

Section 101(51D)

A Benefit or Burden for Small-Business Debtors?

by Lynn L. Tavenner

A basic goal of Chapter 11 of the Bankruptcy Code¹ is to rehabilitate and reorganize the business debtor through a confirmed plan voted on and approved by a majority of creditors. Yet, more and more Chapter 11 debtors never achieve such rehabilitation. Instead, their assets are sold via the bankruptcy process and, as Douglas M. Foley writes beginning on page 49, recent jurisprudence has focused on the parties' relative rights in such alternative scenarios — especially in larger cases. There are many small businesses, however, that still hold out hope for a successful reorganization of their debts so that a viable entity is preserved at the end of the day. When Congress overhauled the Bankruptcy Code in 2005², it attempted to add small-business provisions whereby a company fitting within the definition could achieve a successful reorganization through a quicker and more streamlined time frame. While the process has proven more unwieldy than likely contemplated, if properly planned and professionally guided, the small-business provisions can be a useful tool.

Section 101(51C) of the Bankruptcy Code defines a small-business case as “a case filed under chapter 11 of this title in which the debtor is a small business debtor.” The term “small business debtor” is defined at § 101(51D) as:

(A) Subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning or operating real

property or activities incidental thereto) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the petition or the date of the order for relief in an amount not more than \$2,190,000 (excluding debts owed to 1 or more affiliates or insiders) for a case in which the United States trustee has not appointed under section 1102(a)(1) a committee of unsecured creditors or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor; and (B) does not include any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than \$2,190,000 (excluding debt owed to 1 or more affiliates or insiders).

For purposes of this article, the term “small business” is defined above. While there remains sparse case authority on this new process, the Bankruptcy Code itself provides a road map to obtain a relatively quick reorganization for a small-business debtor as long as the practitioner is careful to follow the map. While the concepts for the small-business provisions are admirable, the specific language of the relevant code sections has made the implementation somewhat unwieldy. This article will identify certain issues and suggest practical solutions for guiding a small business through a Chapter 11 reorganization.

Reporting Requirements

Reporting requirements are elevated for small-business debtors. The Office of the United States Trustee (UST) is a branch of the U.S. Department of Justice and is charged with oversight of the bankruptcy system. In such capacity the UST reviews required reporting of all debtors-in-possession. Such reports are increased for small-business debtors — presumably under the theory that there will be no Official Committee of Unsecured Creditors (as discussed hereafter) to assist in oversight, and the case will proceed with quicker pace

than other Chapter 11 cases—so that the UST, the court, and others will have the information readily available. The Bankruptcy Code delineates the specific additional reporting requirements, and other duties for the trustee or the debtor-in-possession of a small business. For example, Bankruptcy Code § 308 establishes reporting requirements for a small business such as periodic reports detailing its profitability, projected cash receipts and disbursements, comparison of actual receipts and disbursements to its earlier projections, and statements concerning compliance with bankruptcy rules, tax requirements and other obligations. Furthermore, pursuant to 11 U.S.C. § 1116:

[I]n a Small Business case, a trustee or the debtor-in-possession, in addition to the duties provided in this title and as otherwise required by law, shall —

(1) append to the voluntary petition or, in an involuntary file not later than 7 days after the date of the order for relief —

(A) its most recent balance sheet, statement of operations, cash-flow statement, and Federal income tax return; or

(B) a statement made under penalty of perjury that no balance sheet, statement of operations, or cash-flow statement has been prepared and no Federal tax return has been filed;

(2) attend, through its senior management personnel and counsel, meetings scheduled by the court or the United States trustee, including initial debtor interviews, scheduling conferences, and meetings of creditors convened under section 341 unless the court, after notice and a hearing, waives that requirement upon finding of extraordinary and compelling circumstances;

(3) timely file all schedules and statements of financial affairs, unless the court, after notice and a hearing, grants an extension, which shall not extend such time period to a date later than 30 days after the date of the order for relief, absent extraordinary and compelling circumstances;

