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The Small Business Reorganization Act of 2019: A Powerful Lifeline for Financially Distressed Small Businesses

Introduction

Anyone passing by the Maine Mall in South Portland during the past four or five years has played witness to some of the largest bankruptcy filings in the country, with giant retailers like JC Penney, Sears, Forever 21, Payless, Toys ‘R’ Us, and Sports Authority all going through—or attempting to go through—their own Chapter 11 bankruptcy cases. These bankruptcies are highly publicized, and it is easy to see their impact in everyday life. However, they represent only a small percentage of business bankruptcies nationwide. Yet, until early 2020, multi-billion-dollar companies and local small businesses attempting to reorganize were required to utilize largely identical provisions within Chapter 11 of the Bankruptcy Code.

Recognizing concerns about Chapter 11 for small businesses and their owners, Congress passed the Small Business Reorganization Act (SBRA) in late 2019, with an effective date of February 19, 2020. Through the SBRA, Congress created a new subchapter (Subchapter V) of Chapter 11 of the Bankruptcy Code for certain eligible small business debtors. The SBRA was enacted to help eligible small businesses and individuals restructure through a faster, more affordable, and more effective process than a traditional Chapter 11 bankruptcy case historically offered to these debtors.¹

As the SBRA turns toward the end of its third year, this article reflects on the early years of Subchapter V, its origins, statistics on SBRA cases nationally and in Maine, and some important basics about how the law works. Thus far, the SBRA largely is functioning as intended, and, as a result, numerous debtors have reorganized successfully in SBRA cases, including many that likely would have closed and liquidated but for the SBRA. Accordingly, it is vital for anyone working with small businesses

and their owners in Maine to remain aware of the SBRA as an effective tool in times of financial distress.

A. The SBRA: A Strong Start Both Locally and Nationally.

1. Chapter 11’s Historic Challenges for Small Businesses and Their Owners.

Scholars and practitioners have long recognized the high costs and daunting complexities of traditional Chapter 11 cases. Together, these and other factors have made reorganizing and exiting chapter 11 too difficult or too expensive for many businesses and individuals.² Although Chapter 11 of the Bankruptcy Code is highly effective in preserving the going-concern value of businesses, saving jobs, and maximizing creditor recoveries, those tools have not always worked quite as well for—and may be inaccessible to—small businesses and their owners.³

The SBRA took effect right as the COVID-19 pandemic began upending the global economy and everyday life. At the same time, Maine relies heavily on entrepreneurs and small businesses to provide critical services, goods, and employment opportunities, with small businesses accounting for more than half of Maine’s workforce.⁴ The SBRA, therefore, took effect at an opportune time to offer a new solution to small businesses (and eligible individuals with sufficient business-related debts) that are experiencing financial distress but are not ready to—and should not have to—close their doors forever.

Although the legislative history is limited, the Report from the House Committee on the Judiciary (Report No. 116-171) summarized the need for the SBRA as follows:

[S]mall business chapter 11 cases continue to encounter difficulty in successfully reorganizing.... As the bill's sponsor, Representative Ben Cline (R-VA), explained at the hearing held by the Subcommittee on Antitrust, Commercial, and Administrative Law on June 25, 2019 at which H.R. 3311 was considered, the legislation allows these debtors "to file bankruptcy in a timely, cost-effective manner, and hopefully allows them to remain in business" which "not only benefits the owners, but employees, suppliers, customers, and others who rely on that business."

As recognized in the House Report, the ability for these businesses to reorganize is critical.

