

Legislative Update

BY ROBERT C. MEYER

Small Business Reorganization Act Arrives This Month

Editor's Note: Make plans to attend an ABI webinar at 1 p.m. ET Feb. 11 that will provide an in-depth look at the SBRA. Register today at abi.org/events.

When a small business case walks through an attorney's door and seeks bankruptcy protection, a new facet has been created that might allow for an expedient, efficient and less expensive manner to resolve their financial problems. This facet is known as the Small Business Reorganization Act of 2019 (SBRA).

The SBRA did not create "small business" bankruptcy. In 1994, Congress attempted to streamline and make reorganization more affordable for a "small business,"¹ but that legislation was uniformly perceived as having missed the mark. The SBRA is a second attempt to hone the chapter 11 process for a more affordable methodology. This article addresses past issues for small businesses trying to reorganize under chapter 11, then discusses the types of debtors that might be best suited to use the SBRA's provisions.

Old Law

Chapters 11 and 13 are the reorganization chapters of the Bankruptcy Code. Each offers redelivery of the debtor's assets to the debtor after preparing a plan, which is confirmed by the court. However, these chapters differ greatly when evaluating entry to the bankruptcy court.

Under the old law, chapter 13 was an exclusive club for individuals only.² Corporations, trusts and partnerships are not allowed to use this chapter,

which remains true. Chapter 11 permits entities or persons to file, but the rights of the entities, as opposed to the rights of individuals, are not identical in chapter 11. Individuals are not treated equally in chapter 11 to their entity counterparts.

Chapter 11 is an exclusive club because it is costly and requires fees that are tenfold or more over what a chapter 13 costs. Chapter 11 requires extensive writing in the form of disclosure statements, plans and more. A chapter 13 plan is simple, often created by a form demanded upon by the court,³ which can be found on a court's website in an editable PDF file. In addition, the "simple" chapter 13 plan does not require creditor approval, as there is no ballot offered to a creditor that can reject the plan. In chapter 13, where costs are curtailed by combining the plan to a simple and inexpensive "form" that does not need creditor approval, it is a common and accommodating refuge for individual debtors. Costing only a few thousand dollars to file, chapter 13 is extremely debtor-friendly — a low-cost reorganization that does not require creditor approval.

Chapter 13 addresses some debts that cannot be discharged anywhere but in chapter 13. Many of the debts not dischargeable in chapters 7 or 11 are specifically discharged in chapter 13. This nuance alone might be the sole reason to file under chapter 13.

Unfortunately, chapter 13 is not open to all individual debtors. A chapter 13 debtor's debt is limited to \$1,257,850 of secured debt and \$419,275 of unsecured debt.⁴ Individuals with loads of debt surpassing the statutory ceilings (an "asset individual") often have to use chapter 11. In short, the "asset"

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1 Term as defined by 11 U.S.C. § 101(51C).
2 11 U.S.C. § 109(e).

3 Fed. R. Bankr. P. 3015.1.
4 11 U.S.C. § 109(e).

Exhibit 1

Issue	Chapter 7 Preferable?	Chapter 13 Preferable?
A debtor can pay trustee in 6-12 months for nonexempt assets.	Yes.	No, as it delays discharge to three or more years out.
A debtor cannot pay trustee in 6-12 months for nonexempt assets.	Maybe, if the trustee will allow longer period to pay to retain nonexempt assets.	Yes, if the trustee will not allow payment period for a longer period.
Debts under the ceilings of \$1,257,850 of secured debt and \$419,275 of unsecured.	Yes, but look to the other issues of payment and need for discharge.	Yes.
Debts greater than ceilings of \$1,257,850 of secured debt and \$419,275 of unsecured.	Yes, but look to the other issues of payment and need for discharge.	Cannot qualify.
Do you need expansive discharge provided by chapter 13?	No, even if nonexempt property is small in value, go to chapter 13 if nondischargeable debt is large amount.	Yes, "embezzler's discharge" has value.

individual is not permitted to reorganize in an efficient or inexpensive manner.

First Questions Asked Before the New Act

An “asset” individual (someone whose assets would be administered for the benefit of creditors by a chapter 7 trustee) could only seek bankruptcy to either be liquidated in chapter 7 or pay attorneys for a sophisticated chapter 11. Any “asset” individual who walked into a bankruptcy practitioner’s office would be asked three primary questions: (1) Can you pay off the chapter 7 trustee for the assets you want to retain;⁵ (2) if not, is your debt below the parameters recited above;⁶ and (3) regardless of your answer to the first question and an affirmative answer to the second question, do you need the discharge of chapter 13? Exhibit 1 outlines how these questions steer a debtor to chapter 13.

