The *130th* CLLA Annual Convention

Four Years of the SBRA: How is it Working?

Panelists:
Honorable Mary Ann Whipple
U.S. Bankruptcy Court, Northern District of Ohio, Toledo, Ohio
Matthew Brash
Newpoint Advisors Corporation, Chicago, Illinois; Sub V Northern District of Illinois
Beverly Weiss Manne, Esq.
Tucker Arensberg, P.C., Pittsburgh, PA
Zach Shelomith, Esq.
LSS Law, Fort Lauderdale, Florida

1

Panel Description

i. The Small Business Reorganization Act is four years old.
ii. What lessons have we learned?
iii. In the post-COVID world, does Subchapter V work better for small businesses?
iv. How do creditors view the Subchapter V experience?
v. What have Subchapter V trustees learned about their role in a case?
vi. What is working and perhaps not working…so far."

2

2

Legislative history

- Chapter 11 bankruptcy is governed by 11 U.S.C. § 1101 et. seq. enacted in 1978, effective in 1979 and amended multiple times thereafter
- Amendments in 2017 enabled small businesses to elect "small business case" treatment which "simplified" certain provisions of chapter 11
- August 23, 2019, the "Small Business Reorganization Act of 2019" ("SBRA") was signed into law as a new subchapter V of chapter, codified at 11 U.S.C. §§ 1181 – 1195

3

3

Impact of COVID-19
The CARES Act

- Due to the crises faced by business as a result of the COVID-19 pandemic, Congress enacted the ***Coronavirus Aid, Relief, and Economic Security Act*** ("CARES Act") on 3/27/20 which modified, on a temporary basis, the SBRA.
- The SBRA originally defined a "small business debtor" as "a person or entity engaged in commercial or business activity with aggregate secured and unsecured debts of $2,725,625."
- The SBRA debt ceiling increased under the CARES Act, to $7,500,000.
- Bankruptcy Threshold Adjustment And Technical Corrections Act; S. 3823 – 117th Congress: Became law on June 21, 2022, and extended the debt ceiling of $7,500,000 for two years (***sunsets June 2024***).

4

4

Back To The…Norm? Chapter 11/Sub V Stats

- Commercial Chapter 11 filings increased 72% to 6,569 in calendar year 2023
- Subchapter V elections within Chapter 11 increased 45% to 1,939 in calendar year 2023
- Sub V Cases in panelists' states (2023 through November):

  *Florida – 238 *Illinois – 83 *Ohio – 24 *Pennsylvania - 46
- Per EPIQ Bankruptcy expect another increase in 2024 due to:

  -Runoff of pandemic stimulus

  -Increased cost of funds

  -Higher interest rates

  -Rising delinquency rates

  -Near historic levels of household debt

5

5

The SBRA Trustee

- §1183(a) provides for appointment of a standing trustee by the UST or if there is no standing trustee a trustee in *every* case.
- Trustee will provide to the UST a "verified statement" that they are disinterested, stating their rate of compensation and accepting the appointment.
- Not an operational trustee and only operates the debtor's business if the debtor is removed as a DIP.

6

6

The SBRA Trustee Continued...

- Trustee's service terminates upon substantial consummation of a consensual plan under §1191(a) unless reappointed by U.S.-Trustee to modify a plan after confirmation or if debtor is removed as DIP.
- If plan is confirmed as non-consensual under §1191(b), the Trustee shall make payments under the plan except as otherwise provided in the plan or in the confirmation order.

