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APRIL 6, 2020 | HANSON BRIDGETT BUSINESS DISRUPTION STRATEGIES PRACTICE GROUP

CARES Act Extends Certain Bankruptcy Provisions to Expanded Group of Small Businesses

by Neal L. Wolf

The provisions of the newly-enacted CARES ACT that have been receiving the most attention from owners of small businesses that have been devastated by the COVID-19 pandemic are those relating to the business-sustaining forgivable loans and tax benefits that will potentially be available to those companies. One feature of the statute that has received far less attention, but can be quite important *to a much larger class of small businesses*, is the extension of the right to seek relief under the *debtor-friendly* provisions of subchapter V of chapter 11 of the Bankruptcy Code, The Small Business Reorganization Act of 2019 ("subchapter V" or the "SBRA").

Under pre-CARES ACT law, only those persons or companies carrying debt in an aggregate amount not greater than $2,725,625 could avail themselves of the beneficial provisions of subchapter V. A little more than one week ago, however, in the CARES ACT, Congress raised the subchapter V debt ceiling to $7,500,000. The heightened ceiling will remain in place for a one-year period, unless Congress later extends it. By almost tripling the debt threshold, Congress has conferred a substantial benefit upon owners of beleaguered businesses with aggregate debt falling somewhere within the old and new thresholds.

Quite coincidentally, the SBRA, which was enacted in late August of 2019, itself took effect in February of 2020, just as the COVID-19 pandemic began to hit the United States. SBRA provides small business debtors with a number of advantages they do not enjoy in traditional chapter 11 cases. These subchapter V benefits include, without limitation, the following:

SBRA cases should be concluded much more quickly than traditional chapter 11 cases. In a subchapter V case, the reorganization process is both accelerated and truncated. The debtor must file a plan of reorganization within 90 days after the commencement of the case. The 90-day deadline may be extended by the bankruptcy court only "if the need for the extension is attributable to circumstances for which the debtor is not justly to be held accountable." The debtor is not required to file, and obtain the approval of, a disclosure statement, a traditional Chapter 11 requirement that, by itself, often consumes 30 days or more. Moreover, under the SBRA, a standing trustee is appointed to, among other duties, help move the case along. In

addition, under subchapter V, not later than 60 days after the commencement of the case, the court is required to "hold a status conference to further the expeditious and economical resolution" of the case.

In a pre-SBRA "small business case," in which the debt ceiling was $2,566,050, the debtor had the exclusive *right*, as distinguished from *obligation*, to file a plan of reorganization within 180 days after the commencement of the case. Moreover, that 180- day "exclusivity period" could be extended by the court in specified circumstances. In a traditional chapter 11 case, in which there is no debt ceiling, the debtor has the exclusive *right*, as distinguished from *obligation*, to file a plan of reorganization within 120 days after the commencement of the case. That exclusivity period also may be extended by the court for cause. In both of these circumstances, the standard for extension of the exclusivity period is less stringent than under subchapter V.

SBRA cases should be less expensive than traditional chapter 11 cases. In a traditional chapter 11 case, an official committee of unsecured creditors is appointed by the United States trustee. That committee typically employs, with bankruptcy court approval, its own professionals, including but not limited to attorneys and, when the committee deems it appropriate, financial advisors and/or other professionals to assist the committee in the performance of its duties. The court-allowed fees and expenses of those professionals are *borne by the debtor*. In a case that is filed under subchapter V, no committee is appointed unless the bankruptcy court finds "cause" to do so. While a standing trustee is appointed in a SBRA case, the amount of fees that are awarded to such standing trustee should not approach the fees and expenses that are typically awarded to committee professionals.

As noted above, in a SBRA case, the debtor is not required to file, and to obtain judicial approval of, a disclosure statement. The disclosure statement process, alone, can be both quite expensive and extended. Moreover, as noted above, SBRA cases are likely to be of far shorter duration than traditional cases. Shorter cases are generally less expensive than cases of longer duration. As cases drag on, more professional fees and expenses are usually incurred.

