

SMALL BUSINESS REORGANIZATION ACT: Perfect Timing in Age of COVID-19

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In the face of the increasing devastating financial impact spread by COVID-19 on a global scale, the timing of the Small Business Reorganization Act of 2019 (SBRA) was fortuitous. The headlines are sobering. “Coronavirus Economic Impact: 92% of Small Business ‘Reinvent’ Due to Pandemic” as reported in the *International Business Times* on July 28, 2020. “Eighty-one percent of small U.S. companies surveyed by Veem, a global payments network, expect the new coronavirus pandemic to affect their business over the next 12-16 months, and nearly 90% are bracing for an economic slowdown. In a short time, COVID-19 has had a devastating impact on small businesses in the state of Nevada, marked by high unemployment, empty buildings, supply-chain disruptions caused by factory shutdowns, border restrictions and industry-wide furloughs. ...”

Tourism and hospitality drive the Las Vegas market, and the pandemic has hit Nevada’s economy hard. On July 16, 2020, KVVU-TV (Fox 5) reported “City of Las Vegas offering second round of grant money for small businesses impacted by pandemic.” In mid-July 2020, Fox 5 also reported, “the City of Las Vegas announced that it is reopening its emergency grant program to provide an additional \$2 million in funding to help small businesses impacted by the pandemic. New applications will be accepted until July 31 or until sufficient applications have been received, the city said. According to the release, last month, the city created and offered an emergency grant to help city businesses fund expenses associated with personal protective equipment (PPE), facility retrofit for health and safety measures or other expenses reasonably needed to prepare the business for reopening or expanded reopening. This emergency grant was made possible by the city through \$4 million in funds received from the Coronavirus Relief Fund of the CARES Act.”

“Each grant was approximately \$4,000 and was awarded to 1,000 businesses ranging from restaurants and bars to retail and cosmetology establishments ...,” according to the Fox 5 report. “The City [sic] says that the second round of the program includes

expanded eligibility requirements. As such, home-based businesses are now able to apply if they meet the employee threshold requirement (three to 25 employees). The program will also cover any businesses that were open on or prior to March 11, as evidenced by a business license.”

For many small businesses in Nevada, the aid is simply not enough and, in some instances, too late. Despite the lifeline, small businesses are scrambling, and many of them may need to turn to voluntary bankruptcy to seek relief and breathing room from the barrage of creditors pressuring them, despite pinched cash flow given the ever-present pandemic. The alternative for some creditors is to seek involuntary bankruptcy relief, with the options of Chapter 7 liquidation or a Chapter 11 reorganization. Historically, filing for Chapter 11 was costly and a substantial time investment before reaching the finish line of plan confirmation, which process could include plan objections,

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voting deficiencies with apathetic creditors and costly evidentiary hearings to prove the requirements necessary for plan confirmation under Bankruptcy Code §1123.

The SBRA attempts to simplify and streamline Chapter 11 bankruptcy for small businesses. Highlighted below are the major provisions of the SBRA and an evaluation of their utility for small businesses in Nevada that may be the perfect candidate for filing under the SBRA given the current crisis.

Although still relatively untapped by debtors, the new Chapter 11 could be the solution for many small businesses in Nevada. The key distinguishing features set forth

below highlight why the new Chapter 11 could be the right answer for Nevada's struggling small businesses that are not ready to throw in the towel just yet.

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Small Business Chapter 11

The SBRA creates Subchapter V of Chapter 11 of the Bankruptcy Code. Congress passed amendments to the Bankruptcy Code, and the SBRA was signed into law on August 23, 2019. The SBRA became effective February 19, 2020. Rather than create a new form of Chapter 11, the

Eligibility

Subchapter V cases can be filed by debtors with no more than \$2,725,625 of total (secured and unsecured) debt. (This amount was increased for one year to \$7,500,000 for cases filed after signing of the Coronavirus Aid, Relief and Economic Security Act (CARES Act)). See 11 U.S.C. § 1182(1)(a). These changes opened Subchapter V to virtually all small business, non-single asset real estate entities, where at least 50 percent of the debt arose from commercial or business activities. Companies may use it, as may individuals for debts whose debts are mostly commercial or business debts. An eligible debtor must elect application of Subchapter V.

Why Subchapter V?

Bankruptcy offers an automatic stay, use of cash collateral, tools for lending, picking and choosing contracts to keep or discard, sale of assets, and ultimately reorganization. Traditional problems with

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bankruptcy involve time and expense. SBRA attempts to help in these ways:

Plan exclusivity: In traditional Chapter 11, the debtor has a limited, exclusive period to file a plan, which can be terminated. In Subchapter V, only the debtor can file a plan. Creditors may not hijack the bankruptcy.

No creditors committee: In most Chapter 11 cases, a committee of creditors is appointed to watchdog the debtor in possession. The committee can employ counsel and professionals at the debtor's expense. There generally is no creditors committee in Subchapter V. The SBRA provides that a committee of creditors will not be appointed unless ordered by the bankruptcy court for cause, which should decrease the costs of a Chapter 11, as the debtor under the SBRA is not burdened with the fees and costs of the committee's professionals. *See* 11 U.S.C. § 1181(b) (rendering 11 U.S.C. § 1102(b) inapplicable absent court order for cause).

Standing trustee: In Chapter 13, a standing trustee handles payments to creditors, and supervises the debtor and the plan. In Subchapter V, a standing trustee is appointed, and may continue to handle payments after plan confirmation. The idea is for the trustee help the debtor to confirmation.

Speed: The debtor must file a plan within 90 days of the voluntary bankruptcy filing. *See* 11 U.S.C. § 1189(b). The disclosure requirements of Chapter 11 are simplified, and the disclosure statement hearing need not occur separately.

Loans on residences: Residential mortgages for loans used primarily in connection with a small business, but not used to acquire the residence, may be modified. This is not true in Chapter 11.

Flexible cramdown:

Cramdown is plan confirmation over objection of one or more creditor classes. Subchapter V dispenses with the requirements that all impaired classes accept the plan, and that one such class

must be calculated without including insiders. The absolute priority rule, requiring full creditor payment or termination of owners' equity, does not apply. One price of cramdown under Subchapter V is that post-petition property acquisitions and earnings from services performed by the debtor are included in the debtor's estate, increasing creditor recoveries. Another is that the cramdown plan can be modified after it is substantially consummated. A third is that the discharge does not occur until completion of all plan payments or a limited hardship discharge is granted.

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Nevada small businesses now have the option of filing for bankruptcy relief under the optional Subchapter V. On its face, the new option offers what appears to be a simpler and more immediate path to reorganization. Notwithstanding the benefits, a caveat remains, and Nevada small businesses must be mindful that under the SBRA, a trustee's control and provisions directing increased creditor distributions are the tradeoffs that cannot be underestimated in the new Chapter 11. The CARES Act opens Subchapter V to most small businesses. The SBRA is without question a big change for small businesses, but practically speaking, for some small businesses, the most simple, efficient option in the bankruptcy toolbox to address financial distress is to liquidate in Chapter 7. The goal, however, was for the SBRA to strike a balance between Chapter 7 and Chapter 11 bankruptcies for small-business debtors by endeavoring to lower costs and streamline the plan confirmation process.

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