7

7

The SBRA Trustee §1183(a) (b)

Duties.--The trustee shall--

(1) perform the duties specified in paragraphs (2), (5), (6), (7), and (9) of section 704(a) of this title;

(2) perform the duties specified in paragraphs (3), (4), and (7) of section 1106(a) of this title, if the court, for cause and on request of a party in interest, the trustee, or the United States trustee, so orders;

(3) appear and be heard at the status conference under section 1188 of this title and any hearing that concerns-

(A) the value of property subject to a lien;

(B) confirmation of a plan filed under this subchapter;

(C) modification of the plan after confirmation; or

(D) the sale of property of the estate;

8

8

The SBRA Trustee §1183(a) (b)

Duties.--The trustee shall—

(4) ensure that the debtor commences making timely payments required by a plan confirmed under this subchapter;

(5) if the debtor ceases to be a debtor in possession, perform the duties specified in section 704(a)(8) and paragraphs (1), (2), and (6) of section 1106(a) of this title, including operating the business of the debtor;

(6) if there is a claim for a domestic support obligation with respect to the debtor, perform the duties specified in section 704(c) of this title; and

(7) **facilitate the development of a consensual plan of reorganization.**

9

9

Getting the Sub V Trustee Paid:

Problems faced by a trustee in getting paid: see In re Tri-State Roofing, 2020 WL 7345741, at *1 (Bankr. D. Idaho Dec. 7, 2020):

> The Trustee has not represented that there are any funds held by him to distribute. The Court presumes that because the Trustee is pursuing this award of compensation under § 330 to be allowed as an administrative expense, there is property of the estate still held by the Trustee to permit the distributions described in § 1194. Judge Terry L. Myers has previously held that administrative expense claims are not monetary judgments but rather entitle the claimant to receive a distribution from the bankruptcy estate. In re Soelberg, Case No 15-01355-TLM (Bankr. D. Idaho August 13, 2019) (citing In re 3109, LLC, 2014 WL 1655415 (Bankr. D.C. Apr. 25, 2014)). If there are no funds currently held by the Trustee, it is difficult to understand how this claim would be paid.

10

10

Getting the Sub V Trustee Paid:

Should a Chapter V trustee be able to get a wage attachment? Section 105?

How can a trustee make sure he/she gets paid other than getting the plan confirmed?

Should a cash collateral order contain provisions for debtor's counsel to escrow fees for the trustee fees incurred through confirmation?

11

11

Getting the Sub V Trustee Paid:

- Subchapter V provides that the trustee's fee can be paid "through" debtor's Subchapter V plan, or in many filed plans, on or around the effective date or as soon as reasonably possible.
- There has been several situations in many, if not all, jurisdictions in which the Subchapter V Trustee is not being paid – either due to a case being dismissed or converted; a plan being rejected; a debtor unable to make plan payments or other factors.
- Sub V Trustees are being asked to attend trials / evidentiary hearings, testify to the viability of a plan of reorganization.
- Sub V Trustees are carrying outstanding, unpaid balances up to 6 figures.

12

12

Getting the Sub V Trustee Paid:

How Is it Being Fixed?:

- Sub V's filing motion for a retainer at beginning of case (see In re Roe, 2024 WL 206678; Bankr. D. Ore. Jan 18, 2024)
- Certain jurisdictions are requiring debtors to carve out a monthly payment for the Sub V in their cash collateral budgets
- Debtor's counsel setting aside, as part of their retainer, fees/expenses to cover the Sub V Trustee
- Sub V Trustee's are looking to their respective US Trustee to advocate for local rule changes
- Judges not tolerant of Sub V Trustees NOT getting paid

13

13

The Apathetic Creditor Problem: Confirmation When a Class of Creditors Does Not Vote

- Bankruptcy Court shall confirm a consensual Sub V plan under § 1129(a) if all requirements of § 1129(a) except (a)(15) are met

--All impaired classes must accept the plan, § 129(a)(8), §1191(a)

- But what happens when there are no votes in an Impaired Class, as often occurs with IRS, state taxing agencies and other federal government agencies, among other creditors?

-- Can a plan still be confirmed as a consensual plan, or must it be confirmed as a non-consensual plan under § 1129(b)?

14

14

The Apathetic Creditor Problem: Confirmation When a Class of Creditors Does Not Vote

Alternatives:

1. Non-voting impaired class is deemed to have accepted the plan. Cases so holding generally adopt the reasoning of *In re Ruti Sweetwater*, 836 F.2d 1263 (10th Cir. 1988)(holder of impaired secured claim that did not vote or object to the confirmation would be treated as accepting the plan)

E.g.

