



September 2020

A Publication of The Commercial Collection Corp. of NY, Inc.

## **Understanding the Small Business Reorganization Act** (SBRA)

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The Small Business Reorganization Act (SBRA) was signed into law in August 2019 and took effect in February 2020. This Act is a way to allow small businesses to file for the protection of a Chapter 11 Bankruptcy, but in a quicker and much less expensive way. Traditional Chapter 11's were deemed too expensive and complex for small businesses hoping to successfully reorganize and continue operations.

In the original version of the SBRA, the qualifying debt level of a debtor was not to exceed \$2.7 million dollars. With the recent passage of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) in March 2020, it raised the maximum qualifying debt limit of the SBRA to \$7.5 million dollars. It is estimated that 80%-85% of all debtor's would qualify for this protection. The increase of the maximum qualifying debt limit of \$7.5 million dollars provided by the CARES Act is set to expire on March 27, 2021. The modifications put into place by the CARES Act were intended to help small businesses weather the economic storm caused by COVID-19.

There are a number of differences between an SBRA Chapter 11 and a traditional Chapter 11 Bankruptcy. Below are several examples of these modifications.

- No public entity can file for protection under the SBRA.
- A minimum of 50% of debt included in the SBRA must arise from commercial or business activities.
- There is no provision for a creditor's committee.
- Appointment of a Standing Chapter 11 Trustee with Some Oversight Authority to assist in the facilitation and Follow-Through of a Chapter 11 Plan. However, the Trustee does not have as much operational control over the operations of the debtor business as compared to a traditional Chapter 11 Bankruptcy.
- The debtor has the exclusive right to file a plan of reorganization.
- These reorganization plans (also called repayment plans) have a filing deadline of 90 days from the date the SBRA was originally filed.
  - o The court may extend the 90 day period if the need for the extension is attributable to circumstances beyond the control of the Small Business Debtor.
- The Plan Shall Include:
  - o A brief history of the operations of the debtor.
  - o A Liquidation Analysis.
  - o Projections showing the ability of the debtor to make payments under the plan.

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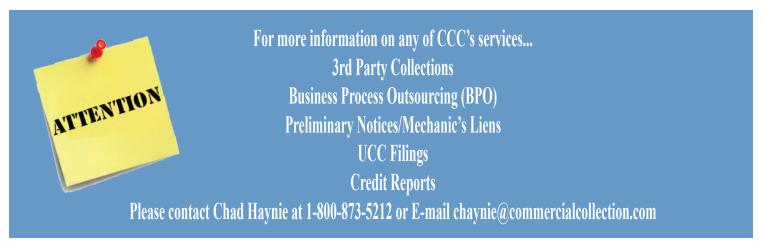




- The Plan Shall Provide:
  - o For the submission of all or such portion of future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan.
- A reorganization plan filed by the debtor needs to be approved by the court, but can be approved without any approval of creditors.
- Repayment plans range between 3 to 5 years.
- The debtor's owner keeps 100% of its ownership interest (equity in all assets) as long as the plan is comprised of all disposable income during the term of the plan. Disposable income is the excess of the current monthly income that is not necessary to keep business operations running.
  - o CARES Act payments are excluded from the definition of "current monthly income."
- A Small Business Debtor and its affiliates may file Small Business Chapter 11's, as long as the combined total of the debts of all debtors does not exceed \$7.5 million.
- Personal guarantors are insiders that can be considered affiliates under the SBRA and may file Chapter 11's under these provisions.
  Guarantors who file Chapter 11 under these provisions of the SBRA are protected from enforcement. Guarantors who do not file personally are not protected from enforcement.
- Administrative Expense claims can be paid over the life of the repayment plan, in contrast to confirmation requirement to be paid in full in a traditional Chapter 11.
  - o These Administrative Expense claims include creditors that continue to do business with the debtor on a post-petition basis. These receivables are subject to being paid out over the 3-5 year repayment plan period.
- Once a payment plan is confirmed, debtors can fully fund a plan (through borrowed funds, loan, etc...) and pay creditors in full of the court approved amount and receive a discharge. Hypothetically, fully funded SBRA filings can provide the debtor a discharge within 30 days of the filing date.

The CARES Act amended the SBRA by adding a due diligence requirement to Section 547(b) requiring a debtor or trustee to conduct reasonable due diligence to determine affirmative defenses to preferences prior to commencing action. However, once an action is commenced, preference defendants still retain the burden of proving preference defenses.

While the SBRA and its modifications were enacted into law to protect small businesses, creditors need to keep a closer eye on their A/R. The temporary increase of the maximum debt limit, overall lower expense, and quicker finalization, will make filing an SBRA Chapter 11 an easy avenue for some debtors to pursue.



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