

CHAPTER 11 - 101 THE NUTS AND BOLTS OF CHAPTER 11 PRACTICE: A PRIMER

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Small Business Provisions

Editors' Note: *This is the fifteenth of 22 installments that are being published here, with permission from the American Bankruptcy Institute. The series, read consecutively, will give the reader a broad overview of the Chapter 11 bankruptcy process. The installments are chapters from a CD-Rom that is available for purchase for \$50 (\$20 to ABI members) through the ABI. For more information, you can call the ABI at (703) 739-0800 or go to www.abiworld.org. The authors welcome your comments and questions as well, and you may feel free to contact them. Jonathan Friedland is a member of the ABI Board of Directors as well as a member of NACM Oregon.*

One of the things about Chapter 11 that presents itself in many contexts in practice is the fact that it is a “one-size fits all” statute: for the most part, the same exact Bankruptcy Code sections, Rules, and case law applies to Betty & Veronica’s Bake Shop as to J.P. Dithers & Company. This comes up all the time: for example, a motion to extend a deadline, like exclusivity, is common in large cases and is often granted, since the time limits that the Code provides as defaults often cannot accommodate the realities of the large case. There are, however, some Bankruptcy Code sections that address the particular needs of smaller cases.

These provisions impose deadlines and reporting requirements that may be burdensome. However, they also contain provisions that may make it easier and more cost effective for smaller companies to obtain the benefits of Chapter 11, in part by expediting the plan confirmation process and by instilling some rigor and discipline to prevent the case from losing momentum and bogging down in the swamp that Chapter 11 can become.

BAPCPA added or amended many sections dealing with small business debtors. These include:

§§ 101(51)(C) and (D); 308; 1116; 1125(f); 1121(d) and (e); 1129(e); and 362(n).

“Small Business” Debtors Defined

A small business debtor is a person engaged in commercial or business activities other than owning or operating real estate. See § 101(51)(D). It may not have more than \$2 million in debt, excluding debt to insiders or affiliates. For the DIP to be a “small business debtor,” the UST must not have appointed a Creditors’ Committee or, if a committee has been appointed, it is necessary that the committee not be “sufficiently active and representative to provide effective oversight of the debtor.” FRBP 1020(c). So, a case could be filed with the DIP otherwise meeting the definition of a small business debtor, but the DIP could then fail to qualify for that status when a committee is appointed, and perhaps, could regain the status of a small business debtor if the committee becomes insufficiently active. This potentially shifting status may be a source of confusion and litigation, with its attendant costs.

Initial Interview

The UST has an obligation to conduct initial interviews with small business debtors prior to the Section 341 meeting of creditors. The interview is intended to allow the UST to evaluate the DIP’s viability and to agree upon scheduling in the case. The UST is also given an opportunity at this meeting to advise the debtor of its reporting and filing obligations, which if not met, will result in a motion by the UST for conversion or dismissal.

Duties in Small Business Cases

Section 1116 sets out a list of duties for the trustee or DIP in small business cases:

- (1) the DIP must append to the voluntary petition (or, in an involuntary case, filed not later than seven 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) senior management personnel and counsel must attend meetings scheduled by the court or the United States trustee, including initial interviews, scheduling conferences, and meetings of creditors convened under § 341, subject to waiver of this requirement by the court upon a finding of extraordinary and compelling circumstances;
- (3) the DIP must timely file all schedules and statements of financial affairs, subject to possible 30-day extension or longer if the court finds extraordinary and compelling circumstances;
- (4) the DIP must file all post-petition financial and other reports required by the FRBP or local rules;
- (5) maintain insurance customary and appropriate to the industry, subject to § 363(c)(2);
- (6) timely file tax returns and other required government filings and timely pay all taxes entitled to administrative expense priority except those being contested by appropriate proceedings; and
- (7) allow the UST, or a designated representative of the UST, to inspect the debtor’s business premises, books, and records at reasonable times, after reasonable prior written notice.

The unexcused failure to meet the reporting requirements of § 1116 is grounds for conversion or dismissal of the case. *See* § 1112(b)(4)(F). It appears that if a DIP misses a reporting deadline and cannot prove a “reasonable justification” for such error,

§ 1112(b)(2)(B)(i), *requires* dismissal or conversion upon motion of any party in interest.

Exclusivity, Disclosure, and Confirmation

In small business cases, the court may determine that the plan contains sufficient information, and, in that event, no disclosure statement is required. *See* § 1125(f)(1). Disclosure statements can also be submitted on standard forms. *See* § 1125(f)(2). Conditional approval is allowed with final approval to be given at the confirmation hearing. *See* § 1125(f)(3)(A). The hearing on approval of the disclosure statement can be combined with the confirmation hearing itself. *See* § 1125(f)(3)(C). These innovations for small business debtors may allow more cost efficient reorganizations.

The period within which the DIP has the exclusive right to file a plan is cut off at 180 days after the order for relief. *See* § 1121(e)(1). A plan and disclosure statement must be filed no later than 300 days after the order for relief. *See* § 1121(e)(2). Both of these deadlines may be extended but only upon a showing “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.” *See* § 1121(e)(3)(A).

In a small business case, the bankruptcy court is to confirm a plan not later than 45 days after the plan is filed if the plan complies with the applicable provisions of the Bankruptcy Code. Like the deadlines for the exclusivity period and the time for filing plans, this time for confirmation of a filed plan can only be extended upon a showing by the debtor that confirmation of a plan is likely to result within a reasonable time period. *See* § 1129(e); *see also* § 1121(e)(3).

The basic approach of the small business provisions is to expedite the process of plan proposal and confirmation. This is a step toward improving efficiency and controlling costs, as is the Bankruptcy Code’s express recognition of the use of standard forms, which implicitly recognize that simple “pot plan” or “earn out” reorganizations for small businesses can (and should) be a commodity practice, like Chapter 7 and 13.

However, other provisions are less obviously beneficial. For example, the definition of “small business” is confusing at best. Further, the reporting requirements and supervisory role of the UST will only

be effective tools if embraced by debtors and their counsel; the UST in most districts is ill-equipped to analyze or scrutinize the reports that the statute requires, particularly if there is a high volume of filings.

It will be interesting to see what the effect of the small business provisions will be. They are likely to be a step in the right direction, but Chapter 11 remains a forum that is inherently unfriendly to small businesses due to the high fixed cost of the process, which does not decrease in direct proportion to the size of the business.

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Watch for next month's issue!