In re Jaramillo, 2022 WL 4389292 (Bankr. D.N.M. Sept. 22, 2022)(applying *In re Ruti Sweetwater's* deemed acceptance rule in Subchapter V cases consistent with realities of modern bankruptcy practice for individuals and small businesses; confirmation should not be derailed by non-voting creditors)

In re Robinson, 632 B.R. 208 (Bankr. D. Kan. 2021)(no votes cast on plan; *In re Ruti Sweetwater* binding)

15

15

The Apathetic Creditor Problem: Confirmation When a Class of Creditors Does Not Vote

Alternatives, cont.:

2. Non-voting impaired class is not deemed to have accepted the plan, equating non-voting with rejection. Plan can be confirmed only as non-consensual cramdown plan under Section 1191(b).

E.g. In re Creason, 2023 WL 2190623, (Bankr. W.D. Mich. February 23, 2023)(court rejects *In re Ruti Sweetwater* as non-binding out of circuit precedent that represent minority position, requiring plan to be confirmed as non-consensual)

16

16

The Apathetic Creditor Problem: Confirmation When a Class of Creditors Does Not Vote

Alternatives:

3. Non-voting impaired class is not considered for purposes of evaluating whether proposed Sub V plan meets Section 1129(a)(8) standards for consensual confirmation.

E.g. In re Franco's Paving, LLC, 654 B.R. 107 (Bankr. S.D. Tex. 2023) (Agrees with *In re Ruti Sweetwater* policy choice but rejects binary choice of deemed acceptance or deemed rejection and overrules UST objection to confirmation. For purposes of compliance with Section 1129(a)(8), court relies on Section 1126 and disregards altogether classes of non-voting impaired creditors [IRS and SBA] and confirms plan as consensual.)

17

17

Channeling Injunction / Third Party Release in Sub V Cases

Case Study: Hal Luftig Company, Inc. (U.S. Bankruptcy Court, Southern District of New York; Case No.: 22-11617 (JPM)

The corporate debtor was a notable Broadway producer. An individual was the sole owner and president of the corporate debtor.

Overview: Should the Court grant a non-consensual third-party release to a non-debtor (the Debtor's president and sole shareholder) as part of the confirmation of the Debtor's Small Business Plan of Reorganization

- If the Supreme Court decides in *Purdue* that bankruptcy courts can issue nondebtor, nonconsensual, third-party releases, and if the district court approves the report and recommendation by Bankruptcy Judge John P. Mastando, III, Subchapter V may allow multimillion-dollar releases for the owners of small businesses when the businesses themselves have little other debt.
- An investor claimed it had not received its share of the income from a pair of productions. So, the investor initiated an arbitration against the corporate debtor and the owner. The arbitrator gave the investor an award of $2.9 million against the debtor and the owner, jointly and severally. The district confirmed the award, which was automatically stayed for 30 days.
- Debtor filed its plan and adversary proceeding; Judge entered a preliminary injunction preventing the investor from enforcing the arbitration award against the owner

18

18

Channeling Injunction Issues: Hal Luftig Company, Inc. Continued

The Plan:

- Called for paying about $275,000 in secured and priority claims in full on confirmation.
- Classified the unsecured investor with its $2.9 million claim in a class by itself and provided it would receive a portion of the cash from the owner, plus a share of the debtor's disposable income over the life of the five-year plan.
- Proposed to pay unsecured creditors with about $300,000 in claims a *pro rata* share of the debtor's disposable income for the duration of the plan.
- Provided the owner would receive no distribution but would retain ownership AND the owner would continue working for the debtor while spending half of his time on the debtor's affairs.

The unsecured class voted in favor of the plan, but the investor class voted against the plan, requiring the Judge to consider confirmation as a cramdown under Section 1191(b).

In his November 22 opinion, Judge Mastando found jurisdiction to confirm the plan over objections by the investor and the U.S. Trustee. However, he read the Second Circuit's decision in *In re Purdue Pharma LP*[1], as requiring him to issue a report and recommendation to the district court regarding confirmation of the plan.

Judge Mastando concluded that the plan would be a release of the investor's "direct" claims against the owner.

