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Important Business Bankruptcy Law Amendments for Small Business

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On Friday, August 23, 2019, the President signed into law amendments to the United States Bankruptcy Code dealing with small business debtors, that is, debtors with debts of less than approximately $2,500,000. Although drafting and negotiating these changes began last year, in a larger sense, this process has been underway since 1979 when the Bankruptcy Act was replaced by what we know as the Bankruptcy Code and the introduction of Chapter 11 Reorganization.

The Bankruptcy Code now includes a Subchapter V which aims to make true reorganizations of small business more likely to succeed by treating such businesses much the way one would treat an individual seeking relief from its debts. Indeed, portions of Subchapter V appear to have been inspired by successful consumer reorganizations under Chapter 13.

An important aspect of new Subchapter V is that a small business debtor may no longer effect a cram down of its secured debt. Instead they will need to pay lenders in full according to the terms of the loan documents (although such payments may be made over time). This is of obvious benefit to lenders to a small business debtor.

When we have represented small business debtors we have often encouraged them to look at alternative remedies outside of the Code. Insolvency professionals like us will consider out of court workouts, assignments for the benefit of creditors, receiverships, and trust mortgages, when dealing with a relatively small business enterprise. Subchapter V will address some of those same issues and allow us to consider more often using the Bankruptcy Code where appropriate. Some of the highlights, in addition to doing away with cramdown, include:

1. There will not be the added cost of the creditors' committee, unless the court orders otherwise. Instead there will be a standing chapter 11 subchapter V trustee much like there is a standing trustee in a chapter 13 case.
2. The absolute priority rule which required that all creditors be paid in full or otherwise consent or else equity would lose its interest in the business, is done away with.
3. The plan process is simplified by eliminating the disclosure statement and incorporating some of its features into the proposed plan of reorganization.
4. It is intended that these cases will move on a fast track. In 60 days there is to be a status conference with the court and the debtor must show that it is working on a confirmable plan of reorganization. No later than 90 days of filing a case, the plan must be filed.

5. Venue for preference litigation under $25,000 must take place in the venue of the defendant. This amount represents an increase from $10,000 previously included in the Bankruptcy Code.

We are well aware that the chapter 11 process was often too expensive to permit successful reorganization under its provisions. The high cost of administration is now limited for small businesses. Hopefully this new amendment will avoid the damage that is often done to the debtor and its creditors when a business is forced to seek protection under the Bankruptcy Code. Unsecured creditors and lenders should now consider the impact and benefits of Subchapter V of Chapter 11 when engaging in a business transaction or dealing with a troubled situation involving a small business Debtor who owes less than $2.5 million.

As lenders and insolvency professionals know well, Chapter 11 has evolved since its inception. More often than not, Chapter 11 is less a reorganization and more a vehicle for the sale of assets. Indeed, what was once automatically thrust into a chapter 7 liquidation with oversight of a Chapter 7 trustee, is now frequently accomplished through chapter 11, in prepackaged planning.

While there are many features to the new subchapter, it appears to treat a small business chapter 11 case more like a chapter 7 or a chapter 13 case.

In the coming months we expect to see the development of case law addressing some of the issues and revealing some of the intricacies of this new approach. In the weeks to come we will issue further alerts as to any such developments.

Please note that this is a general overview of developments in the law and does not constitute legal advice. Nothing herein creates an attorney-client relationship between the sender and recipient. If you have questions regarding these provisions, or any other aspect of bankruptcy law, please contact Michael Traison at 312.860.4230

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