

AMERICAN BANKRUPTCY INSTITUTE JOURNAL

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On Our Watch

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Small Business Reorganization Act: Implementation and Trends

Editor's Note: To stay current on the effects of this legislation, bookmark ABI's SBRA Resources website at abi.org/sbra.



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The Small Business Reorganization Act of 2019 (SBRA) ushered in substantial changes to bankruptcy law and practice when it became effective on Feb. 19, 2020. ABI Consultant **Ed Flynn** recently provided an excellent analysis of the first 1,000 cases filed under subchapter V.² Although he identified several questions to be answered as additional data becomes available, he concluded that subchapter V was "off to a pretty good start." We agree with Mr. Flynn that by all current measures, the SBRA is working as Congress intended, and we share in this article details about the U.S. Trustee Program's (USTP) implementation of SBRA and preliminary answers to some of the questions he posed.

SBRA's Background and Implementation

Congress passed the SBRA with the goals of providing distressed small business owners the opportunity to reorganize their businesses more quickly and at a lower cost and allowing creditors to get paid sooner. Under the SBRA, small business debtors — defined as debtors with less than \$2,725,625 in noncontingent liquidated debts³ that also meet other criteria — may elect to have their cases administered under the new subchapter V of chapter 11 of the Bankruptcy Code, which pro-

ceeds under a tight timeline. To illustrate, within 24-48 hours after a small business debtor files and elects to proceed under subchapter V, the U.S. Trustee appoints a subchapter V trustee and schedules the § 341 meeting of creditors for a date as early as possible in accordance with applicable rules. The U.S. Trustee also conducts the initial debtor interview within 10 days of the filing. In addition, the court holds a status conference within 60 days of filing, and the debtor must file a plan within 90 days.⁴

A key component of the SBRA is the assistance of a subchapter V trustee to assess the viability of the business and facilitate the development of a consensual plan to reorganize the business. The U.S. Trustee appoints and supervises subchapter V trustees and oversees the administration of subchapter V cases. In implementing the SBRA, the USTP recruited, vetted and trained approximately 250 selectees from more than 3,000 applicants. The subchapter V trustees were selected for various pools from which they are appointed on a case-by-case basis. The selected trustees have a strong business acumen and include lawyers, CPAs, MBAs, restructuring consultants and financial advisors with diverse backgrounds in such areas as business, law, accounting, turnaround management and mediation.

The USTP developed a comprehensive handbook to guide subchapter V trustees in carrying out their SBRA responsibilities.⁵ Immediately following appointment in a case, subchapter V trustees begin their primary pre-confirmation task of facilitating the development of a consensual reorganization plan

¹ **Nancy J. Gargula**, U.S. Trustee for Regions 10 and 21, contributed to this article.

² See Ed Flynn, "Subchapter V's First 1,000 Cases," XXXIX *ABI Journal* 11, 30-31, 42-43, November 2020, available at abi.org/abi-journal (unless otherwise specified, all links in this article were last visited on Dec. 1, 2020).

³ The Coronavirus Aid, Relief and Economic Security Act of 2020 (CARES Act) temporarily raised the debt ceiling to \$7.5 million for cases filed between March 27, 2020, and March 26, 2021.

⁴ The court may extend this deadline when the "need for the extension is attributable to circumstances for which the debtor should not justly be held accountable." 11 U.S.C. § 1189.

⁵ *Handbook for Small Business Chapter 11 Subchapter V Trustees*, U.S. Dep't of Justice, available at justice.gov/ust/private-trustee-handbooks-reference-materials/chapter-11-subchapter-v-handbooks-reference-materials.

by participating in both the USTP's initial debtor interview and the § 341 meeting of creditors. As anticipated, subchapter V trustees generally have not needed to hire professionals, which has helped to reduce the cost to debtors and increase recoveries to creditors.

Unlike compensation for chapter 7 panel trustees or standing chapter 12 and 13 trustees, subchapter V case trustee compensation is not based on case disbursements⁶ or plan payments. Instead, subchapter V trustees must apply for fees and expenses pursuant to § 330 of the Bankruptcy Code. Accordingly, all fees must be reasonable and necessary under the circumstances of the case, and all expenses must be actual and necessary. Subchapter V trustees understand that they need to manage their time and control costs in the cases to which they are appointed. In fact, when appointed, they must file an affidavit with the court disclosing their proposed arrangement for compensation, so all parties are fully informed.

