

The Small Business Reorganization Act A New Lifeline for Small Businesses

By Douglas Provencher

With their doors closed, revenue streams shut off and cash bleeding out, businesses face a life and death challenge. Employees are being furloughed or laid off. Cash is being hoarded. The Government has promised loans and grants. But time goes on. Businesses need relief now, not in a few weeks, a month or more.

How do they survive? How do they get through the shut down and come out on the other side?

Nobody wants to file bankruptcy, but it may be the best option.

A financial reorganization under Chapter 11 provides breathing room while a business rearranges its finances. A profitable business that just needs some time is a perfect candidate for Chapter 11.

But, Chapter 11 is terribly expensive. The latest PG&E Chapter 11 has generated tens of millions of dollars in professional fees. Even a “mom and pop” Chapter 11 will cost tens of thousands of dollars. Not only must a Chapter 11 debtor pay its own attorneys and accountants, it often has to pay its creditors professionals. Then add to that the fees to the U.S. Trustee and the complicated financial reporting requirements. These requirements make Chapter 11 an expensive and time-consuming process.

Many a business has looked at Chapter 11 only to discover it is too expensive to reorganize. They are too poor to file bankruptcy. The excessive cost of a traditional Chapter 11 did not go unnoticed. Last year, in a moment of unusual foresight, Congress passed the Small Business Reorganization Act (SBRA). It went live February 19, 2020.

Now as the financial consequences of the coronavirus commence their assault on small businesses, the Small Business Reorganization Act may provide a lifeline to small businesses during this crisis. SBRA’s intent is to make reorganization under Chapter 11 more accessible for small businesses by reducing the cost, the time in court and the “red tape.”

Initially, only a business with debt less than \$2,725,625 could reorganize under SBRA. The CARES Act response to the COVID-19 crisis quickly changed this raising the qualifying debt limit to \$7,500,000 for the next year.

Highlights of the new SBRA law include:

1. A fast track 90-day Chapter 11 process to file a reorganization plan. The cumbersome financial disclosure statement requirement is eliminated.
2. A standing trustee is appointed to assist the debtor and its creditors to agree on a financial plan.
3. There are no U.S. Trustee fees.
4. There is no creditors' committee.
5. Only the debtor may file the reorganization plan.
6. The owners may retain their ownership interests.
7. If the owners have a business loan, such as an SBA loan secured by their home, the terms of this loan may be modified.
8. A debtor's payment plan goes for three to five years.

Ideally the SBRA, will help the creditors and the debtor. The debtor will have up to five years to pay and the creditors may recover moneys from future income from a business that has no income during this crisis.

The SBRA also allows administrative expenses, such as legal fees, to be paid over the life of the plan. A traditional Chapter 11 required they be paid at plan confirmation.

In a SBRA case, the debtor is expected to file its plan within 90 days. This may be extended under limited circumstances but the COVID-19 may be an extenuating circumstance.

Unlike a Chapter 11 where, if a trustee is appointed, the owners lose all control, under the SBRA, a trustee is appointed to assist the debtor and its creditors negotiate a reorganization plan. But the trustee does not take control of the business. The SBRA trustee has the power to investigate the debtor's finances, but the trustee's primary job is to help the creditors and the debtors to reach a consensual reorganization plan. This may be particularly helpful as we enter a financial crisis and some financial institutions become less willing to compromise.

Another particularly powerful tool for a small business owner is the ability to modify a loan secured by the owner's home if the loan was used for the business. This is very common for any business owner with an SBA loan and a home. The SBA lender usually demands a lien against the home.

The SBRA also eliminates a complicated Chapter 11 rule that prohibited owners from maintaining their ownership interest in their business unless all creditors agreed. The “new value” rule required owners to put up new money if they wished to continue to own their business. This is not the case under the SBRA.

Small businesses are in uncharted waters. Businesses flourishing weeks ago may be in serious trouble. The SBRA is an option allowing businesses to put their obligations on hold while they negotiate with their lenders and explore other financial resources. The SBRA may provide a small business the time it needs to survive until this crisis subsides and businesses are able to reopen.