[1] 69 F.4th 45 (2d Cir. May 30, 2023), *cert. granted sub nom. Harrington v. Purdue Pharma L.P.*, No. (23A87), 2023 WL 5116031 (U.S. Aug. 10, 2023).

19

19

Channeling Injunction / Third Party Releases: Hal Luftig (cont'd)

Findings:

In his 65-page opinion, the Judge proceeded to analyze the seven requisites in *Purdue* for confirmation of a plan with nonconsensual, nondebtor releases of direct claims.

(1) whether there is an identity of interests between the debtors and released third parties, including indemnification relationships, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate

(2) whether claims against the debtor and nondebtor are factually and legally intertwined, including whether the debtors and the released parties share common defenses, insurance coverage, or levels of culpability;

(3) whether the scope of the releases is appropriate such that its breadth is necessary to the plan

(4) whether the releases are essential to the reorganization

(5) whether the non-debtor contributed substantial assets to the reorganization

(6) whether the impacted class of creditors "overwhelmingly" voted in support of the plan with the releases; and

(7) whether the plan provides for the fair payment of enjoined classes

The Court finds that the first, second, fourth, fifth, and seventh *Purdue* factors "unequivocally weigh in favor of approving the Lutfig Release (and the sixth factor is less significant under the present facts)."

20

20

§ 1111(b) Election

Under § 506(a)(1) of the Bankruptcy Code, a secured creditor's claim is secured only to the extent of the collateral's value. Any amount over that value is bifurcated into a separate unsecured claim

If a secured creditor's claim is "nonrecourse" against the debtor, the creditor will not have an allowed unsecured claim for any deficiency after bifurcation. As a result, an undersecured creditor holding a nonrecourse claim could lose a significant portion of its claim (that is, any deficiency) in bankruptcy, particularly where the collateral has lost value or has been undervalued during the bankruptcy case.

§ 1111(b) protects an undersecured creditor's interests in chapter 11. Section 1111(b)(1)(A) grants an undersecured creditor an allowed claim for any deficiency, whether the claim is recourse or not. Section 1111(b)(2), in turn, allows an undersecured creditor to instead "elect" having its entire claim treated as fully secured by the collateral while waiving any deficiency. If an undersecured creditor makes that election, the creditor is entitled "to receive payments with a face value equal to the amount of its claim, the present value of which must at least equal the value of the collateral."

The purpose of § 1111(b) is to protect secured creditors from the potential undervaluing of collateral — whether intentionally by the debtor, under current market conditions or otherwise.

21

21

§ 1111(b) Election

Subchapter V poses several issues to creditors contemplating a § 1111(b) election:

- Declining the election to control the unsecured class and block confirmation is not an available strategy, as subchapter V allows confirmation even if no classes have accepted the plan.
- There is no set deadline for creditors to make a § 1111(b) election in subchapter V.
- Bankruptcy courts have differed as to whether the purposes and policies underlying subchapter V play a role in interpreting the "inconsequential value" exception under § 1111(b)(1)(B)(i). Under that exception, a creditor may not make a § 1111(b) election if the secured creditor's lien "is of inconsequential value . . . ."

22

22

11 U.S.C. § 363 – Sale and Lease of Assets

- A Section 363 sale is a sale of a company's assets pursuant to Section 363 of the Bankruptcy Code. The Bankruptcy Court will approve a 363 sale if the debtor can demonstrate a "substantial business justification" for the sale.
- Defining ordinary and not in the ordinary course of business (e.g. – pushback of collateral)
- If it is in the best interest of the creditors, how does a Subchapter V Trustee advocate for a sale of collateral/assets when the debtor and/or debtor's counsel is against?
- Ensuring what efforts are being made to meet the "commercially reasonable" goal

23

23

Alternatives: When a Debtor Defaults on Payments under Sub V Plan

What happens when a debtor stops paying?

