SBRA: Eligibility, Governance and Oversight

Editor’s Note: President Donald Trump recently signed into law several bankruptcy law changes, one of which was the SBRA. ABI was involved in the development of the package and held a live webinar to discuss the laws. The full webinar is available at abi.org/newsroom/press-releases/educational-press-briefings. Follow ABI’s coverage of the bankruptcy laws, including the SBRA, at abi.org/newsroom.

As noted in last month’s Legislative Update, on Feb. 19, 2020, the Small Business Reorganization Act of 2019 (SBRA) will take effect, adding another option for small business debtors to reorganize under chapter 11: subchapter V of chapter 11. Concerned that most small business debtors — the majority of chapter 11 filers — face difficulty successfully reorganizing under the current chapter 11 structure, Congress passed the SBRA to streamline chapter 11 reorganization for small business debtors.

These concerns date back many years. In fact, Congress had passed legislation in 2005 that was also designed to streamline chapter 11 reorganizations for small business debtors (the “2005 Reforms”). However, the “2005 Reforms” have not increased a small business debtor’s chances of successfully reorganizing under the Bankruptcy Code. As a result, since 2010, the National Bankruptcy Conference (NBC) has advocated for reforms targeted at small business debtors in chapter 11. Likewise, in 2014, ABI released a comprehensive report on chapter 11 and devoted substantial attention to proposed reforms designed to improved reorganizations for small business debtors.

Eligibility

There are two eligibility requirements for a small business seeking chapter 11 relief under subchapter V. First, the debtor must be a small business debtor, which includes individuals, partnerships and corporations under the definition of “person” under §101(41). The SBRA has modified the definition of “small business debtor,” which is applicable whether a debtor seeks relief under subchapter V.

In order to qualify as a small business debtor under amended §101(51D), the following criteria must be met:

1. The debtor must be engaged in commercial or business activities;
2. The debtor must have no more than $2,725,625 of noncontingent liquidated secured and unsecured debt as the date of filing or the order for relief;
3. 50 percent of such debt must have been generated from business and commercial activities; and
4. The debtor cannot have as its primary activity the owning of single-asset real estate.

Second, a debtor must opt in to be a small business debtor under subchapter V. The SBRA is silent on the mechanics of opting in, so the Bankruptcy Rules will need to be amended to address the proce-

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1 The views and opinions expressed herein are those of the author.
4 The SBRA’s effective date is 180 days after its enactment on Aug. 23, 2019. SBRA § 5.
5 Subchapter V will be in new Bankruptcy Code §§ 1181-1195, with conforming amendments scattered about in the Code. Unless noted otherwise, all Code references are to title 11 of the U.S. Code amended by the SBRA.
7 Id at 3.
8 Id at 4.
9 See Oversight of Bankruptcy Law and Legislative Proposals: Hearing Before the Subcomm. on Antitrust, Commercial, & Admin. Law of the H. Comm. on the Judiciary, 116th Cong. 1 (prepared statement of A. Thomas Small on behalf of NBC) (detailing NBC reform proposal for small business dating back to 2010) [hereinafter, the “Small Statement”], available at docs.house.gov/meetings/JJ/05/20190625/109657/HHRG-116-JU05-Wstate-SmallT-20190625.pdf (unless otherwise specified, all links in this article were last visited on Oct. 29, 2019). See also National Bankruptcy Conference, Small Business Working Group Report, Aug. 26, 2010 (summarizing NBC-proposed reform for small business debtors) [hereinafter, the “NBC Report”].
The voluntary petition will need to include an opt-in box to select treatment as a subchapter V debtor. If a debtor fits within the definition of a “small business debtor” but does not opt in to subchapter V, the 2005 Reforms remain applicable. In fact, the 2005 Reforms are mandatory. Thus, subchapter V does not replace the 2005 Reforms, but rather adds another filing option for debtors classified as small business debtors that the debtor can opt-in.

Governance and Oversight

DIP

The SBRA governance and oversight landscape retains some aspects of current law and modifies it in several ways for the subchapter V debtor. Importantly, the small business debtor is a debtor-in-possession (DIP) as under current law. Absent a confirmed plan or confirmation order directing otherwise, the DIP remains in possession of property of the estate. The DIP will also have the rights, powers and duties of a trustee under chapter 11 in a non-subchapter V case under § 1106(a)(1), including operating the business.

