LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
MONDAY, OCTOBER 26, 2020

PERSPECTIVE

Small Business Chapter 11 update: Where are we 8 months in?

By M. Jonathan Hayes

We are now eight months into the Small Business Reorganization Act of 2019, which took effect in February. The act attempted to establish a cheaper, quicker route for small businesses to reorganize under new Subchapter V of the Bankruptcy Code. Here are a few of my observations over the past several months.

First, some small businesses seem to view SBRA as a panacea enabling them to get through a reorganization plan quickly, keep their assets, lose their debts, and not have to pay some incomprehendible amount to get there.

The main difference between a Subchapter V and a "regular" Chapter 11 reorganization is that a plan may be easier to confirm under the new law since it eliminates the "consenting class" requirement and the "absolute priority rule." That is not that big a deal, at least at the outset.

As to the consenting class, Congress decided long ago that debtors should not be able to cram down everyone — and so required the consent of at least one class of impaired creditors to approve a plan. That is often a big hurdle, but just as often it is no hurdle at all. In most cases, there is *some* secured creditor you can get to vote for the plan, thus the consenting class. But if there is no such creditor, then Subchapter V is a huge advantage.

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As to the absolute priority rule — under which a dissenting class of creditors must be provided for in full before a lower class can be paid — that only applies when the unsecured class of creditors votes *no* on the plan. Remember, you only count those who actually vote, which tends to be few. We go into every Chapter 11 figuring to get the unsecured class to vote *for* the plan, thus no absolute priority rule issue. The pitch is that the plan will pay unsecured creditors a lot more than they will get in a Chapter 7 liquidation. The unsecured creditors usually listen, eventually, unless the major creditor is an ex-spouse, ex-partner or some enemy who won't use good business judgment to decide. So the practical effect of Subchapter V is that we no longer have to be particularly attentive to the complaints of the major unsecured creditors. If there is a major unsecured creditor who can kill the plan by themselves and we can't convince them they are better off agreeing to the plan, then Subchapter V is huge.

Second, under Subchapter V, we now get a trustee. The U.S. trustee's office has so far appointed eight or so small business trustees, most if not all of whom are well-known bankruptcy attorneys and good people. I wish a few of them were what you would call "consumer" or even "small business" debtor attorneys, but I have no complaints so far.

The small business trustee's job is to do some independent investigation of the debtor and its business, its assets, and generally become familiar with the operations. I have found myself annoyed at the initial contacts with the trustees in my cases. When the trustee starts asking questions, my initial reaction, muttered only to myself, tends to be, "mind your own business." I have to work on that. On the other hand, it is helpful at hearings when the trustee appears and says, "I have been communicating with Hayes and agree with his position."

Importantly, the trustee is supposed to "facilitate the development of a consensual plan of reorganization." That helps a ton, especially when we have a creditor determined to scuttle any plan. There is a little fear that the trustee will push the debtor to pay more in the plan instead of pushing creditors to accept what is being offered. I'm hopeful and looking forward to selling creditors with the help of the trustee.

But, the client asks, how much will I have to pay the trustee? This is still a pretty big unknown. This issue dominates the discussions with attorneys when we start comparing notes. There is a lot of fear that the trustee's request for fees will swamp the plan. Especially when the most obvious benefit to debtors is that the process won't cost an arm and a leg. A trustee's fees can kill the golden goose. My understanding is that the U.S. trustee will be watching that carefully but for now it is still a big unknown.

Third, to the U.S. trustee's office, it's business as usual even though they don't get their quarterly fees any longer. This means that the "compliance" required by the U.S. trustee, the so-called (and so-dreaded) "7-day package," must still be timely prepared and submitted. There is still an initial debtor interview with the U.S. trustee and the first meeting of creditors is still conducted by the trustee. I assume the staff attorney for the U.S. trustee will continue to appear at hearings, which I have no issue with. These efforts have an impact on the cost and the "complexity" of the process.

Fourth, the new scheme requires that a plan of reorganization be filed within 90 days of the petition date. Of course, that can be extended and I am sure most judges will permit extensions if there is anything resembling a good reason to do so. In a traditional Chapter 11, the "plan" is a two-step process. First, a disclosure statement must be drafted providing creditors with "adequate information" about the debtor and the plan. That is a big job. Subchapter V does away with the disclosure statement. Some of the information required in the disclosure statement must now be put into the plan, but not much really. That is a major benefit to proceeding under Subchapter V.

What about the 90 days? Isn't that a little quick? It might be. Filing a plan quickly can help keep down fees, but it rarely happens. The problem is two-fold. First, to be confirmed, the plan must pay creditors more than they would get in a liquidation. Second, the plan payments must be feasible. Both of those requirements are still alive and well — and a fundamental part of the whole process.

Most small business debtors are not masters at bookkeeping, to be polite. To file a plan within 90 days the debtor has to be able to tell the court and creditors how much creditors would get in a liquidation, as of confirmation. Sometimes that's easy, sometimes not. It's really a waste of time to file a plan unless you're pretty comfortable that you can establish the liquidation value of the debtor's assets. Sometimes you need appraisals, sometimes the appraisals are fought by creditors. Liquidation value includes the value of the business as a going concern. That is often nothing, but if there is value there, it must be quantified. The court must make a specific finding that the plan pays creditors more than the liquidation value of the assets. I think it will be fairly common that this cannot get done in 90 days.

As to projections — i.e., where's all this money coming from to make the plan payments — debtors rarely have a clue what that even means, much less how to put them into an Excel spreadsheet. How much is *likely* to come in next month and how much is going out is critical and largely a mystery to many small business owners. So the time between the petition date and proposing the plan is often needed to get some meaningful profit and loss statements. Even three months of actual results will likely not be enough to project out profits for the next five years. On the other hand, as in Chapter 13, the projections are guesstimates. Most judges give the debtor the benefit of the doubt. The debtor will not receive a discharge until the payments are all made, so why not give the debtor a chance?

My attitude for now is that we are filing a plan with 90 days unless it *cannot* be done.

I still have high hopes. It really should function like a Chapter 13. There should be a "small business Subchapter V day" each month at each court. See what the trustee has to say, are any creditors objecting? Confirm the plan or give the debtor another month to fill in any remaining gaps. There will be many of these in the next year says my crystal ball. ■

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