Bankruptcy Code Changes, Part 2: Small Businesses Catch a Break

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Recent amendments to the U.S. Bankruptcy Code will likely increase bankruptcy filings by small businesses and farmers.

Two of the changes in particular will be of high interest to those who work in agriculture and small business lending: the Family Farmer Relief Act of 2019 and the Small Business Reorganization Act of 2019.

This is part 2 of a two-part series dealing with the amendments, looking at the basics of the Small Business Reorganization Act of 2019. To read part 1 of the series on the Family Farmer Relief Act, click here.

For years, small businesses and their owners, as well as their creditors, have struggled to successfully navigate the complexity and costs of a Chapter 11 bankruptcy.

A new amendment in the U.S. Bankruptcy Code could change that.

Effective February 22, the recently passed Small Business Reorganization Act of 2019 will aim to make small business bankruptcies faster and cheaper through the creation of a new subchapter to Chapter 11 of the Bankruptcy Code. This new subchapter will be available generally to small businesses with aggregate, non-contingent, liquidated secured and unsecured debts in an amount of not more than $2,725,625.

Key provisions of the act include providing for the appointment of a standing trustee, streamlining the reorganization process, eliminating the new value rule and allowing for the modification of certain residential mortgages.

A standing trustee appointed in small business cases is expected to facilitate the reorganization and monitor consummation of the plan, much like a Chapter 12 Trustee for farmers. The new subchapter will streamline the process by requiring the small business debtor to file a plan within 90 days and removing creditors' ability to file a plan on behalf of the debtor. The debtor will no longer need to secure approval of a disclosure statement or solicit votes for plan confirmation.

Additional efforts to streamline the process include the elimination of an unsecured creditors committee, unless otherwise ordered by the court. The act also removes the requirement that equity holders in the small business debtor give "new value" to retain their equity when creditors are not paid in full. Rather, a small business debtor's plan must not discriminate unfairly, be fair and equitable, and, like a Chapter 13, devote the debtor's "projected disposal income" to the plan.

The act removes the prohibition against an individual small business debtor's modification of residential mortgages. That allows a small business debtor to modify a mortgage secured by their residence if the loan

was commercial in nature and not used to acquire title to the residence.

The act also makes two amendments to the preference recovery provisions of Section 547 of the Bankruptcy Code. Section 547(b) is amended to add a requirement that the claim asserted by the trustee must be "based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses under subsection (c)." It remains to be seen how proof of the trustee's compliance with this requirement will make its way into the litigation process.

The venue requirement of 28 U.S.C. 1409(b), which forced a trustee to commence small preference cases in the district court for the district where the defendant resides, has been increased to $25,000, capturing more cases. Presumably, this will force trustees to consider the economic utility of filing small preference cases in courts other than the district where the bankruptcy case is pending.

If you have any questions about this new law, please contact Tim Dietrich, Joe Schalk or any member of the Barley Snyder Finance & Creditors' Rights Practice Group.

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