

community BANKER

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Welcome to the latest issue of the COMMUNITY BANKER.

The Community Banker is prepared by attorneys at Olson & Burns P.C. to provide information pertaining to legal developments affecting the field of banking. In order to accomplish this objective, we welcome any comments our readers have regarding the content and format of this publication. Please address your comments to:

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The attorneys at Olson & Burns represent a wide range of clients in the financial and commercial areas. Our attorneys represent more than 30 banks throughout North Dakota.

A Brief Update on the Small Business Reorganization Act (Pub. L. 116-54)

Effective February 20, 2020, an amendment to the Bankruptcy Code aims to make small business bankruptcies faster and less expensive. The "Small Business Reorganization Act" (SBRA) is designed to help small businesses to reorganize in bankruptcy by choosing ("opting-in") to be treated as a subchapter V debtor under the SBRA. The SBRA is an effort to create a workable compromise for small-business debtors between having to file a Chapter 7 or a Chapter 11 bankruptcy, when neither chapter is a good fit.

Prior to the SBRA, a floundering small business had two choices - Chapter 7 or Chapter 11. With the filing of a Chapter 7 case, a bankruptcy estate comprised of the debtor's nonexempt property is created, a trustee is appointed to liquidate the assets of the estate, and the proceeds are distributed to the debtor's creditors. For those small businesses hoping to *survive* bankruptcy and retain control of the organization, Chapter 7 is absolutely not an option.



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In a Chapter 11, the debtor keeps control over its business operations and restructures debt through a court-approved plan. But, even though the Chapter 11 debtor retains control, the debtor has extensive oversight from the bankruptcy court and the U.S. trustee. Further, the Chapter 11 debtor's plan to repay its debts must meet rigorous requirements and be approved by the court before the debtor can exit bankruptcy. In bankruptcy, the debtor must obtain court approval of all non-ordinary course-of-business transactions and must comply with the U.S. trustee's monthly reporting requirements. This all requires much lawyering and many administrative fees; as a result, a small-business debtor may not be able to afford the costs of a chapter 11.

What the SBRA does:

* **Amends the Bankruptcy Code.** It adds a new subchapter V to Chapter 11, defining a "small-business debtor" as an individual or an entity with not more than \$2,725,625 in debt. A small business debtor does not include the single-asset real estate debtor;

* **Mandated Trustee.** It requires that a standing trustee be appointed in every small business Chapter 11, similar to a Chapter 12 and Chapter 13. In that the SBRA is a debtor-in-possession law, the trustee is *not* an operating trustee, and is there to monitor and supervise the restructuring, to review the debtor's financials, to make recommendations to the court, and help the debtor comply with the plan. The trustee will be compensated from the assets of the estate;

* **Modification of Some Residential Mortgages.** The SBRA eliminates the prohibition against an individual small business debtor modifying his or her residential mortgages. It now allows a small business debtor to modify a mortgage secured by a residence *if* the underlying loan was not used to acquire the residence and was primarily used in connection with the debtor's small business;

* **Unsecured Creditors' Committee is Unlikely (but still possible).** As another way of lowering costs, an unsecured creditors' committee will not be appointed *unless* ordered by the bankruptcy court for cause. (When an unsecured creditor's committee is formed in a regular Chapter 11, the committee can hire its own attorney, accountant, and other professionals, which the debtor is required to pay for. Generally, the SBRA enables a small-business debtor to avoid this expense.);

* **Simplification.** It streamlines the plan confirmation process and should reduce plan confirmation costs. (In a regular Chapter 11 case, the debtor must file a detailed disclosure statement with the bankruptcy court, which must be approved by the court before creditors can vote to accept the debtor's plan.) Under the SBRA, a debtor will generally not be required to file a disclosure statement, thereby speeding up the process and removing the likelihood of contested hearings and the accompanying lawyer's fees. Reduced costs and a simplified plan confirmation process is expected to increase the chance for a small business to survive bankruptcy and retain control of its operations;

* **The Debtor Files the Plan.** The SBRA permits only the debtor to file a plan of reorganization, which must be done within 90 days. (In a regular Chapter 11, the debtor's has a limited exclusive right to file a plan. Once the exclusivity period expires, creditors are free to file their own competing plans and submit them to the court.) Lenders should be aware that the new subchapter will now allow a small business to confirm a plan over the objections of creditors. This is a *big* change, made to increase the reorganization success rate for small businesses;

*** No Absolute Priority Rule.** The prohibition on equity owners retaining their interests in the debtor without paying holders of non-consenting impaired classes (see § 1129(b)) does *not* apply in cases under subchapter V. Owners of a small-business debtor can retain their ownership interest, provided the plan does not “discriminate unfairly” and is “fair and equitable.” It will also be easier for a small-business debtor to confirm a plan over the objections of creditors. Generally, a plan will be confirmed if it does not discriminate unfairly, is fair and equitable and, provides that all of the debtor’s projected disposable income will be applied to payments under the plan or the value of property to be distributed under the plan is not less than the projected disposable income of the debtor. Note - in order to confirm a plan, with or without consent, a small-business debtor must still meet the feasibility test of §1129(a)(11);

*** Administrative Expense Claims.** The SBRA eliminates the requirement that the debtor pay administrative expense claims, including claims incurred by the debtor for post-petition goods and services, on the effective date of the plan. The SBRA allows a small-business debtor to extend payment of administrative expense claims out over the term of the plan;

*** Limitations on Discharge.** In many cases the court will grant the debtor a discharge after completion of all payments due within the first three years of the plan, or such longer period as the court may fix (not to exceed five years). The discharge relieves the debtor of personal liability for all debts provided under the plan except any debt: (1) on which the last payment is due after the first three years of the plan, or such other time as fixed by the court (not to exceed five years); or (2) that is otherwise non-dischargeable. All exceptions to discharge under the Bankruptcy Code apply to the small business debtor. This is different from a typical corporate Chapter 11, which has a more limited set of exceptions to discharge;

*** Chapter 11 Still Exists!** The SBRA does not repeal existing Chapter 11 provisions for small-business debtors, and creates an alternative procedure that small-business debtors may elect to use. Proceedings using the current Chapter 11 provisions will continue to be called “small business cases,” while cases under the new procedure will be called “cases under subchapter V of Chapter 11.” For small-business debtors who do not opt-in, the 300-day deadline for filing a plan and disclosure statement and the requirement of confirmation within 45 days of any such filing, along with all the other provisions of the Bankruptcy Code currently required of Small Business Debtors, still apply.

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