

**REVISED TESTIMONY OF A. THOMAS SMALL
ON BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE**

The written testimony on behalf of the National Bankruptcy Conference was prepared before the introduction of the Small Business Reorganization Act of 2019, H.R. 3311. The Small Business Reorganization Act of 2019 incorporates, with a few modifications, the most important features of the National Bankruptcy Conference's small business bankruptcy reorganization proposal. The original written testimony referred to sections of subchapter V as proposed by the Conference and this revised version refers to sections of subchapter V as they appear in H.R. 3311. The revised testimony also identifies several significant differences between the Conference proposal and H.R. 3311.

Bankruptcy professionals have known for decades that chapter 11 does not work well for small business debtors, and in 2009 the National Bankruptcy Conference formed a working group to see if there were a better way to reorganize financially troubled small businesses. In 2010 the Conference, a voluntary, non-partisan, not-for-profit organization composed of about 60 of the nation's leading bankruptcy judges, professors and practitioners, proposed that Congress enact a new subchapter (subchapter V) of chapter 11 exclusively for small businesses. In 2018, a second Conference working group reviewed the 2010 proposal and the Conference believes strongly that the proposal, that is the basis of H.R. 3311, would solve the small business reorganization problem. A copy of the Conference's proposal is attached.

[Chapter 11] was designed for large corporations with extensive operations and complex capital structures, not small enterprises that depend critically on the skills of a single owner-manager and family members. The model for Chapter 11 was the publicly-traded manufacturer, not the local diner. As a result, many distressed small businesses are forced to wind down using antiquated state-law procedures instead of chapter 11. If they do enter chapter 11, their cases are often dismissed or converted to liquidation.

Report prepared in 2010 by the Small Business Working Group of the National Bankruptcy Conference (the report can be found at the NBC website at www.nationalbankruptcyconference.org).

The NBC report in 2010 concluded that chapter 11 often does not work well for smaller businesses for a number of reasons including that chapter 11 gives secured creditors excessive influence over the process, chapter 11 generates exorbitant administrative costs, and chapter 11 includes requirements such as a high voting threshold and elaborate disclosures. Furthermore, specific "small business debtor" and "individual debtor" obstacles added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 present roadblocks to reorganization.

Subchapter V remedies all of those problems, and provides incentives and procedures to encourage small business debtors and their creditors to arrive at consensual

plans. The “Small Business Reorganization Act of 2019” (S. 1901, H.R. 3311)), incorporates the important aspects of the Conference proposal, and the National Bankruptcy Conference enthusiastically supports that pending legislation. References in this revised testimony to sections of subchapter V are to sections in S. 1901 and H.R. 3311.

Summary of Subchapter V

The Small Business Reorganization Act of 2019 would create a new subchapter of chapter 11 for the reorganization of a small business debtor [as defined in Bankruptcy Code § 101(51D) and which among other requirements provides that the debtor be engaged in commercial or business activities, and that the debtor have aggregate noncontingent, liquidated, secured, and unsecured debts as of the date of the order for relief in an amount equal to not more than \$2,725,625 (excluding debts owed to 1 or more affiliates or insiders)]. § 1182(1).

The subchapter is voluntary, and the election procedure is left to the Bankruptcy Rules. H.R. 3311 § 4(a)(2)(B).

There will be a standing trustee in every subchapter V case who will perform duties similar to those performed by a chapter 12 or chapter 13 trustee. § 1183. The small business debtor will be a debtor in possession. §§ 1182(2) and 1184. A debtor in possession could be removed “for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor.” § 1185.

Only the subchapter V small business debtor may file a plan, and the case will be on a fast track. § 1189. The debtor must file a plan within 90 days after the order for relief, but that time may be extended. §1189(b). A status conference is required in every subchapter V case. § 1188.

Unless the court for cause orders otherwise, there will be no creditors’ committee and no disclosure statement. § 1181(b). Although there will not be a disclosure statement in most subchapter V cases, each subchapter V plan must include “a brief history of the business operations of the debtor, a liquidation analysis, and projections with respect to the ability of the debtor to make payments under the proposed plan of reorganization.” § 1190.

A small business debtor in subchapter V is required to make the same disclosures that a small business debtor is required to make under Bankruptcy Code § 1116. § 1187(a) and (b). Additionally, a small business debtor in subchapter V must file the periodic reports that a small business debtor is required to file under Bankruptcy Code § 308. § 1187(b).

There are two ways to have a plan confirmed under subchapter V - consensually under § 1191(a) or nonconsensually under § 1191(b).

To have a consensual plan under § 1191(a), all the requirements of § 1129(a), other than § 1129(a)(15) [special disposable income requirements for individual chapter 11 debtors], must be met, including the high voting requirements of § 1126.

