

BANKRUPTCY ISSUES AS A RESULT OF COVID-19 – SMALL BUSINESS REORGANIZATION ACT AND CARES ACT

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SMALL BUSINESS REORGANIZATION ACT



SMALL BUSINESS REORGANIZATION ACT

- Small Business Reorganization Act of 2009 (SBRA) took effective Feb. 19, 2020.
- Designed to assist small businesses and individuals that qualify for a speedier and less expensive Chapter 11.
- Alternative to traditional Chapter 11 proceedings.
- Only the Debtor can propose a plan.
- Plan must be filed within 90 days of filing bankruptcy.
- No Disclosure Statement required.

SMALL BUSINESS REORGANIZATION ACT (CONT.)

- Confirmation of Plan
 - Plan in SBRA proceeding does not need to obtain the consent of an impaired class of creditors.
 - Plan must not discriminate unfairly and must be fair and equitable to all classes of claims.
 - Debtor must pay all of its disposable projected income to its creditors under a plan for 3 to 5 years.

SMALL BUSINESS REORGANIZATION ACT (CONT.)

- No Absolute Priority Rule
- Administrative claims do not need to be paid in full upon confirmation but can be paid through throughout the Plan term of 3 to 5 years.
- No Unsecured Creditors Committee in a normal case.
- Trustee more akin to a business advisor appointed in each case.

SMALL BUSINESS REORGANIZATION ACT (CONT.)

- Mortgages may be modified unlike in other Chapter 11 cases if the mortgage is not a purchase money security interest and was obtained to fund the business.
- Debt limit of \$2,725,000.00 now increased for cases filed after March 27, 2020 up to \$7.5 million.
- However, increase debt limit expires March 27, 2021.
- No U.S. Trustee quarterly fees
- At least 50% of debt must be business related.

SMALL BUSINESS REORGANIZATION ACT (CONT.)

- Non eligible Debtors include:
 - Public companies or any affiliate of a public company
 - Shopping centers
 - Office buildings
 - Industrial/warehouse buildings
 - Apartment complexes



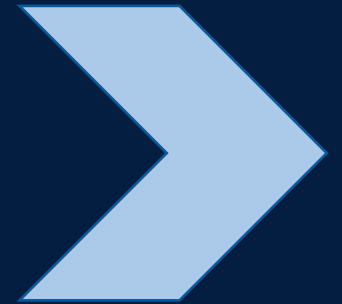
EXPANSION OF SBRA
UNDER CARES ACT



- CARES Act was signed into law on March 27, 2020
 - It redefined “debtor” under Section 1182 of the Bankruptcy Code to remove the reference “small business debtor” and replace with a definition that is totally the same, except for the debt cap which is increased to \$7,500,000.00.
 - The amendment to Section 1182 definition of “debtor”, including the new higher debt cap applies only to cases that are filed on or after March 27, 2020.
 - The definition of debtor, including the debt cap, under Section 1182 will sunset on March 27, 2021.



TROUBLED INDUSTRIES



TROUBLED INDUSTRIES

- Automotive
 - Choppy restart
 - Supply chain links
 - Parts suppliers restarting at different times
 - Mexico shut down until end of May, 2020

TROUBLED INDUSTRIES

- Retail
 - Art Van
 - Modell
 - Pier One
 - JC Penney
 - Neiman Marcus

TROUBLED INDUSTRIES

- Restaurants
 - Craftworks (Logan's Roadhouse)
- Entertainment/Theater
 - AMC
 - VIP Cinema
- Health Care
 - Hospitals

RETROACTIVE EFFECT OF SBRA

- Unlike the CARES Act which is very clear that it does not apply to cases filed before its enactment on March 27, 2020, SBRA is silent on its retroactive effect.
- Most, if not all bankruptcy courts, are allowing Chapter 11 cases filed before February 19, 2020 to be re-designated to a case under Subchapter V.

- In re Deidre Ventura, 8-18-77193-REG, 2020 WL 1867898 (Bankr. E.D.N.Y. Apr. 10, 2020)
 - Debtor is an individual who owns and operates a bed and breakfast at her principal residence.
 - At the Court's suggestion, 15 months after the case was originally filed, the Debtor amended her petition to re-designate the case as a Subchapter V.
 - The secured creditor and the UST each filed an objections to the Debtor's designation under Subchapter V and the amended petition.

- UST argued “procedural issues” and in overruling the UST’s objection Judge Grossman said that requiring compliance “with the procedural requirements of a law that did not exist is the height of absurdity.”
- The secured creditor raised more substantive issues and argued: (i) it had “vested rights” in the case because it had a pending plan and a confirmation date; (ii) the debtor does not qualify as a “small business debtor”; (iii) the debtor should be judicially estopped from amending her petition; and (iv) the mortgage could not be modified under Section 1190(3).

