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# The Small Business Reorganization Act: A New Tool to Help Small Businesses Devastated by COVID-19

April 2020 • [David Brennan](#)

Among the many tragic effects of the COVID-19 pandemic is its impact on small businesses. Small businesses often have very limited cash reserves, and many have seen their revenues drop to zero overnight as a result of the pandemic. The CARES Act passed by Congress in late March 2020 attempted to provide some relief to small businesses – notably, forgivable loans under the Paycheck Protection Program – but early results suggest that the relief delivered by the CARES Act will be insufficient to meet the enormous need.

Reorganization under Chapter 11 of the Bankruptcy Code has been available to small businesses for many years, but only in theory. The burdensome costs of a reorganization (including the fees of attorneys and other professionals), the substantial delays encountered in a Chapter 11 case, and the difficulty for business owners to confirm reorganization plans while retaining their equity, make Chapter 11 reorganization practically inaccessible to smaller businesses.

### *The Small Business Reorganization Act*

Fortunately, Congress recognized the problems faced by small business Chapter 11 debtors, and in August 2019 – well before the pandemic began – passed legislation which may help small businesses to reorganize more quickly, and with fewer obstacles, in Chapter 11. The Small Business Reorganization Act (SBRA) was passed last

August, and coincidentally became effective in February 2020, early in the course of the pandemic. The legislative history of the SBRA suggests that Congress understood that the inability of small businesses to reorganize effectively under Chapter 11 means that those businesses commonly liquidate or simply dissolve, harming not only the business owners but their creditors (which often receive nothing), employees (who lose their jobs), vendors and suppliers (who lose revenue) and state and local governments (which lose tax revenue, pay unemployment and other benefits, and so on). In a Congress known for stubborn partisan gridlock, the SBRA was a rare piece of successful bipartisan legislation.

### *Significant Components of the SBRA*

The SBRA creates a new Subchapter of Chapter 11 of the Bankruptcy Code, known as “Subchapter V.” It is a relatively concise piece of federal legislation, contained in a few new sections (sections 1181 through 1195) of the Code. A full description of the SBRA’s provisions is beyond the scope of this Client Alert, but we can summarize a few of the Act’s key features.

**Eligibility.** The SBRA provides that reorganization under Subchapter V is available to small businesses with debts of \$2,725,625 or less, not including debts owed to affiliates and insiders. To combat the COVID-19 pandemic, the CARES Act raised that limit substantially, to \$7,500,000, for a year (until March 2021). Notably, an individual can file under Subchapter V if 50% or more of his or her debts were incurred in the operation of a business.

**Subchapter V Trustee.** Trustees are rarely appointed in Chapter 11 cases, and usually only due to the gross incompetence or dishonesty of the debtor. As in other Chapter 11 cases, the debtor in a Subchapter V case is a “debtor in possession,” with the authority to operate its business, unless removed for incompetence or dishonesty. But in Subchapter V cases, a new kind of trustee – a Subchapter V Trustee – will automatically be appointed. The Subchapter V Trustee doesn’t operate the debtor’s business, but performs a limited set of duties, including objecting to filed claims where appropriate; assisting the debtor in formulating a plan of reorganization; facilitating the development of a consensual plan (i.e., one that creditors will support); and monitoring payments to creditors under a confirmed plan.

**Prompt Deadline to File a Plan.** In Chapter 11 cases, there is a 120-day “exclusive period,” during which only the debtor may propose a plan of reorganization. Once that period expires, other parties in the case may file a competing plan. In Subchapter V cases, only the debtor may file a plan, and the debtor must do so within 90 days of the filing of the bankruptcy case.

**No Unsecured Creditors’ Committee.** If enough unsecured creditors agree to serve, an Unsecured Creditors’ Committee is appointed in every Chapter 11 case. The fees of

the committee's professionals (lawyers and accountants, primarily) must be paid by the bankruptcy estate, compounding the cost of the debtor's reorganization. A committee can have outsize leverage in the case, and often frustrates the debtor's ability to confirm a plan. The SBRA provides that in Subchapter V cases, it is presumed that an Unsecured Creditors' Committee will not be appointed.

**Payments to Unsecured Creditors.** The owners of the debtor in a traditional Chapter 11 case cannot retain their ownership interests unless all unsecured creditors are paid in full under the reorganization plan. In Subchapter V, the debtor can confirm a plan which allows the owners to retain their interests, so long as the debtor directs all of its "projected disposable income" to payments to creditors for a period of three years from the confirmation of the plan. (The court may extend the three-year period to not longer than five years.)

The SBRA became effective a very short time ago. Its effectiveness as a tool for small business survival remains to be observed, especially while in-person bankruptcy court hearings are canceled due to the pandemic, and courts grapple with how to hold remote hearings. Once in-person gatherings are permitted again, we can hope that Subchapter V may provide an effective way for small businesses to reopen, reorganize, and survive.

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