In a SBRA case, only the debtor may file a plan of reorganization, thus giving it more control over its financial destiny. This exclusive right to file a plan of reorganization gives the debtor a large measure of control over its financial destiny. It can structure a plan of reorganization that works for it. That plan might involve the extended payment, over a three to five year period, of both administrative expenses and creditor claims.

As discussed more fully below, the plan may even involve the forgiveness of a substantial portion of the unsecured debt. In a SBRA case, the debtor alone can file a plan and the debtor's plan in effect "sets the table" for negotiations with creditors and plan confirmation. In a traditional chapter 11 case, if and when the exclusivity period expires, the debtor loses a significant amount of control, to its great prejudice. In that event, any party or parties in interest including, but not limited to, a secured creditor and/or the official committee of unsecured creditors may file a plan or plans of reorganization. Indeed, two or more competing plans of reorganization may be filed. Such plans may involve highly undesirable treatment of the debtor, such as a highly compressed debt repayment schedule or even the immediate liquidation of the debtor. Needless to say, in such circumstances, the debtor's control over its financial destiny is greatly compromised.

In a SBRA case, the debtor's plan of reorganization need not be approved by the affirmative vote of at least one class of creditors whose rights are "impaired" under the plan. In a traditional chapter 11 case, such approval is a necessary condition for plan confirmation. In such a case, it is sometimes quite difficult for a debtor to obtain the approval of an impaired class of non-insider creditors. This can be

especially true in the common circumstance in which a secured creditor with a relatively large claim is "undersecured" (in the sense that the creditor's claim is greater than the value of its collateral). In that circumstance, the secured creditor can almost certainly block confirmation of the plan of reorganization if it wishes to do so. In a subchapter V case, the plan of reorganization can be confirmed through the so-called "cram down" process even if all impaired classes of creditors vote against the plan.

In a SBRA case, equity holders may possibly maintain their equity interests in the business without the need to contribute "new value" to the business notwithstanding the facts that a class of impaired unsecured creditors (a) have voted to reject the plan of reorganization and (b) will not be fully repaid under the plan. In a traditional chapter 11 case, the "absolute priority rule" applies. Under that rule, when the members of a dissenting class of unsecured creditors are not to be fully repaid, and the class rejects the plan of reorganization, the equity holders ***may not retain*** their equity interests. The SBRA, in effect, replaces the absolute priority rule with a "best-efforts" test, under which the debtor is required to commit all of its "projected disposable income" to the payment of that class of creditors during a three to five year period. "Disposable income" is defined as that income that is not reasonably necessary to be expended for the "continuation, preservation, or operation of the business of the debtor."

In a SBRA case, the debtor may pay administrative expense claims over a three to five-year period, rather than at the time of its emergence from bankruptcy. In a traditional chapter 11 case, the debtor is required to pay its "administrative expenses" including, without limitation, its professional fees and claims that arose after the commencement of the case, upon the effective date of its plan of reorganization (in other words, at the time of the debtor's emergence from bankruptcy). This obligation can be quite daunting for a debtor that, like most bankruptcy debtors, is confronted with serious liquidity issues. Under subchapter V, however, the debtor can pay such administrative expenses, including the fees of the standing trustee that is appointed in the case, over the life of a three to five-year plan of reorganization.

A few final words: Because of the costs and uncertainties associated with the bankruptcy process, the bankruptcy court should, in virtually every instance, be a ***court of last, not first, resort***. The COVID-beleaguered (indeed, any financially troubled) small business debtor should make every reasonable effort to restructure its balance sheet and alter its debt obligations on an out-of-court, consensual, basis before commencing a bankruptcy case. There are circumstances, however, when it is highly necessary and/or desirable to file a bankruptcy case. Through its enactment of both the CARES ACT and the SBRA, Congress has provided the small business debtor with a number of quicker, more effective, and less expensive statutory tools with which the achieve a debt restructuring.

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