(4) file all postpetition financial and other reports required by the Federal Rules of Bankruptcy Procedure or by local rule of the district court;

(5) subject to section 363 (c)(2), maintain insurance customary and appropriated to the industry;

(6) (A) timely file tax returns and other required government filings; and

(B) subject to section 363 (c)(2), timely pay all taxes entitled to administrative expense priority except those being contested by appropriate proceedings being diligently prosecuted; and

(7) allow the United States trustee, or a designated representative of the United States trustee, to inspect the debtor's business premises, books, and records at reasonable times, after reasonable prior written notice, unless notice is waived by the debtor.³

While at first blush it might seem that these additional reporting requirements will make Chapter 11 cost prohibitive for small businesses, Chapter 11 is not a free pass for any debtor. Practically speaking, any small-business debtor that seriously desires to reorganize under Chapter 11 should be in a position to comply with these requirements. If it cannot do so, then such debtor likely would have had a difficult time achieving confirmation even before the enactment of the small-business provisions of the Bankruptcy Code.

Plan Issues

Under the Bankruptcy Code, a small business has unique issues related to its plan of reorganization in terms of exclusivity, disclosure and solicitation,

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and confirmation. First, a small business has different exclusivity periods for the filing and solicitation of a plan of reorganization. Specifically, § 1121 provides:

(e) In a small business case —

(1) only the debtor may file a plan until after 180 days after the date of the order for relief, unless that period is —

(A) extended as provided by this subsection, after notice and a hearing; or

(B) the court, for cause, orders otherwise;

It is imperative that the small-business debtor (and its counsel) be aware of the deadlines.

(2) the plan and a disclosure statement (if any) shall be filed not later than 300 days after the date of the order for relief; and

(3) the time periods specified in paragraphs (1) and (2), and the time fixed in section 1129(e) within which the plan shall be confirmed, may be extended only if—

(A) the debtor, after providing notice to parties in interest (including the United States trustee), demonstrates by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time;

(B) a new deadline is imposed at the time the extension is granted; and

(C) the order extending time is signed before the existing deadline has expired.⁴

On the front end, a small-business debtor has 180 days (as opposed to the traditional 120 days) for exclusivity, with extensions available up to 300 days. But it should move forward with diligence. Specifically, while a small business may have unique exclusivity, it also has specific deadlines that counsel must be cognizant of and operate within—the 300th day appears from the Bankruptcy Code to be a drop-dead date for the debtor (not others) to file a plan. It remains

to be seen from a judicial perspective in bankruptcy courts in Virginia what will happen if a small business does not perform within the delineated parameters. It could be that the debtor is out of luck if it misses these deadlines, and a disgruntled creditor might suggest that such action constitutes cause to convert or dismiss the case pursuant to § 1112 of the Bankruptcy Code. Therefore, it is imperative that the small-business debtor (and its counsel) be aware of the deadlines.

The Bankruptcy Code provides additional disclosure and solicitation alternatives to a small business. Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), conditional approval of a disclosure statement in a small-business case was the extent of available relief. As we may recall from our pre-BAPCPA practice, after the court conditionally approved a disclosure statement, the debtor solicited acceptances or rejections of the plan by mailing a copy of the conditionally approved disclosure statement. Thereafter, the court held a combined hearing on the plan and the disclosure statement. BAPCPA provides more flexibility to this process. For example, pursuant to Code § 1125(f) a court may now conclude that the plan itself provides adequate information; thus, the need to file a separate disclosure statement is eliminated. A court may also now approve a form disclosure statement. And BAPCPA preserves a court's ability to conditionally approve a disclosure statement and combine the disclosure statement and plan confirmation hearings.⁵ These additional disclosure and solicitation alternatives for a small business could significantly reduce the traditional costs of the plan solicitation process. Counsel should take advantage of these options.