If a consensual plan is confirmed under §1191(a), the trustee's service is terminated upon "substantial consummation." § 1183(c). Also, if a consensual plan is confirmed under §1191(a), the debtor receives a discharge at confirmation under § 1141(d).

If a consensual plan is not confirmed under § 1191(a), the debtor may seek a non-consensual confirmation under § 1191(b). Confirmation under § 1191(b) requires that all of the requirements of § 1129(a) be met other than § 1129(a)(8), (10) and (15). Additionally, the plan must "not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and had not accepted the plan." §1191(b). The condition that a plan be fair and equitable with respect to a class of secured claims means that the requirements of §1129(b)(2)(A) be met. § 1191(c)(1). The condition that a plan be fair and equitable with respect to each class of claims or interests means "as of the effective date of the plan -- (A) the plan provides that all of the debtor's projected disposable income to be received in the 3-year period, or such longer period not to exceed 5 years as the court may fix, beginning on the date that the first payment is due under the plan will be applied to make payments under the plan; or (B) the value of the property to be distributed under the plan in the 3-year period, or longer period not to exceed 5 years as the court may fix, beginning on the date on which the first distribution is due under the plan is not less than the projected disposable income of the debtor." § 1191(c)(2).

Finally, to be confirmable under § 1191(b), the court must find that the debtor "will be able to make all payments under the plan, or there is a reasonable likelihood that the debtor will be able to make all payments under the plan, and the plan provides appropriate remedies, that may include the liquidation of nonexempt assets, to protect the holders of claims or interests in the event that the payments are not made." §1191(c)(3).

For purposes of §1191(b), "disposable income" means "the income that is received by the debtor and that is not reasonably necessary to be expended -- (1) for (A) the maintenance or support of the debtor or a dependent of the debtor or (B) a domestic support obligation that first becomes payable after the date of the filing of the petition; or (2) for the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor." § 1191(d).

A plan confirmable under § 1191(b), may, notwithstanding §1129(a)(9)(A), provide for payment through the plan of a claim of a kind specified in § 507(a)(2) or (3). § 1191(e).

If a plan is confirmed under § 1191(b) the trustee remains in place until the plan is completed, and the debtor does not receive a discharge until completion of all payments due within the first three years of the plan, or such other longer period not to exceed five

years as the court may fix. § 1192. The debts that are discharged when a plan is confirmed under § 1191(b) are the debts provided for in § 1141(d)(1)(A) and all other debts allowed under § 503 except “any debt -- (1) on which the last payment is due after the first 3 years of the plan, or such other time not to exceed 5 years fixed by the court; or (2) the kind specified in section 523(a) of this title.” § 1192.

Plan modifications are allowed, but a plan confirmed under §1191(a) may not be modified after “substantial consummation.” § 1193(a) and (b). A plan confirmed under § 1191(b) may be modified by the debtor at any time within 3 years, or such longer time not to exceed 5 years as fixed by the court. § 1193(c).

Section 1195 provides that “[n]otwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title, by a debtor solely because such person holds a claim of less than \$5,000 that arose prior to commencement of the case.” § 1195.

The annual compensation of the subchapter V standing trustee and the percentage fee charged would be determined by the United States trustee pursuant to 28 U.S.C. § 586(e). If a plan is confirmed under § 1191(a) and the services of the trustee are terminated upon “substantial consummation,” the court shall award compensation to the trustee “consistent with services performed” and subject to the limits established under 28 U.S.C. § 586(e)(1). The quarterly fees provided in 28 U.S.C. § 1930(a)(6) shall not apply in a subchapter V case.

Incentives for Consensual Plans

Subchapter V provides a number of incentives and procedures for debtors and creditors to arrive at consensual plans. Small business debtors in subchapter V will want to attain confirmation through a consensual plan to avoid 3 to 5 years of trustee supervision and to receive a discharge upon confirmation. Secured creditors will want to arrive at a consensual plan to avoid the possibility of a nonconsensual plan under § 1191(b). One of the standing trustee’s duties is to “facilitate the development of a consensual plan of reorganization,” and one function of the mandatory status conference is “to encourage and facilitate the attainment of a consensual plan of reorganization.” § 1183(b)(7) and § 1188. Status conferences work well in chapter 12 cases and chapter 12 trustees frequently assist family farmers and their creditors in reaching consensual plans.

How is Subchapter V Advantageous to Creditors?

Subchapter V has a number of advantages for creditors. One important advantage is that there will be an impartial independent trustee in every subchapter V case who provides oversight of the debtor’s operations, examines the debtor’s affairs, makes recommendations concerning confirmation of the plan, mediates disputes, facilitates a consensual plan, and, if a plan is confirmed under § 1191(b), monitor’s compliance.

