any affiliated debtors whose cases are jointly administered with the debtor’s case; and
  - Less than \$10 million in assets or liabilities on a consolidated basis with any debtor or non-debtor affiliates as of the petition date.

*Comparison:* Section 101(51D) currently defines a “small business debtor” as a person engaged in a commercial or business activity (including affiliates but excluding SARE) with aggregate liabilities of no more than \$2,343,300 (excluding debts to affiliates/insiders).

- **Balance Sheet** - A debtor purporting to qualify as an SME under this definition must file a balance sheet reflecting a good faith estimate of its assets and liabilities as of the petition date with its chapter 11 petition.
- **Objection** - The court, the U.S. Trustee, or a party in interest may object that the debtor does not qualify as an SME within 14 days of the filing.
- **Motion to Seek Treatment as SME** - A privately-held company with assets or liabilities between \$10 million but less than \$50 million in assets or liabilities on a consolidated basis with any privately-held debtor or non-debtor affiliates may file a motion for SME treatment, either with the petition or within 7 days of order of relief in an involuntary case.
- **No SARE** - As with “small business debtor” cases, the definition of SME excludes “single asset real estate” cases as defined in section 101(51B) of the Bankruptcy Code.

As part of its housekeeping, the Commission recommended that the “small business case” and “small business debtor” provisions of the Bankruptcy Code should be deleted in their entirety. Those sections include:

- Section 101(51D) – Definition of Small Business Debtor
- Section 308(b) – Reporting Requirements
- Section 1116 – Additional Filing Requirements (financial information); Special meeting requirements with US Trustee (see also 28 U.S.C. Sec. 586(7)); Other Requirements
- Section 1121(e) – 180 days exclusive period (shortened or extended for cause); plan/DS filed within 300 days but can be extended for cause

- Section 1125(e) and (f) – Expedited Plan and Disclosure Statement (waiver of DS if Plan contains adequate info; alternatively, conditional approval of DS); expedited confirmation (45 days of filing)
- Bankruptcy Rule 1020 – Filing Requirements and Timing
- 28 U.S.C. Sec. 586(a)(7) – Obligation to meet with US Trustee prior to 341 meeting to discuss viability, business plan, chapter 11 requirements, and case scheduling (see also Section 1116)

## II. General Application of SME Principles

### Recommended Principles

A debtor that satisfies the definition of an SME should be subject to the principles set forth herein for SME cases without further action by the court, trustee, or debtor in possession.

- **SME Election in Petition** - If an objection is timely filed to the debtor’s indication in the petition that it qualifies as an SME under the Bankruptcy Code definition, such debtor should be treated as an SME unless and until the entry of an order of the court sustaining any such objection.
- **SME Sought by Motion** - If a debtor timely files a motion seeking to be treated as an SME, such debtor should be treated as an SME only upon the entry of an order of the court overruling any objections thereto and authorizing the debtor’s designation as an SME.
- **Valuation Information Package** - If a debtor qualifies or is designated as an SME, the court may for cause, after notice and a hearing, permit the SME debtor to use good faith estimates in compiling a “valuation information package” if audited or unaudited financial statements are not readily available. The court also may set a deadline by which the SME debtor should turn over its “valuation information package” to a requesting party in interest.

## III. Oversight of SME Cases

### Recommended Principles

- **Treatment as Debtor in Possession** - The debtor should be permitted to operate as a debtor in possession with all rights, powers, and duties set forth in section 1107 of the Bankruptcy Code and subject to the appointment of a chapter 11 trustee for cause under section 1104.
- **Creditor’s Committee** – As a rule, a committee of unsecured creditors under section 1102(a) should not be appointed in an SME case. However, an unsecured creditor or US Trustee may move for appointment of a committee and one may be formed if the court determines that the appointment is necessary to protect the interests of unsecured creditors in the case.

*Comparison:* No Committee is appointed in a “small business case” or, if one is formed, it must be effectively inactive.

- **Committee Appointment Pending SME Motion** - If the debtor does not satisfy the Bankruptcy Code definition of SME but files a timely motion to be treated as an SME in the chapter 11 case, the U.S. Trustee should not appoint a committee of unsecured creditors unless the court denies the debtor’s motion. The U.S. Trustee should suspend its ordinary appointment process pending resolution of the debtor’s motion.
- **Notice to Creditors Regarding Rights to Move for Appointment of Committee** - If the debtor qualifies as an SME or is designated an SME by the court, the notice of the chapter 11 case served upon creditors should explain that the U.S. Trustee will not appoint a committee of unsecured creditors in the case unless such committee is requested by an unsecured creditor or the U.S. Trustee and the court orders such appointment. If the debtor indicates in its petition that it qualifies as an SME, such notice also should explain that parties in interest have 14 days from the date of such notice to object to the debtor’s treatment as an SME.
- **Appointment of an Estate Neutral**
  - As part of its overall chapter 11 recommendations, the Commission proposed that the Court, on the recommendation of the US Trustee, could appoint an “estate neutral” who would assist the SME with financial reporting and compliance, strategy, development of restructuring options, and/or fulfill an investigative role (in that case, much like an examiner).
  - An estate neutral could be appointed in a case with a creditor’s committee.
  - The estate neutral would be paid by the estate, subject to a fee structure to be developed under the Bankruptcy Code, and based on the size of the case or the amount of creditor distributions.

#### IV. Plan Timeline in SME Cases

##### Recommended Principles

- **Plan Timeline** - Within 60 days of the entry of the order for relief, the SME debtor should develop and file with the court a timeline for filing and soliciting acceptances of its plan.