In addition to the solicitation alternatives, BAPCPA has changed confirmation deadlines for a small business. Specifically, pursuant to § 1129(e), a timely filed plan of a small business must be confirmed with forty-five days of filing. This period may be extended if, after having given requisite notice, the movant demonstrates by a preponderance of the evidence that it is more likely than not the court will confirm a plan within a reasonable time.⁶ Given the short window, a small-business debtor arguably should file a motion to extend the time for plan confirmation beyond the forty-five day period along with the plan and disclosure statement. This is especially true given that § 1121(e)(3)(c) provides that

the order extending time must be signed before the expiration of the existing deadline.⁷

Cost Issues

While Congress attempted to reduce the expense associated with a small-business reorganization through the streamlined process, the jury is still out on whether this goal was achieved. There has been little empirical evidence collected to date. From a legal fee perspective the costs remain — but hopefully only for a compressed period of time (and at an amount no greater than those arising in a similar non-small-business case for the same time period). In addition to legal fees, the small-business debtor still has to pay UST fees under the same scale as other debtors.

Furthermore, there is no discount on the required filing fee. Accordingly, the small business debtor should be prepared for significant reorganization costs; however, in many instances, achieving a successful reorganization could be well worth the costs.

One potential area for cost reduction relates to creditor committees. Pursuant to § 1102(a)(1), the UST “shall appoint a committee of creditors holding unsecured claims” to assist in the oversight of the case. However, pursuant to § 1102(a)(3), “[o]n request of a party in interest in a case in which the debtor is a small-business debtor and for cause, the court may order that a committee of creditors not be appointed.” The Bankruptcy Code does not define cause. Furthermore, there is little if any published case law on the issue. However, some small-business debtors have been proactive at the inception of the case and requested the court to find cause to not appoint an official committee.

Indeed, there is precedent in the Eastern District of Virginia for the court to find cause to not appoint a creditors committee in a small-business case. While “cause” is not defined in the Bankruptcy Code, and the legislative history does not provide assistance in developing a definition, cause has been found to not appoint a committee for the following reasons: not in the best interests of the debtors’ estates, creditors, and parties in interest; the administrative costs resulting from appointment of an unsecured creditors committee will necessarily be disproportionate to the claims pool that such a committee represents; the financial burden on the debtors’ estates caused by the appointment of a committee of unsecured creditors greatly outweighs any benefit; and appointment will serve only to dilute recoveries for unsecured creditors.⁸ While each case is certainly fact-specific, practitioners should consider

whether their small-business debtor can establish the same type of “cause” to have the court enter a similar order.

Conclusion

The foregoing does not constitute an exhaustive list of all Bankruptcy Code provisions that affect small businesses, but it does identify major issues that every small-business debtor will likely face and should be prepared to effectively address.⁹ While no Chapter 11 filing or out-of-court restructuring will provide a small business with a fix for a bad business model, lack of financing, or other disreputable business issues, the small business provisions of the Bankruptcy Code to provide a springboard for professionals to assist their clients in obtaining access and effectively utilizing the bankruptcy process.

Endnotes:

- 1 All statutory references are to the Bankruptcy Code, 11 U.S.C. §§ 101, *et seq.* unless otherwise noted.
- 2 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”).
- 3 11 U.S.C. § 1116.
- 4 11 U.S.C. § 1121(e).
- 5 11 U.S.C. § 1125(f).
- 6 11 U.S.C. § 1121(e)(3).
- 7 *See In re Caring Heart Home Health Corp.*, 380 B.R. 908, 910 (Bankr. S.D. Fla. 2008) (noting that the BAPCPA amendments “include a number of traps for the unwary”).
- 8 *See In re Greenbrier Hotel Corp.*, No 09-31703-KRH (Bankr. E.D. Va. March 20, 2009) (Order Granting Motion of the Debtors for Entry of an Order Finding Cause to Not Appoint a Committee of Unsecured Creditors Pursuant to Bankruptcy Code § 1102(A)(3)), in which Judge Kevin R. Huennkens found cause to order the UST not to appoint a committee).
- 9 For additional information on this topic, *see Chapter 11 Bankruptcy for Small Businesses: The Good, the Bad and the Ugly*, Beran, P. and Tavenner, L., Virginia CLE Program, July 16, 2009.