Subchapter V cases will move fast and debtors will not languish in chapter 11. Small business debtors with no prospect of reorganization will be identified early, and their cases will be converted or dismissed. Plans that are confirmed under § 1191(b) may contain remedies, such as the liquidation of nonexempt assets, if the small business debtor defaults in payments under the plan. Consensual plans confirmed under § 1191(a) may contain provisions for a standby trustee or for a third party to monitor a debtor's compliance with the plan. Also, the debtor is required to file the same information and periodic reports required of any small business debtor.

Subchapter V gives the debtor a fair and better chance to reorganize, and by preserving the going concern value of the debtor's assets the value of secured creditors' collateral is maintained. Reorganization also provides unsecured creditors a better chance of receiving distributions on their claims.

Some creditors contend that subchapter V does away with the absolute priority rule, but that is not correct. Secured claims are subject to exactly the same absolute priority rule in subchapter V as they are in current chapter 11. A nonconsensual plan can be "crammed down" over the dissent of secured lenders only if the plan satisfies § 1129(b)(2)(A), which is precisely the same standard applied in current chapter 11 cases.

It is true that subchapter V modifies the absolute priority rule in § 1129 with respect to unsecured claims, but does not do away with the rule. Subchapter V instead adopts the alternative absolute priority currently applied in chapter 12, chapter 13, and individual chapter 11 cases. In all of these cases, unsecured creditors are entitled to be paid from the debtor's disposable income over a period of time.

Subchapter V Advantages for Small Businesses

A subchapter V case will move fast and that alone will reduce costs. Furthermore, the case will be less expensive because there will most likely be no disclosure statement and no creditors' committee. Small business debtors will also be able to pay costs of administration through the plan rather than in full at confirmation.

Several confirmation obstacles are also removed, an alternate absolute priority rule will apply with respect to unsecured creditors, and the owners of the small business debtor will be able to retain their ownership interests.

Some small business debtors may not be able to file a plan within 90 days, but a small business debtor that cannot meet the 90-day plan filing requirement can request an extension. The standard for granting an extension under § 1189(b) ("if the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable"), is the same as the standard in § 1221 in chapter 12 cases, and is a less onerous standard than "small business debtors" must meet under § 1121(e) ("preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time") in chapter 11.

Subchapter V is a voluntary chapter, and if a debtor does not believe it can be reorganized on the fast track, or doesn't want the scrutiny of a trustee, the debtor is not compelled to elect to be a small business debtor under subchapter V.

Differences Between NBC's Subchapter V Proposal and H.R. 3311

The National Bankruptcy Conference's proposal provides that a "small business enterprise debtor" may elect to be a debtor under subchapter V. A "small business enterprise debtor" as defined in NBC proposal § 1183(1) is different than a "small business debtor" defined in Bankruptcy Code § 101(51D) (as amended by H.R. 3311). The primary difference between a "small business enterprise debtor" as defined in the NBC proposal and a small business debtor defined in Bankruptcy Code § 101(51D) (as amended by H.R. 3311) is that a "small business enterprise debtor" may not have noncontingent, liquidated, secured, and unsecured debts as of the date of the order for relief in an amount equal to not more than \$7,500,00 (excluding debts owed to 1 or more affiliates or insiders) and a "small business debtor" may not have noncontingent, liquidated, secured, and unsecured debts as of the date of the order for relief in an amount equal to not more than \$2,725,625 (excluding debts owed to 1 or more affiliates or insiders).

Another important difference between the National Bankruptcy Conference's proposal and H.R. 3311 is that the NBC proposal, while retaining chapter 11's high voting requirements of Bankruptcy Code § 1126, changes the voting procedure to allow small business debtors to more easily obtain the affirmative votes of apathetic creditors. NBC recommends changing the voting procedure in a subchapter V case so that "a holder of a claim or interest shall be deemed to have accepted a plan, if the holder fails to file a timely ballot after being notified by the small business enterprise debtor of (1) the treatment that such holder will receive under the proposed plan; and (2) the consequence under this section of the failure by the holder to file a timely ballot." NBC proposal § 1191.

Conclusion

The Small Business Reorganization Act of 2019 retains most of chapter 11's requirements and provisions, but also incorporates some of the features of chapter 12 that have worked so well for family farmers and fishermen. The National Bankruptcy Conference strongly supports The Small Business Reorganization Act of 2019 and believes that it would provide much needed relief for thousands of financially distressed small businesses to the benefit of their owners, creditors, suppliers, customers, employees and the economy as a whole.