

> Covid-19 Client Alert

A Recent Significant Change in the Bankruptcy Code that Can Help a Distressed Small Business Become Much More Useful Because of the CARES Act

On February 19, 2020, the Small Business Reorganization Act of 2019 (the “SBRA”) came into effect. This act was created to enable a small business – a business with less than \$2,725,625 of debt – to reorganize its financial affairs faster and less expensively than it could in a traditional Chapter 11 case by reducing or streamlining many of the administrative and procedural burdens of traditional chapter 11 cases.

The Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), enacted on March 29, 2020, temporarily amends the SBRA by increasing the debt limit to \$7,500,000 so that more businesses can qualify for the new process.

Who is Eligible to be a Debtor Under the SBRA?

A person or entity engaged in commercial or business activity with aggregate liquidated, non-contingent, secured and unsecured debts of less than \$7,500,000. A “single asset real estate” business does not qualify. (There is another section of the Bankruptcy Code that deals with those entities.)

How does the SBRA Streamline and Lower the Cost of the Bankruptcy Process?

The roadmap to exiting Chapter 11 is the debtor’s plan of reorganization. In a traditional Chapter 11 this is a complicated document that has to address many complex provisions of the Bankruptcy Code. Approval of the plan is dependent upon obtaining the vote or consent of certain creditors or classes of creditors. The SBRA radically changes some of the plan requirements to make it easier to quickly exit bankruptcy.

- Under the plan, the debtor pays its secured creditors over time and commits all of its “Disposable Income” to pay creditors over a 3 to 5 year period. “Disposable Income” is defined as income that is not reasonably necessary to maintain support of the debtor, satisfy domestic obligations, or ensure the continued preservation or operation of business.

- The deadline for filing a plan is just 90 days after the case is commenced, but this period can be extended.
- Only the debtor can file a plan. No disclosure statement has to be filed. Information that would normally be in the disclosure statement is folded into the plan.
- A plan may be confirmed even if all impaired classes of creditors vote to reject the plan.
- The debtor may stretch payment of administrative expense claims out over the term of the plan.

What is New in the SBRA?

- A Small Business Trustee is appointed in every SBRA case, but this person is not like a regular trustee. This trustee does not replace the debtor or run the debtor’s business. Basically, the Small Business Trustee is more like a facilitator who (i) will help the debtor formulate a plan and work with the debtor and its creditors to achieve confirmation and (ii) monitor distributions under the plan. If necessary, this trustee can also investigate fraud or misconduct.
- A creditors’ committee is the exception, not the rule.
- There are no quarterly U.S. Trustee’s fees.

What is Radical About the SBRA?

- Equity holders may be able to keep their equity interests in the business even if unsecured creditors are not paid in full under the plan.
- The “absolute priority rule” is a fundamental principle of traditional Chapter 11 cases. It requires that the claims of a dissenting class of creditors – a class that votes against the plan – be paid in full before any class of creditors junior to the dissenting class receives or retains any

property under the plan. This can mean that the owners of a business lose all their equity in the business in a bankruptcy case. This rule does not apply in case under the SBRA.

The increase in the debt threshold applicable to small business bankruptcy cases to \$7,500,000 is a significant benefit to distressed smaller business entities and that before the CARES Act had too much debt to avail themselves of the SBRA. The new debt threshold will enable qualifying persons and entities to have a far greater chance at reorganizing instead of simply liquidating.

This alert addresses many of the highlights of the SBRA. For complete details and information about how it may apply to you, please reach out to our Business Solutions, Restructuring & Governance Team.

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