Small businesses, however, have been far more likely to close than reorganize, as seen early in the COVID-19 pandemic, with one report finding that more than 80,000 small businesses permanently shuttered from March 1 to July 25, 2020, alone.⁵ Even small businesses that took a shot at reorganizing in Chapter 11 faced long odds. A 2018 study in the American Bankruptcy Institute Journal revealed that of 76,845 Chapter 11 cases filed between 2008-2017, only about a quarter of debtors with assets of less than \$10 million (*i.e.*, most of the SBRA's target demographic) were able to confirm an exit plan.⁶ This contrasts with debtors with assets above \$10 million, which had an approximately 40 percent chance of confirming a plan, and debtors with assets above \$100 million, which had an approximately 60 percent chance of confirming a plan.⁷ As a result, the "fresh start" goal underpinning the bankruptcy system, which courts have sought to promote for more than a century, remained elusive to important sectors of the American economy.⁸ The SBRA is changing that.

2. SBRA Statistics in Maine and What They Say About the SBRA So Far.

More than 4,000 businesses or individuals have filed cases under the SBRA across the country, with the number of monthly filings reaching its peak in March 2021 with 194 filings that month.⁹ Among the states within the First Circuit Court of Appeals, more than 130 SBRA cases have been filed, with 24 of those cases filed in Maine.¹⁰ Of the 24 Maine cases, 16 were filed in 2020, six in 2021, and two in 2022 so far.¹¹ A closer look at the Maine SBRA cases reveals several positive signs about the statute's early success.¹²

Successful Outcomes. Of the 24 SBRA cases filed in Maine, 20 confirmed plans of reorganization, three were converted to another chapter or dismissed for grounds unrelated to confirmation, and one remains in progress. That is a plan confirmation rate of approximately 87 percent for filed, completed cases.

Early Focus on Plan Confirmation. Debtors in Maine are filing their plans an average of 83 days into a case, with the earliest

plan filed 28 days after the petition date.¹³

Faster Cases. In cases with confirmed plans, the average time from the start of the case until confirmation of a plan is apparently six months.¹⁴

More Creditor Consent. Of the 20 cases with confirmed plans, all those plans appear to have been confirmed on a consensual basis—that is, without a class of creditors voting against the plan (whether because no objections were filed or because objections were settled during the confirmation process).

Diverse Mix of Debtors. Of the 24 SBRA case filed in Maine, 13 were filed by individuals and 11 were filed by businesses. SBRA debtors in Maine come from a variety of different industries, ranging from logging, to transportation, to retail, to real estate development projects.

Altogether, early Maine data for SBRA cases are consistent with the authors' experience and national statistics. The SBRA is highly effective for debtors. Subchapter V cases move faster than traditional Chapter 11 cases, with proposed plans filed earlier and cases wrapping up on an expedited schedule. Faster cases and streamlined procedures also make Chapter 11 less costly for Subchapter V debtors. And, due in large part to the modified confirmation standards and the skilled panel of Subchapter V trustees in Maine, these cases are more likely to end with a consensual, confirmed plan of reorganization in a matter of months.

3. Early National Statistics Comport with the Success in Maine.

Preliminary SBRA statistics nationally also reflect its early success, consistent with the trend in Maine. According to one survey of the 465 earliest SBRA cases, more than 50 percent had confirmed a plan within six months of filing for bankruptcy, with most of the rest still working through the confirmation process.¹⁵ It is not surprising, then, that a significant majority of eligible debtors are opting into Subchapter V rather than proceeding as traditional Chapter 11 debtors, which supports the growing recognition of the SBRA's benefits among practitioners.¹⁶

B. SBRA Nuts and Bolts: How It Works and What You Should Know.

Like every area of legal practice, bankruptcy law in general, and the SBRA in particular, contains numerous statutes, rules, and other intricacies that require the expertise and experience of skilled advisors. However, no matter the practice area, it is possible—and, perhaps, all too likely—that clients, neighbors, and others will find themselves in situations of financial distress.

Scholars and practitioners have long recognized the high costs and daunting complexities of traditional Chapter 11 cases. Together, these and other factors have made reorganizing and exiting chapter 11 too difficult or too expensive for many businesses and individuals.