*Comparison:* The Reform Committee has balanced the elimination of most of the onerous reporting and scheduling requirements of the existing small business debtor provisions with the concept that the SME (alone or in concert with the estate neutral and/or Committee) must quickly develop and file a schedule for navigating and emerging from chapter 11.
- **Plan Timeline Consultation** - If an estate neutral or a committee is appointed, the SME debtor should consult with such estate neutral or committee in developing its timeline.
- **Plan Schedule** - After the SME debtor files its timeline for filing and soliciting

acceptances of its plan, the court should enter an order under section 105(d)(2)(B) setting the deadlines for the SME debtor's plan process.

- **Exclusivity** - The SME debtor should be subject to the exclusivity periods provided in section 1121.

## V. **Plan Content and Confirmation in SME Cases**

### **Recommended Principles**

- **Treatment of Claims and Interests** - A chapter 11 plan in an SME case should provide for the following treatment of allowed claims and interests in the case:
  - Payment of all administrative and priority claims in accordance with section 1129(a)(9) of the Bankruptcy Code.
  - Bifurcation of each undersecured claim into an allowed secured claim in accordance with section 506 and a general unsecured claim for any deficiency claim; neither section 1111(b) nor section 1129(a)(7)(B) should apply in an SME case.
  - Distributions to secured creditors (i) as provided in the plan and accepted by each class of secured creditors; or (ii) in accordance with section 1129(b)(2)(A).
  - Distributions to unsecured creditors
    - as provided in the plan and accepted by each class of unsecured creditors;
    - in accordance with section 1129(b)(2)(B) (subject to the recommended Commission principles codifying the "*new value corollary*"); or
    - as provided in an "*SME Equity Retention Plan*."
- **New Value Plans and SME Equity Retention Plans**

**New Value Plan** – Prepetition equity interests may receive voting common stock or ownership units in the reorganized debtor, provided that

- all impaired classes have accepted the plan;
- the plan complies with section 1129(b) (subject to the recommended principles codifying the new value corollary); or
- the plan complies with section 1129(b)(2)(A) and provides impaired classes of unsecured creditors that have rejected the plan with preferred stock, or similar economic interests, in the reorganized debtor as described below (an "*SME Equity Retention Plan*").

**SME Equity Retention Plan** - The court should confirm an SME Equity Retention Plan that is not accepted by any class of unsecured claims only if:

- **Continued Equity Support** - The prepetition equity security holders will continue to support the debtor's successful emergence from chapter 11 by remaining involved, on a basis reasonably comparable to their prepetition involvement, in the ongoing operations of the reorganized debtor; and
- **Payment of Excess Cash Flow to GUCs for 3 Years** - The reorganized debtor will make at least annual distributions to GUCs of excess cash flow calculated in a manner reasonable in relation to the company's operating cash flow for each of the three full fiscal years following the effective date of the chapter 11 plan, pursuant to a budget proposed in the plan and disclosure statement.
- **Continuation of Equity** – Prepetition equity retains 100 percent of the common stock, or similar ownership interests, issued or outstanding as of the effective date entitling the holders as a class to receive 15 percent of any economic distributions from the reorganized debtor, including dividends, liquidation or sale proceeds, merger or acquisition consideration, or other consideration distributed to the economic owners of the reorganized debtor.
- **GUC Liquidation Preference** - The prepetition unsecured creditors as a class receive 100 percent of a class of preferred stock, similar preferred interests, or payment obligations issued by the reorganized debtor on the effective date in accordance with the chapter 11 plan with the following features (referred to as the “*creditors’ preferred interests*”):
  - *pro rata* voting rights, limited to voting only on the “extraordinary transactions” (as defined below)
  - entitlement as a class to receive 85 percent of any economic distributions from the reorganized debtor, including dividends, liquidation or sale proceeds, merger or acquisition consideration, or other consideration distributed to the economic owners of the reorganized debtor.
- **Mandatory Conversion of GUC Liquidation Preference** - The creditors' preferred interests mature on the fourth anniversary of the effective date, at which time the interests should convert into 85 percent of the common stock, or similar ownership interests, of the reorganized debtor, unless redeemed in cash on or before the maturity date for their full face amount. The face amount of the creditors' preferred interests should equal the amount of the allowed unsecured claims held by those creditors receiving the creditors' preferred interests and established under the plan or confirmation order. Any cash or other distributions received by the holders of the creditors' preferred interests (whether under the plan on account of their unsecured claims or on account of the creditors' preferred interests) prior to the maturity date should reduce the redemption or conversion

value of such interests.

- **Extraordinary Transactions** - Certain post-effective date transactions are deemed “extraordinary transactions” subject to the vote of holders of creditors’ preferred interests, including:
  - favorable changes in compensation to insiders or affiliates
  - dividends or distributions to equity
  - deferral of dividends or distributions to holders of creditors’ preferred interests
  - sale of all or substantially all of the assets of the reorganized debtor, dissolution of the reorganized debtor, or merger of the reorganized debtor with or its acquisition of another entity; and
  - amendments to the organizational documents that would modify, alter, or otherwise affect the rights of holders of creditors’ preferred interests.

#### **Voting on Extraordinary Transactions –**

- **Plan Can Established Voting Level** - An extraordinary transaction should require at least an absolute majority vote of the holders of creditors’ preferred interest, but the chapter 11 plan may require a higher level of approval.
- **Failure to Obtain Approval** - The consummation of an extraordinary transaction without the requisite approval (a) would be a default under the chapter 11 plan entitling creditors to appropriate relief, and (b) provide creditor preferred interests with a liquidation preference over equity for the face amount of their interest (less any distributions received to date).