The SBRA provides that only the debtor has the power to file a reorganization plan, which tilts the governance power in favor of the debtor and away from creditors. The current duties of small business debtors as detailed in § 1116(1)-(7), as well as the reports required under § 308, are applicable to subchapter V debtors. An essential check on the DIP’s power is the removal of DIP status by the court for cause, including for “fraud, dishonesty, incompetence, or gross mismanagement ... or failure to perform obligations” under a confirmed plan. In the case of termination of DIP status, a trustee (as discussed later) will have the DIP duties under §§ 704(a)(8) and 1106(a), including the operation of the business.

Trustee

A fundamental governance change is that all subchapter V cases will have a trustee — either a standing trustee or a case trustee — regardless of DIP status. This is a substantial change in terms of governance and case oversight, but it is particularly important in smaller cases because there is often a lack of creditor engagement and the absence of an engaged committee to effectively oversee small cases.

The subchapter V trustee duties mirror, in large part, those of a chapter 12 trustee under § 1202(b)(1)-(6). In addition, the SBRA requires the trustee to appear and be heard at required status conferences and to “facilitate the development of a consensual plan of reorganization.” The requirement of a trustee is not only designed to enhance case oversight, but is intended to help facilitate the creation and consummation of a consensual reorganization.

The duration of the trustee’s activity in a case will vary. Trustee services terminate in one of three ways. First, if a consensual plan is confirmed, the trustee services terminate upon substantial consummation of the plan. Second, in the context of nonconsensual plan confirmation, the default rule (absent the plan or confirmation order providing otherwise) is that the trustee is required to make plan payments. Therefore, services in such cases will presumably run the life of the plan. Third, trustee services terminate if there is dismissal or conversion under § 1112.

Court and Status Conferences

Another governance change pertains to the court and status conferences. The court is required to hold a status conference within 60 days of the petition date to “further the expedient and economic resolution of a case.” Prior to such a status conference, the debtor must file a report detailing its efforts to achieve a consensual reorganization plan. This replaces the flexible nature of the ability to hold status conferences under § 105(d), but it might enhance the ability of reaching consensual plans with the debtor’s required accountability and the trustee’s required involvement.

Creditors’ Committees, Trustees and Examiners

Under the SBRA, the default rule is that there are no creditors’ or equity security-holders’ committees in a subchapter V case, but the court can order otherwise for cause. This provision reflects the view that in most smaller chapter 11 cases, the costs associated with such committees, and the failure of these committees to overcome creditor apathy, should make their appointment the exception, rather than the rule, in small business cases.

Section 1104, which provides for the appointment of a trustee or examiner, is inapplicable in a subchapter V case. There is no need for a trustee or examiner, as subchapter V already provides for a trustee with duties aligned to help facilitate reorganization. The SBRA also provides a mechanism for reappointing a trustee whose services have been terminated to appear at a hearing pertaining to modification of a confirmed plan or perform the duties of a DIP upon termination of a debtor’s DIP status.

17 See Small Statement, supra n.9, at 2.
18 Bonapfel, supra n.12, at 13.
19 See, e.g., §§ 1116 (mandatory nature of duties in a small business case); 1121(e) (requirements pertaining to plan, disclosure statement and confirmation in small business case).
20 See § 1182(2). Retaining the DIP model is also consistent with the proposed ABI reform of small and medium enterprises. ABI Report, supra n.10, at 292.
21 See § 1186(b).
22 See§ 1184.
23 See§ 1189(a).
24 This reinforces the Bankruptcy Code’s underlying policy fostering reorganization by giving the debtor this important tool: the exclusive right to file a plan.
25 See § 1187(a)(b).
26 See § 1185(a). DIP status can be reinstated. See § 1185(b).
27 See § 1183(d).
28 See § 1183(a).
29 See ABI Report, supra n.10, at 292 ( noting oversight challenges in smaller chapter 11 cases).
30 See § 1183(b)(1)-(6).
31 See §§ 1183(b)(3) and 1188.
32 See § 1183(c)(7).
33 See Small Statement, supra n.9, at 4.
34 See §§ 1191(a) (requirements for consensual plan confirmation).
35 See § 1183(c)(7).
36 See § 1191(b)(e) (requirements for nonconsensual plan confirmation).
37 See § 1191(b).
38 The SBRA does not address termination of services in this context. See Gore and Ross, supra n.12, at 19-20.
40 This can be extended for circumstances “for which the debtor should not justly be held accountable.” See § 1188(b).
41 See § 1188(a).
42 See § 1188(c).
43 See § 1193(d)(1), (2). Section 109(d) is inapplicable in a subchapter V case. See § 1181(a).
44 Small Statement, supra n.9, at 4 (noting how status conferences in chapter 12 cases have helped achieve consensual plans).
45 See § 1181(b).
46 See ABI Report, supra n.10, at 293.
47 See § 1181(a) (making § 1104 inapplicable in a subchapter V case).
48 See § 1183(d).
49 See § 1181(b)(3)(C).
50 See § 1185.