- At times (unfortunately), debtors in Sub V cases are unable to fulfill the obligations of a confirmed plan –due to external or internal forces
- Some Sub V plans are approved knowing full well there is a decent chance that debtor fails, however, the alternative of a liquidation yields almost no recovery, especially for GUCs. Therefore, the creditors are "rolling the dice" on the debtor.
- Some plans require the debtor to refinance; several circumstances in which the refinance falls through; similar to a sale

A confirmed plan's provisions for default and remedies control.

- In a consensual plan, the default provisions are often negotiated with the various creditors that help result in acceptance of the plan.
- In a non-consensual plan § 1191(c)(3)B)(ii) requires that the plan provide appropriate remedies in the event of default "which may include liquidation of nonexempt assets to protect the holders of claims or interests in the event plan payments are not made."

24

24

Alternatives: When a Debtor Defaults on Payments under Sub V Plan

Subchapter V Trustee's role (Communication, Communication, Communication)

- The Sub V should be following up with the debtor/debtor's counsel and creditors as it relates to plan payments, and if tardy, understand and confirm timing for payments to be made; obtain in writing from debtor or debtor's counsel when the payment will be made/received; notate such date and time and follow-up again on established deadline. If no payment is made, take next appropriate steps.
- What is the "cure period." Most plans detail a timeframe in which the debtor has the ability to cure any tardy payments. However, some plans have a 2 or 3 strikes and your out rule.
- Sub V can contact the UST's office and speak with the Trial Attorney for the case, informing them of the situation. Prepare for circumstances in which payment is made, but tardy.

Default Provisions in a Plan

In *In re Pearl Res. LLC*, 622 B.R. 236, at 249 (Bankr. S.D. Tex. 2020), the following default provisions enabled the court to find adequate provision was made so there was compliance with 1191(c)(3)(B):

> the [Disputed] Allowed Claim shall be paid in full on the second-year anniversary of the Effective Date (the "[Disputed] Payment Deadline"). If the Debtors fail to pay the [Disputed] Allowed Claim on or before the [Disputed] Payment Deadline, the Debtors will be required to sell sufficient Garnet State Lease Collateral to pay the [Disputed] Allowed Claim in full. If the Debtors fail to pay the [Disputed] Allowed Claim in full on or before one year from the [Disputed] Payment Deadline, [Disputed Claimant] shall be free to pursue any and all remedies it may have under Texas state law, including foreclosure of its Retained Lien. Upon full payment of [Disputed Claimant's] Allowed Claim, [Disputed Claimant] shall execute and deliver to [**24] the Reorganized Debtors an instrument releasing its Retained Lien in full and for all purposes in a form as required to record in the Pecos County Real Property Records

Default Provisions in a Plan

In re Opulent Vacations, Inc., No. 23-21941 (JTM), 2023 Bankr. LEXIS 2952, at *7-8 (Bankr. D. Utah Dec. 15, 2023) the default provision read as follows:

> All Defaults Cured and Waived; All Notes and Obligations Decelerated and Treated as Set Forth in the Plan. Pursuant to Bankruptcy Code §§ 1123(a)(5)(G) and 1124(2), among others, and except as otherwise expressly provided by the Plan, all defaults that existed or may have existed under any promissory note, loan document, unexpired lease, executory contract, or other written agreement of or by the Debtor shall be deemed cured and waived as of the Effective Date. All notes, instruments, or obligations for which payment obligations were accelerated prepetition and/or pre-confirmation shall be decelerated as of the Effective Date and treated as set forth in the Plan. All judicial and non-judicial foreclosure actions and proceedings that were instituted pre-petition and/or pre-confirmation shall be canceled, terminated, and/or deemed withdrawn and rescinded as of the Effective Date.

27

27

Default Issues – Modify the Plan?