- On the “vested rights” issue, Judge Grossman followed other courts which have found that the re-designation of a typical small business case under SBRA does not impair a creditor’s constitutional or property rights.
- The more difficult question was the debtor’s intention to use Section 1190(3) which allows a small business debtor to modify a mortgage on the debtor’s principal residence if the loan was “(A) not used primarily to acquire the real property; and (B) used primarily in connection with the small business of the debtor.”
- Judge Grossman framed the Section 1190(3) inquiry a little differently, i.e., whether the “primary purpose of the mortgage was to acquire the debtor’s residence.”

- The Court set this issue for evidentiary hearing to determine the application of Section 1190(3), and will use the following factors in that determination:
 - whether the mortgage proceeds were used primarily to further the debtor's business;
 - whether the property was an integral part of the business;
 - the degree to which the property was necessary to run the business;
 - whether customers must enter the property to use the business;
 - Whether the debtor uses employees and other businesses to run the operations.

- In re Progressive Solutions, Inc., 8:18-BK-14277-SC, 2020 WL 975464 (Bankr. C.D. Cal. February 21, 2020)
 - Chapter 11 debtor filed a Motion for Order Authorizing Amendment of Chapter 11 Petition regarding Subchapter V and Extension of Plan Deadline.
 - The UST raised procedural and timing issues related to the IDI, 341 meeting, status conference and report, and plan deadlines. As in Ventura, the court rejected these concerns, and in doing so pointed out that the court can alter these deadlines.

- The Court also considered the due process concerns with re-designating a pending case to a Subchapter 5 case. The Court inquired whether any creditors or parties in interest had any vested rights that would be disturbed by re-designation. No one could identify any such vested rights.
- The Court came to the conclusion that there was no legal reason to deny the debtor's motion to authorize the filing of an amended petition under Subchapter V.
- The Court then denied the motion to amend holding that there was no legal requirement to have the Court grant leave to amend.

- In re Moore Properties of Person County, LLC, 20-80081, 2020 WL 995544,
 - Chapter 11 Petition filed on February 10, 2020. Debtor designated itself as a small business. Bankruptcy Administrator objected to the designation because the Debtor primarily owned and managed real property.
 - 5 days after SBRA became effective, Debtor filed an amended petition, re-designating the case as one under Subchapter V.

- The two issues present in the case were: “(1) may Debtor, whose case was pending on the effective date, elect to proceed under subchapter V of chapter 11; and (2) is Debtor, who did not meet the definition of a small business debtor on the petition date, eligible to proceed under subchapter V when it now meets the definition under SBRA?”
- In analyzing the issues the Court looked to canons of construction contained in Supreme Court precedent.
- Generally, courts should apply the law in effect at the time it renders its decision, but retroactivity is not favored in the law.

- The presumption against retroactivity particularly applied where applying the law retroactively would “defeat vested “traditional property interests.””
- The Court found that the re-designation to Subchapter V “creates none of the taking or retroactivity concerns expressed by the Supreme Court.
- The two changes to Chapter 11 under Subchapter V, which could have changed the analysis were not present in this case. Namely the ability to modify a mortgage in the debtor’s residence if the proceeds of the mortgage were used primarily in the business and the obligation is not purchase money.

- Subchapter V also modifies the requirements under Section 1129(b), but the court found that removal of the requirement that at least one impaired accepting class must vote in favor of the plan does not defeat vested property rights. The plan still cannot unfairly discriminate and must be fair and equitable.
- Subchapter V also replaces the absolute priority rule with the disposable income requirement, but the Court found that the alteration of confirmation by itself does not amount to an impermissible taking.
- If the case had been in Chapter 11 longer, the ruling may have been different.



