

SMALL BUSINESS REORGANIZATION ACT

An Overview of Subchapter V of Chapter 11 of the U.S. Bankruptcy Code

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ELIGIBILITY: 11 U.S.C. §101(51d)

To qualify as a small business debtor, the debtor must be a person or entity engaged in commercial or business activity with aggregate noncontingent liquidated secured and unsecured debts of less than \$2,725,625.00 as of the date of filing.

There is no requirement that the debtor remain engaged in the commercial or business activity post-petition, but 50% of its pre-petition debt must be attributable to the business of the debtor.

The only excluded activity for the small business debtor is operating “single asset real estate”. So, an apartment building or shopping center owner would probably be excluded.

Once Subchapter V is elected, the debtor must file a copy of the business’s most recent balance sheet, statement of operations, cash-flow statement and federal income tax return or a sworn statement that such documents do not exist.

SBRA TRUSTEE: 11 U.S.C. §1183 & 1194

Every case under Subchapter V will have a trustee appointed, who will have a role similar to the Chapter 12 or 13 trustee. 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.” §1183(c)(7). The length of services of the trustee will depend upon whether the plan proposed for confirmation is a consensual plan or a non-consensual plan.

If a consensual plan is confirmed, the trustee services terminate upon substantial consummation of the plan. If the plan is confirmed without consent of all classes of impaired creditors, the trustee is required to be a conduit for plan payments and the trustee’s services will terminate once all payments are made or the case is dismissed or converted.

PLAN OF REORGANIZATION: 11 U.S.C. §§1189 & 1190

Major differences from current Chapter 11 –

Only the Debtor is allowed to propose a plan AND, unless extended for cause, the plan must be filed within 90 days after the Order for Relief.

No Disclosure Statement required – plan should include a brief history of the business operations, a liquidation analysis and projections with respect to feasibility of the plan.

No Absolute Priority Rule – equity holders can retain their interests in the business even if the plan does not pay unsecured claims in full.

Ability to cram-down debt on homes mortgaged to fund the business – an individual who qualifies as a small business debtor can modify the mortgage on his principal residence, provided that the mortgage loan was not used to acquire the real property, but was used primarily in connection with the business.

The assistance of a Trustee in the evaluation and formation of a plan.

No Quarterly Fees.

CONSENSUAL PLAN CONFIRMATION – 11 U.S.C. §1191(a)- Follow criteria of §1129(a):

Payments to creditors made directly by the Debtor.

Debtor obtains a discharge as soon as the plan is substantially consummated.

Property of the Estate does not include future earnings.

NONCONSENSUAL PLAN CONFIRMATION – 11 U.S.C. §1191(b) “Cram Down”:

Debtor does not need to obtain the acceptance of an impaired class of creditors. However, the Plan must not discriminate unfairly, and is “fair and equitable” with respect to each impaired class that has not accepted it

FAIR AND EQUITABLE:

Debtor must commit all of its “projected disposable income” or property of equivalent value to make payments under the plan for 3-5 years.

Debtor must demonstrate a “reasonable likelihood” that it will be able to make all payments under the plan and plan must provide “appropriate remedies”, which may include the liquidation of nonexempt assets to protect creditors if the debtor fails to make plan payments.

Trustee makes disbursements to creditors unless court orders or plan provides otherwise.

Debtor obtains a discharge after payments are completed in 3-5 years.

Property acquired by the Debtor post-petition becomes Property of the Estate – thus, Debtor cannot use this property outside of ordinary course of business without court approval.