Can the debtor modify the plan? Section 1193 provides, in part:

> (b) Modification after confirmation. If a plan has been confirmed under section 1191(a) of this title [11 USCS § 1191(a)], the debtor may modify the plan at any time after confirmation of the plan and before substantial consummation of the plan, but may not modify the plan so that the plan as modified fails to meet the requirements of sections 1122 and 1123 of this title, with the exception of subsection (a)(8) of such section 1123. The plan, as modified under this subsection, becomes the plan only if circumstances warrant the modification and the court, after notice and a hearing, confirms the plan as modified under section 1191(a) of this title [11 USCS § 1191(a)].
>
> (c) Certain other modifications. If a plan has been confirmed under section 1191(b) of this title, the debtor may modify the plan at any time within 3 years, or such longer time not to exceed 5 years, as fixed by the court, but may not modify the plan so that the plan as modified fails to meet the requirements of section 1191(b) of this title. The plan as modified under this subsection becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan, as modified, under section 1191(b) of this title.

28

28

Default Issues – Relief from Stay?

Consensual Plan: Stay lifted on discharge: if the lien was preserved and default remedies in plan do not apply, creditor can take action to enforce defaults being cautious of the discharge injunction.

Plans often provide the automatic stay will remain in effect until a specified date – usually the effective date of the plan.

Non-consensual Plan:

Per §1192, Debtor does not receive a discharge at confirmation and will not receive a discharge until the end of plan payments. 11 U.S.C. § 1192(a).

While there is no discharge injunction, the automatic stay continues to apply during the plan term. 11 U.S.C. § 362(c)(1)-(2).

Actions to collect debts from estate property /or the debtor continue to be stayed. 11 U.S.C. § 362(a).

> U.S.C.S. § 362
> (c) Except as provided in subsections (d), (e), (f), and (h) of this section—
> (1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate;
> (2) the stay of any other act under subsection (a) of this section continues until the earliest of—
> (A) the time the case is closed;
> (B) the time the case is dismissed; or
> (C) if the case is a case under chapter 7 of this title concerning an individual or a case under chapter 9, 11, 12, or 13 of this title, the time a discharge is granted or denied

29

29

Default Issues – What to do? Dismissal or conversion?

Who has to seek dismissal / conversion?

- If a debtor sees no path forward it would be on them to communicate to their counsel on next steps / action items that will allow for the case to pivot towards a conversion or dismissal. A Sub V trustee should also be communicating with the debtor and debtor's counsel on taking initial steps to conversion, dismissal or other.
- However, debtor's counsel may not take these initial steps and therefore it would be incumbent upon the Sub V trustee or creditor(s) to seek conversion, dismissal or other.
- Creditors should advise their counsel of non-payment and push for a motion to be filed to dismiss or convert (or other).
- Sub V Trustee can ask the UST's office to file a motion to convert or dismiss.

Determining what is in the best interest of creditors?

- Understanding the likely outcome of either a dismissal or conversion; the cost involved; whether having court supervision/oversight is essential for the recovery
- The best outcome for the creditors is usually the more favorable path; Sub V can poll the creditors on how they wish to proceed

30

30

Q & A

31

31

Extra Innings…

October and November 2023 Subchapter V Opinions:

-Reznick v. United States Trustee (In re DA & AR Hospice Care, Inc. (9th Cir. B.A.P. Oct. 20, 2023)

*The Bap upheld the bankruptcy court's determination that debtor's (purported) counsel, Mr. Reznick, knowingly filed a fraudulent Subchapter V case and should be referred to a disciplinary panel (ultimately counsel was suspended for three (3) years).

-Boteilho Haw. Enters. (Bankr. D. Haw. Oct. 24, 2023)

*Liquidation analysis and how it plays into the Sub V debtor paying, at a minimum, the greater of (i) net liquidation value of the estate in a hypothetical Chapter 7 liquidation and (ii) their projected disposable income over 3 to 5 years.

-CYMA Cleaning Contrs., Inc. (Bankr. D.P.R. Oct. 27, 2023)

*Under rule 1020, deadline to object to Sub V designation is 30 days after the conclusion 341 meeting. Deadline expired without an objection but court held that it could *sua sponte* revoke CYMA's designation on the basis that it is a SARE debtor and didn't qualify.

-Hot'z Power Wash, Inc. (Bankr. S.D. Tex. Nov. 7, 2023)

*Similar to *Franco*, the Texas court adopted the reasoning and determined that the subject plan could be consensual under § 1191.

32

32