In many ways, a debtor's SBRA case looks much like a typical Chapter 11 case, in which a debtor obtains a reprieve from creditor collections, agrees to a plan to repay creditors, and receives a discharge of debts. That is a good thing. The SBRA, however, features several changes to the Bankruptcy Code that make the process more accessible—and more effective—for debtors, while still affording them the powerful reorganizing tools that larger businesses have long enjoyed in Chapter 11. In this time of continued economic uncertainty, here are four features of the SBRA that highlight how it works and what financially distressed small businesses and individuals should know:

1. Eligibility and the Debt Ceiling: New Statute Expands Access.

Consistent with its purpose, not everyone is able to proceed under the SBRA. To be eligible, the debtor (which can be a business or an individual): (i) must be “engaged in commercial or business activities”; (ii) must have “aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing ... in an amount not more than \$7,500,000” (including debts of affiliates but excluding debts owed to insiders); and (iii) not less than 50% of those non-insider debts must arise “from the commercial or business activities of the debtor.”¹⁷ (But, a debtor is not eligible for the SBRA if its “primary activity is the business of owning single asset real estate.”)¹⁸

Although the debt ceiling is \$7.5 million today, that was not always the case. Originally set at \$2,725,625, in March 2020, the “Coronavirus Aid, Relief, and Economic Security Act”¹⁹ temporarily increased the debt limit to \$7.5 million. Congress extended the \$7.5 million debt limit through the “COVID-19 Bankruptcy Relief Extension Act of 2021,”²⁰ but the higher threshold returned to \$2,725,625 on March 27, 2022, when Congress failed to pass a further extension in time. However, on June 21, 2022, President Biden signed the “Bankruptcy Threshold Adjustment and Technical Corrections Act,”²¹ which amended section 1182(1)(A) of the Bankruptcy Code to return the debt ceiling to \$7.5 million, effective retroactively.²² That increase, however, will sunset again two years after enactment, on June 21, 2024, unless Congress takes further action in the meantime.

Importantly, as to other eligibility criteria, most courts have taken a broad approach to expand access to the SBRA. That is particularly true as to the “engaged in commercial or business activities” requirement, where courts have determined that

far less than full business operations are required and, instead, winding-down operations, settling claims, and liquidating assets are sufficient business activities for SBRA eligibility.²³

2. No Committee and No Operating Trustee, but a Valuable Subchapter V Trustee.

Like in a traditional Chapter 11 case, debtors opting into Subchapter V retain control over their assets, business operations, and case strategy as the so-called “debtor-in-possession.”²⁴ But unlike a traditional Chapter 11 case, a committee of creditors is not appointed unless ordered by the court for cause, which would be rare.²⁵ The absence of a creditors' committee decreases the cost of a Subchapter V case, because the debtor is required to pay for the committee's professionals.

Another key component of the SBRA is the addition of the Subchapter V trustee, who is a lawyer or other professional appointed by the United States Trustee.²⁶ The Subchapter V trustee does not control the debtor's assets, replace existing management, or represent any party in the case. Rather, the Subchapter V trustee is a neutral, non-operating trustee appointed to assess the viability of the reorganization and to facilitate the development of a consensual plan, often acting as a mediator among the debtor and creditors as a case proceeds.²⁷

3. Faster Cases, New Deadlines, and Streamlined Exit Procedures.

The SBRA also modifies Chapter 11 to speed up and streamline the plan confirmation process and to reduce restructuring costs by moving cases from start to finish more quickly. For instance, the debtor must file a proposed exit plan within 90 days of the start of the case, with a status conference on exit issues to occur within 60 days of the filing.²⁸ This not only places a running clock on the debtor, but also requires the debtor and creditors to focus on the exit strategy earlier than in a traditional chapter 11 case, when it is not uncommon for a debtor to take a year or more before filing a plan.