Nuances that Deprived Debtors of the Use of Chapter 13

When Congress created the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA),⁷ the doors for bankruptcy became even less inviting. Pre-BAPCPA, a debtor would choose chapter 7 as an alternative to chapter 13 if the debt exceeded the above-referenced ceilings. In BAPCPA, Congress

created the “means test” (sometimes called the “abuse” test) and legislated that if certain individuals earn enough to pay creditors on a monthly basis, such debtors must enter chapter 13. This makes such debtors pay their creditors as opposed to filing chapter 7 and delivering negligible payments to the creditors. These people are not usually “asset” individuals.

The concept of the “means test” (through a calculation of “current monthly income”) created a new dilemma: Some individual debtors were rendered unable to file a chapter 7 or 13. Such instances can arise when the amount of debt exceeds the ceiling of chapter 13. There is too much cash flow to be allowed to file under chapter 7, and too much debt to be allowed to file under chapter 13. When this occurs, the debtor (if seeking bankruptcy protection) can only file under chapter 11, thus making discharge vastly costlier and much more cumbersome.

This did not seem fair. These debtors were not vastly different from their chapter 13 peers, and the liquidity of such parties was negligible. Because of this, these debtors’ chapter 11 petitions would unjustly cost more than 10 times as much in fees and expenses to get the same results as could be provided in chapter 13.

New Law Congressional Response

The SBRA effectively seeks to address some of these described nuances — but in limited fashion. The Bankruptcy Code provisions from the SBRA effectively hybridized chapters 11 and 13. The beneficiaries are

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5. If a party wants to keep its assets, but cannot afford to pay a trustee in an expedient fashion, or has nondischargeable debt in chapter 7 that is dischargeable in chapter 13, chapter 13 would be the best bankruptcy chapter under which to file.

6. This means \$1,257,850 of secured debt and \$419,275 of unsecured debt.

7. Pub. L. 109-08.

Exhibit 2

Item	Chapter 11	Chapter 13	Chapter 11 SBRA Sub. V
Debt Ceiling	No.	\$1,257,850 secured. \$419,275 unsecured. § 109(e).	\$2,725,625 of secured and unsecured. No single-asset real estate. § 101(51D)(A).
Single-Asset Real Estate Allowed	Yes and no. DIP is not excluded from being single asset, but there is case law against such filings.	Yes.	No. § 101(51D)(A).
Trustee?	No.	Yes, not operating. § 1303.	Yes, not operating. § 1183.
U.S. Trustee Fees	Yes.	No.	No.
Exclusive Plan Provider	No.	Yes. § 1321 "debtor shall file a plan."	Yes. § 1189(a) "only the debtor."
Obtain a Consensual Plan	No.	No.	Yes, try at least. § 1188(c).
Disclosure Statement	Yes.	N/A.	No. § 1187(c).
File Financial Documents	Yes. The assistant U.S. Trustee has many requirements.	Some.	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.
Status Conference Deadline	Not in the Code, but ordered by many courts.	N/A.	Yes, less than 60 days. § 1188(a).
Deadline to File Plan	No, but small and other issues require a filing.	Yes, 14 days. Bankruptcy Rule 3015(b).	Yes, 90 days. § 1189(b).
Form Plan	Not really. Small Business Form Number B 25A.	Bankruptcy Rule 3015.1 requires Local Form.	Not yet.
Creditors' Committee Can Be Formed	Yes.	N/A.	Not usually. § 1181(b).
Does the Absolute Priority Rule Apply?	Yes. § 1129(b)(2)(B)(ii). Individual exception must meet § 1115 (after acquired property becomes estate property).	No.	No. § 1181 excludes § 1129(b).
New Value Rule	Yes. Note § 1115 individual exceptions.	No.	No.
Modify Home/Residence Mortgage	No. § 1123(b)(5).	No. § 1322(b)(2).	Yes (need business nexus). § 1190(3).
Pay Administrative Fees on the Effective Date	Yes, required.	Loose; over time, but pay in full.	No, over a period of time.
Must Have at Least One Impaired Class Vote for Plan	Yes, and cramdown must meet § 1129.	No.	No, so long as it does not discriminate unfairly. § 1191(b) excepting. § 1129(a)(8) and (10).
Effect of Cramdown on Property of the Estate	No.	N/A.	Yes, post-confirmation, pre-discharge-acquired property becomes property of estate. § 1191(c).
Projected Period for Disposable Income to Creditors	Not finite.	3-5 years. § 1322(d)(2)(C).	3-5 years. § 1191(c)(2)(A).
Discharge Exceptions	Limited. § 1141 includes all of § 523 exceptions.	Limited to some extent. §§ 523(a)(1)(A), (6) (7) (10) (11) (12)(13) (14) (15) (16) (17) (18) and (19) are dischargeable.	Limited. § 1141 includes all of § 523's exceptions.
Modification of Plan Restrictions	Yes. § 1127.	Yes. § 1329.	Yes. § 1193.
Attorney Conflict if Owed Money Pre-Petition	Jurisprudence says "yes."	Usually not an issue.	No, if less than \$10,000. § 1195.
Deliver Post-Petition Income to Creditors by Individuals	Yes. § 1129(a)(15)(B).	Yes. § 1322(a)(1).	No. § 1191(b) excepts § 1129(a)(15), but "all disposable income" must go to creditors. § 1191(c)(1) and (2).
Co-Debtor Stay	Not in Code, often in plan.	Yes. § 1301.	Not in Code, might be in plan?