After completing their service in a case, subchapter V trustees file a final report stating whether they have administered assets (generally, the debtor remains in possession and the trustee will not administer assets, unless the court orders otherwise) or have served as the plan-disbursing agent. Typically, where a consensual plan is developed and confirmed, the trustee does not serve as the disbursing agent and will file the final report after substantial consummation of the confirmed plan. When a nonconsensual plan is confirmed, the trustee will usually act as the plan-disbursing agent and the final report will include an accounting for funds that the trustee handled and disbursed throughout the case. Subchapter V trustees also submit monthly reports to the USTP that provide detailed financial information on their assigned cases.

Preparing for any new law is a significant undertaking, especially one that brought as many changes as the SBRA. The USTP is fortunate to have been able to work cooperatively and collaboratively with key stakeholders and its partners in the bankruptcy community to meet this important mandate.

SBRA Trends

Once implementation was complete and the law became effective, two major questions remained: How many filers would use the new law, and would the SBRA work as Congress intended? We can say — without a doubt — that subchapter V has proven to be popular and is showing signs of success.

Overall Filing Trends

From Feb. 19 through Sept. 30, 2020, approximately 1,100 small business debtors in USTP districts elected to proceed under subchapter V. This total includes more than 100 cases — many originally filed prior to the SBRA's effective date — that amended into subchapter V. Over three-quarters of all small business chapter 11 debtors since the SBRA's enactment are proceeding under subchapter V, and this percentage has been fairly stable. Use of subchapter V has been widespread geographically, with subchapter V fil-

ings in every USTP region and all but one USTP field office. More than two-thirds of subchapter V filings have been by business entities, with the remainder filed by individuals who operate a business.

Indicia of SBRA's Success: Higher Plan Confirmation Rates, Speedier Plan Confirmation, More Consensual Plans and Improved Cost-Effectiveness

By analyzing the subchapter V trustees' monthly reports and information from other sources on a subset of the 625 cases that were filed under or amended into subchapter V through June 30, 2020, the USTP can begin to answer some of the questions posed in the recent *ABI Journal* article.⁷ The indicia noted herein are based on the status of these cases as of September 2020, and the early results are promising.

Preparing for any new law is a significant undertaking, especially one that brought as many changes as the SBRA.

One indicator that the SBRA is working as Congress intended is the percentage of cases with confirmed plans. More than 100 cases in the group, or nearly 20 percent, had confirmed plans. This is six times higher than the percentage of confirmed plans for small business cases that did not proceed under subchapter V during the same time frame. About 7 percent of the total cases amended out of subchapter V, often following a determination by the USTP that the debtor was ineligible to proceed under subchapter V. Of those that had not amended out of subchapter V, about 15 percent were converted or dismissed. Anecdotal reports suggest that some of these cases were successful because the subchapter V trustee facilitated a consensual resolution with parties who decided that they could resolve matters outside of bankruptcy court.

A closely related indicator of success is how long it takes from case filing to confirmation. Early indications are that subchapter V cases are confirming more quickly than other small business cases not proceeding under subchapter V. Although it is too early to determine an average time to confirmation, so far there are more subchapter V cases confirming in a short amount of time compared to similar small business cases that did not proceed under subchapter V. Already, around 40 of the subchapter V cases in the group (or 20, if factoring out a large group of related cases) had plans confirmed within 120 days. By comparison, none of the non-SBRA small business cases had a plan confirmed within 120 days during the same period, and only about 10 small business cases per year on average had plans confirmed within 120 days over the past three years.

Success also can be measured by how many reorganization plans are consensually confirmed. Thus far, the majority of the plans that were confirmed — more than 60 percent (or 80 percent, if factoring out a large group of related cases that had a nonconsensual plan confirmed) — were consensual.

⁶ SBRA-conforming amendments specifically make 11 U.S.C. § 326(a) inapplicable to subchapter V cases, which precludes determining compensation based on disbursements.

⁷ Flynn, *supra* n.2.

This is an encouraging statistic, because it suggests that the subchapter V trustees are successfully resolving confirmation disputes.

Finally, although there is not yet sufficient data to determine conclusively whether the law has affected fees, both anecdotally and from our own observations, the subchapter V trustees are resolving disputes prior to litigation, which should further reduce or eliminate unnecessary costs.

Conclusion

The SBRA was enacted to assist small business owners with a more efficient and economical path to reorganization. By all current measures, it appears that the SBRA is working as Congress intended. The USTP remains dedicated to supporting the SBRA and will continue to monitor its progress, analyze case data and make adjustments as appropriate to ensure that the mandates of the new law can continue to be carried out successfully. **abi**

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