CARES ACT AMENDMENTS



CARES ACT SEC. 1113 AMENDED THE BANKRUPTCY CODE

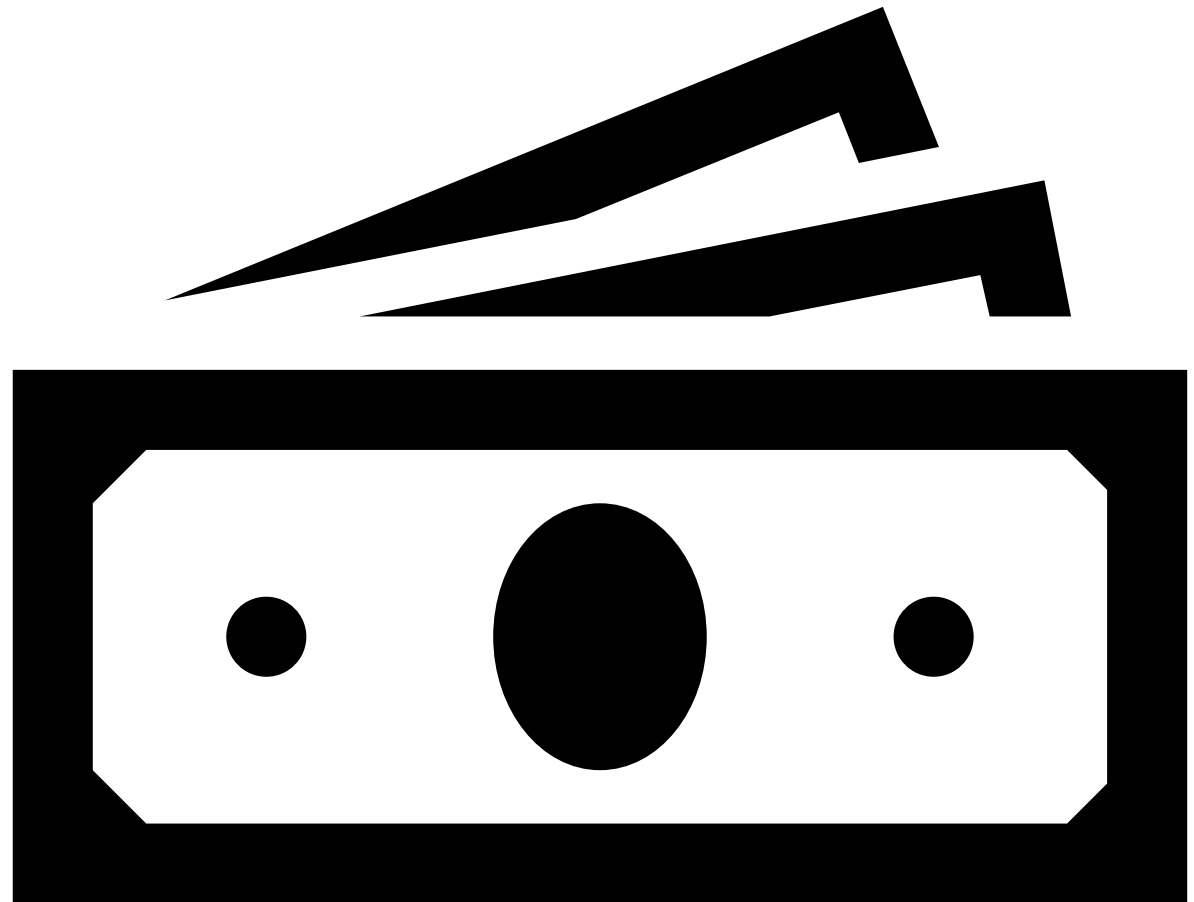
- The CARES Act contains a variety of provisions designed to help people in financial distress, both in and out of bankruptcy, but all provisions sunset on March 27, 2021.

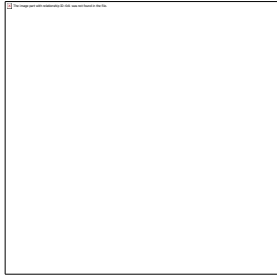
ECONOMIC IMPACT OR STIMULUS CHECKS

\$1200 for qualifying individuals

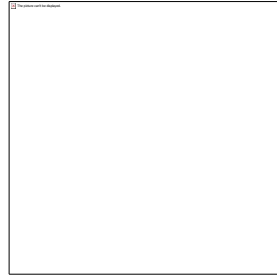
\$2400 for married filing jointly

\$500 per child

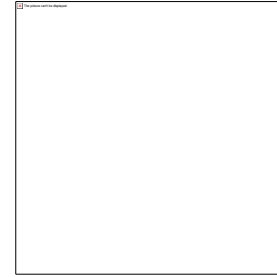




Sec. 2201 – recovery rebate



Debtor must file tax return for 2018 and/or 2019 to receive stimulus credit



Payments under Federal law excluded from income, includes unemployment benefits Sec. 2102

- Secs. 4022-4024
- Only applicable to federally backed loans
- Apply to single and multi-family residences
- 180 days, with potential extensions



GARNISHMENTS

- Federal and state debt collectors cannot collect stimulus funds under CARES Act
- No provision to protect funds from private debt collectors in CARES Act

GARNISHMENTS

“I ran down to the levee but the devil caught me there He took my COVID-19 check and he vanished in the air”

by Christopher Weakley April 16,
2020 Comment to Market Watch
<https://www.marketwatch.com/story/debt-collectors-are-going-after-millions-of-stimulus-checks-5-ways-to-stop-them-2020-04-14>



- California, Illinois, Oregon and Washington
- Governors issued executive orders prohibiting debt collectors from seizing stimulus funds



STUDENT LOANS

- Sec. 3513 – applies to all direct loans taken out since 2010, included Parent PLUS
- Most Federal Family Education Loan Program or FFEL loans do not qualify
- Most Perkins loans do not qualify
- Relief for qualified loans is automatic, waivers are retroactive to March 13, 2020

THANK YOU! IF YOU HAVE ANY QUESTIONS,
PLEASE CONTACT ONE OF THE PRESENTERS.



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