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the truly “small” debtors: individuals or mom-and-pop/small businesses.

Major Changes from Chapter 11

There are benefits for both the debtor and creditors under the SBRA’s provisions. First and foremost, the SBRA is much less expensive: no U.S. Trustee quarterly fees, no lengthy disclosure statements, and a simplified plan that trims much of the legal expense associated with chapter 11. In addition, those pesky reports required by the assistant U.S. Trustee are not required, thus saving legal and accounting expenses.⁸

Also pleasing (to the debtor) is that an SBRA debtor, unlike its chapter 11 counterpart, has exclusivity in filing a plan.⁹ Under the SBRA, a debtor’s plan also is not subjected to the “absolute priority rule” and its associated “new value exception.”¹⁰ This makes plan confirmation more feasible for many individual debtors.

In chapters 11 and 13, modifying the mortgage on the individual’s residence is disallowed.¹¹ Under the SBRA, debtors have a sliver of opportunity to do so.¹² The cases interpreting this new provision might open a floodgate of filings under the SBRA, but only time will tell.

The SBRA, for good reason, mandates communication between the debtor and creditors. However, this leaves the creditors with less power than they held with the ballot. Under the SBRA, the debtor must meet and attempt to obtain a consensual plan from the creditors.¹³ In addition, a status conference must be held within 60 days of the SBRA debtor’s filing of the petition.¹⁴

Under the SBRA, creditors also receive concessions. The single-asset real estate case, something that has haunted secured creditors for decades, will not be tolerated under the SBRA.¹⁵ Also, some creditors are frustrated with the delays inherent in chapter 11. Under the SBRA, the debtor must file their plan within 90 days.¹⁶

Major Similarities to Chapter 13

The plans in chapter 13 or for the SBRA debtor cannot be extended to longer than five years.¹⁷ A chapter 13 debtor has a trustee, as does the SBRA debtor. The trustee for an SBRA debtor is nonpossessory, like its chapter 13 counterpart.¹⁸ The chapter 13 debtor is duty-bound to file a plan¹⁹ — creating an exclusivity. An SBRA debtor similarly is the “only” party who may file a plan.²⁰

Chapter 11 mandates addressing administrative claims with payment on the effective date. The chapter 13 or SBRA debtor can pay post-petition administrative claims/expenses in the plan. In addition, much administrative headache is relieved for chapter 13 and for an SBRA debtor, as neither Code section requires ballots to be filed, counted, represented with a report and determinative of confirmation.²¹

Chapter 11 requires a large disclosure statement, often costing more than the price tag for a new motor vehicle. Chapter 13 and SBRA debtors are not required to file a disclosure statement.²²

Conclusion

Although chapter 13 — and its associated indexing for debt ceilings²³ — will continue to maintain its viability for a majority of individual debtors, the SBRA presents a modification of rules and associated benefits for “small business debtors” for which the prior Bankruptcy Code provisions did not provide. For some, an SBRA debtor will appear to be just a chapter 13 debtor with more debt. For others, it will be an entity filing with chapter 13-like issues.

Practitioners who are representing debtors with discharge concerns should not avoid the necessity of chapter 13 over the SBRA. If dischargeable debt is not a debtor’s primary concern, and the residence mortgage debt is troublesome, then the SBRA and its ability to give a sliver of hope to modify home mortgages might be enticing. As an aid in diagnosing what Code provision might best suit a client, Exhibit 2 on p. 48 shows the primary contrasts and similarities between chapters 11 and 13 and the SBRA. **abi**

8 11 U.S.C. §§ 1106 and 1107, and Fed. R. Bankr. P. 2015.

9 11 U.S.C. § 1189(a).

10 11 U.S.C. § 1181 excludes 11 U.S.C. § 1129(b).

11 11 U.S.C. §§ 1123(b)(5) and 1322(b)(2), respectively.

12 11 U.S.C. § 1190(3).

13 11 U.S.C. § 1188(c).

14 11 U.S.C. § 1188(a).

15 11 U.S.C. § 101(51D)(A).

16 11 U.S.C. § 1189(b).

17 11 U.S.C. §§ 1322(d)(2)(C) and 1191(c)(2)(A), respectively.

18 11 U.S.C. §§ 1303 and 1183, respectively.

19 11 U.S.C. § 1321.

20 11 U.S.C. § 1189(a).

21 11 U.S.C. § 1188(c).

22 11 U.S.C. § 1187(c).

23 11 U.S.C. § 104(a).