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U.S. Trustee/Bankruptcy Administrator

Although there is a trustee in every subchapter V case, the U.S. Trustee and Bankruptcy Administrator (BA) will continue to carry out their mandated oversight functions, much as is done currently in non-subchapter V cases. Thus, even though there will likely not be any committee and no traditional trustee or examiner, the subchapter V debtor will have a trustee coupled with this additional layer of oversight by the U.S. Trustee/BA. The exact role of the U.S. Trustee/BA in subchapter V cases, beyond those duties that are statutorily mandated, is not clear at this juncture.

Costs of Oversight

The change in governance and oversight will have an impact on the economic costs of a debtor opting for subchapter V. The trustee will be compensated either as a standing trustee, replicating chapter 12 by receiving a percentage fee from payments made under a plan, or as a case trustee. This cost will be borne by the estate.

However, under subchapter V, there are no quarterly fees. Therefore, the cost of the trustee will be offset, at least in part, with the elimination of the quarterly fees. Moreover, the default rule against committees will likely eliminate that cost in most subchapter V cases, further offsetting the costs associated with a trustee.

Trustee costs could also be offset by other provisions of the SBRA. However, these additional potential offsets are beyond the scope of this article. Nonetheless, collectively, these offsets will hopefully make the process more efficient and drive down the administrative costs associated with chapter 11 relief under subchapter V. For example, the fast-track nature of the case and the elimination of the disclosure statement should both decrease administrative costs. Moreover, the increased leverage provided to the DIP with the elimination of the absolute-priority rule and relaxed acceptance requirements, both of which should decrease contested litigation, will likely also decrease administrative costs. Empirical work in the future can evaluate whether the SBRA saves costs in the long run, but at the outset, anecdotal indicators suggest that the aggregate of administrative costs, even with a trustee, should be lower than in non-subchapter V cases.

Conclusion

The SBRA is a step in the right direction toward enhancing a small business debtor’s opportunity for a successful reorganization. The governance and oversight attributes of the SBRA — although not perfect in all respects — are a reasonable effort to balance the panoply of interests in a chapter 11. The SBRA has an eye toward facilitating the rescue of small businesses while at the same time providing governance and oversight mechanisms that are designed to protect minority interests.

52 28 U.S.C. § 586(e). In the case of a consensual plan where a trustee’s services are terminated upon substantial consummation, the court can award compensation “consistent with the service performed” to the trustee subject to the statutory limits for a standing trustee. 28 U.S.C. § 586(e)(5).
53 The SBRA does not expressly provide for compensating nonstanding trustees such as the case trustee; however, “presumably such a trustee is entitled to compensation under § 330(a)(1).” Bonapfel, supra n.12, at 6. Section 330 expressly provides that a court may award compensation to a trustee and that this Bankruptcy Code section is applicable to subchapter V cases. See, e.g., § 1181 (detailing sections inapplicable in subchapter V). Important to case trustees, the limitations on compensation applicable to a standing trustee under § 326(b) are not applicable to the case trustee. Bonapfel, supra n.12, at 6.
55 See § 1189(b) (generally, if not extended, a debtor must file plan within 90 days of filing).
56 See § 1181(b) (default rule of no-disclosure-statement requirement).
57 The absolute-priority rule in § 1129(b) as applied to a dissenting impaired unsecured creditor class is eliminated and replaced with a disposable-income test, feasibility finding, and provision for remedies if plan payments are not made. See § 1191(c); Bonapfel, supra n.12, at 9 (detailing new requirements).
58 Section 1191(b) eliminates the requirement that at least one impaired class accept a plan as required under § 1129(a)(10).

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