4. More Powerful Exit Plans and Easier Confirmation.

In one of the biggest substantive changes from a traditional Chapter 11 case, the SBRA modifies the requirements for a debtor to confirm a plan of reorganization, particularly in contested confirmation situations. If a creditor objects to approval of a debtor's plan, the debtor and its owner can retain the assets and equity as long as the plan does not “discriminate un-

fairly” and is “fair and equitable” to the dissenting creditors.²⁹ To meet that requirement, if the other statutory standards are met, the debtor can confirm a contested plan—and, ultimately, receive a discharge of its liabilities—as long as it proposes to contribute its projected net disposable income for three to five years to pay creditors, whereas in a traditional Chapter 11 case, the debtor may be required to pay all creditors in full to preserve equity.³⁰ This change can result in needing less money to preserve equity and achieve significant debt savings through Subchapter V, freeing up future cash to fund operations, invest in capital expenditures, and otherwise put revenue back into the business (or other ventures) post-bankruptcy.

Conclusion: Takeaways as Year Three Wraps Up.

By all indications, the SBRA is off to a strong start. At the same time, it is vital for Congress to permanently extend (and even raise) the \$7.5 million debt ceiling beyond June 2024 to ensure that businesses and individuals will benefit from the SBRA. And although bankruptcy filings remain below historic levels, according to one 2022 survey by Reuters, U.S. small business confidence fell to an 11-month low in early 2022 due to worker shortages and rising labor and material costs.³¹ There is no doubt that a need exists for the SBRA, and there is good reason for optimism that its early success will continue into the future as practitioners further refine their SBRA practices and case law develops.

ENDNOTES

1 *See, e.g., In re Parking Mgmt., Inc.*, 620 B.R. 544, 547 (Bankr. D. Md. 2020) (Subchapter V “offers small business debtors a streamlined Chapter 11 procedure that is intended to be less costly and time-consuming than a traditional case”); H.R. REP. NO. 116-171, at 1 (2019), <https://www.congress.gov/congressional-report/116th-congress/house-report/171> (Subchapter V is meant to be a streamlined “process by which small business debtors reorganize and rehabilitate their financial affairs”).

2 AMERICAN BANKR. INST. COMM’N TO STUDY THE REFORM OF CHAPTER 11, 2012-2014 FINAL REP. AND RECOMMENDATIONS (2014), 275-77, <http://commission.abi.org/full-report> (describing view that traditional chapter 11 process is now too slow and too costly for small and medium-sized businesses to effectively make use of it).

3 *Hearing on Oversight of Bankruptcy Law & Legislative Proposals Before the Subcomm. On Antitrust, Com. and Admin. L. of the H. Comm. On the Judiciary*, 116th Cong. 3 (2019), <https://docs.house.gov/meetings/JU/JU05/20190625/109657/HHRG-116-JU05-Wstate-KeachR-20190625.pdf> (statement of Robert J. Keach, Bernstein Shur, Am. Bankr. Inst. Past President and Co-Chair, Comm’n to Study the Reform of Ch. 11).

4 UNITED STATES SMALL BUSINESS ADMINISTRATION, 2019 SMALL BUSINESS PROFILE, 81 (2019), <https://advocacy.sba>

[gov/2019/04/24/2019-small-business-profiles-for-the-states-and-territories/](https://www.sba.gov/2019/04/24/2019-small-business-profiles-for-the-states-and-territories/) (Maine, 2019 hyperlink).

5 Madeline Ngo, *Small Businesses Are Dying by the Thousands – and No One is Tracking the Carnage*, BLOOMBERG (Aug. 11, 2020), <https://www.bloomberg.com/news/articles/2020-08-11/small-firms-die-quietly-leaving-thousands-of-failures-uncounted>.

6 Ed Flynn, *Chapter 11 is for Individuals and Small Business?*, AM. BANKR. INST. J., Dec. 2018, <https://www.abi.org/abi-journal/chapter-11-is-for-individuals-and-small-business>.

7 *Id.*
8 *See, e.g., Traer v. Clews*, 115 U.S. 528, 541 (1885) (“The policy of the bankrupt act was, after taking from the bankrupt all his property not exempt by law, to discharge him from his debts and liabilities, and enable him to take a fresh start.”); *BFP v. Resol. Tr. Corp.*, 511 U.S. 531, 563 (1994) (describing the “fresh start” for debtors as “at the core of federal bankruptcy law”).

9 Data as of August 12, 2022. AM. BANKR. INST., *SBRA Resources* (Feb. 23, 2022), <https://www.abi.org/sbra> (navigate to “Bankruptcy Statistics” subheading, and follow hyperlink “For more detail and further analysis on Subchapter V cases” to access full data on Subchapter V cases).

10 The authors’ analysis does not include one case originally filed under the SBRA but that was converted to a traditional Chapter 11 case because the debtor was ineligible for the SBRA.

11 *Id.*

12 Data is derived from an analysis by the authors of publicly available dockets on PACER. For full disclosure, Mr. Prescott has represented the debtors in five Subchapter V cases filed in Maine, and he has represented creditors in several others.

13 This average excludes one case that converted to the SBRA because it was pending for months before the SBRA took effect. A plan was filed 224 days after the petition date in this case, and only 88 days after the case was converted to subchapter V.

14 Again, this average excludes one case that converted into the SBRA after the SBRA took effect. A plan was confirmed after 304 days in that case.

15 J. Michelle M. Harner & Kimberly Goodwin-Maigetter, *Subchapter V Cases by the Numbers*, AM. BANKR. INST. J., Oct. 12, 2021, <https://www.abi.org/abi-journal/subchapter-v-cases-by-the-numbers>.

16 Press Release, H. Comm. On the Judiciary, COVID-19 Bankruptcy Relief Extension Act Signed into Law (March 29, 2021), <https://judiciary.house.gov/news/documentsingle.aspx?DocumentID=4497>.

17 11 U.S.C. § 1182(1)(A).

18 *Id.*; *see also*, Adam R. Prescott & Kyle D. Smith, *Coverage Gap: Rethinking SBRA’s Exclusion of SARE Affiliates*, AM. BANKR. INST. J., Oct. 20, 2021, <https://www.abi.org/abi-journal/coverage-gap-rethinking-sbra’s-exclusion-of-sare>

affiliates.

19 Public Law No.: 116-136.

20 Public Law No.: 117-5.

21 Public Law No.: 117-151.

22 Public Law No.: 117-151.

23 See, e.g., *In re Offer Space, LLC*, No. 20-27480, 2021 WL 1582625 (Bankr. D. Utah Apr.

22, 2021) (debtor was eligible by having active bank accounts; having accounts receivable; analyzing and exploring counterclaims in a lawsuit; and winding down its business); *In re Ikalowych*, No. BR 20-17547, 2021 WL 1433241 at *275-76 (Bankr. D. Colo. Apr. 15, 2021) (“engaged in commercial or business activities” includes “any private sector actions related to buying, selling, financing or using goods, property or services for the purpose of earning income[.]”).

24 11 U.S.C. §§ 1107, 1182(2).

25 *Id.* §§ 1102(a)(3), 1181(b). The creditors’ committee is typically composed of a debtor’s largest unsecured creditors.

26 *Id.* § 1183.

27 *Id.*; *In re Seven Stars on the Hudson Corp.*, 618 B.R. 333, 346 n. 81 (Bankr. S.D. Fla. 2020) (Subchapter V trustee serves “as a *de facto* mediator between the debtor and its creditors”).

28 11 U.S.C. § 1189(b).

29 *Id.* § 1191(b).

30 *Compare id.* § 1129(b)(2)(B)(ii) (mandating that a dissenting class of unsecured creditors must be paid in full before a junior class of claimants may receive or retain property), *with id.* § 1191(b), (c) (providing that a Subchapter V plan that proposes to pay three to five years of projected disposable income is “fair and equitable”).

31 *U.S. small business sentiment drops to 11-month low*, REUTERS (Feb. 8, 2022, 6:10 AM), <https://www.reuters.com/business/us-small-business-sentiment-drops-11-month-low-nfib-2022-02-08/>.

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