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Attorneys

The 128th CLLA Annual Convention

**The Small Business Reorganization Act:
What's Working? What isn't?**

Panelists:

Honorable Donald Cassling
U.S. Bankruptcy Court, Northern District of Illinois, Chicago, Illinois

Beverly Weiss Manne, Esq.
Tucker Arensberg, P.C., Pittsburgh, PA

Zach Shelomith, Esq.
LSS Law, Fort Lauderdale, Florida

Randall Woolley, Esq.
Darcy & Devassy PC, Chicago, Illinois

Materials By: Beverly Weiss Manne, Esquire- April 14 2022 ©

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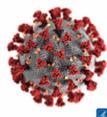
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Legislative history

- 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 11 U.S.C. §§ 1181 – 1195

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Impact of COVID-19: The CARES Act



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- 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.

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Legislative history

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- The COVID 19 Bankruptcy Relief Extension Act of 2021 amended the SBRA to (1) exclude certain COVID-19 aid payments from income for the purposes of bankruptcy, and (2) increased the debt eligibility threshold for businesses qualifying for certain types of Chapter 11 reorganization bankruptcy extended the expiration date of the \$7.5 million debt limit to March 27, 2022. Public Law No: 117-5
- Bankruptcy Threshold Adjustment And Technical Corrections Act; S. 3823 – 117th Congress: Passed in the Senate on April 7, 2022, but has been held at the House as of 4/11/2022: Increases the debt limit back to \$7.5 million not less than 50% of which arose from commercial or business activities of the debtor. Provides for retroactive application to any case commence on or after March 27, 2020

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SBRA Basics: Purpose of the SBRA

- In enacting the SBRA, the House Judiciary Committee stated:
 - Small businesses--typically family-owned businesses, startups, and other entrepreneurial ventures— “form the backbone of the American economy.” By their very nature, however, the longevity of these businesses is limited. According to the Small Business Administration Office of Advocacy, approximately 20 percent of small businesses survive the first year, but by the five-year mark only 50 percent are still in business and by the ten-year mark only one-third survive. Notwithstanding the 2005 Amendments, small business chapter 11 cases continue to encounter difficulty in successfully reorganizing..the legislation allows these debtors “to file bankruptcy in a timely, cost-effective manner, and hopefully allows them to remain in business” which “not only benefits the owners, but employees, suppliers, customers, and others who rely on that business.” Report of Committee on the Judiciary, House of Representatives, Report 116-171, 116th Cong., 1st Sess., on Small Business Reorganization Act of 2019, at 1 -2.

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Impact of COVID-19 The CARES Act: 2021 Developments

- 3,225 SBRA cases were filed between January 2020 and April 2022.
<https://app.powerbi.com/view?r=eyJrIjoiNzJmYWJlNDQzMGNlMjY0MDA5LTNmZWMtODU5YTOyMDRjYWNjIiwidCI6Im10NDhhOWMyLTJhNmYtNGNiYS1hYzI1LWYyZTI0MGJjNGI1ZCIsImMiOiJ9> last visited April 14, 2022
- 1/3 of the filings wouldn't have been eligible but for the higher debt limit.
- In March 2022 – right before the expiration of the \$7.5 million eligibility limit, 183 cases were filed across the U.S.
- 9th and 11th Circuits have the highest volumes of Subchapter V cases.
- Cases in panelists' states:
 - Illinois: 129 cases * Florida 467 cases * Pennsylvania 79 cases

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Benefits of SBRA v Traditional Ch. 11 considerations

- Cost savings in subchapter V:
 - Chapter 11 Reorganization –debtor stays in possession and operates
 - A professional with a \$10,000 or less pre-petition claim is not disqualified as disinterested §1195
 - No creditor committee unless ordered by court
 - No quarterly U.S. trustee fees
 - Preference reform: preference complaints only can be filed following the completion of “reasonable due diligence in the circumstances of the case and taking into account a party’s known or reasonably knowable affirmative defenses” and the threshold for suing a preference defendant outside of its district has been increased from \$10,000 to \$25,000.

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SBRA Chapter 11 filing considerations: Plan considerations

- Only a debtor can file a plan
- Eliminates separate disclosure statement
- A plan can provide for payments to creditors over 3-5 years
- SBRA Trustee collects and distributes plan payments to creditors
- SBRA Trustee fees are paid under plan, based upon trustee’s hourly billed fees.
- Administrative claims can be paid over the life of the plan (3 to 5 years)
- § 1190(3) permits modification of claims secured by mortgages on the debtor's principal residence (unlike § 1123(b)(5), which precludes modifications of claims secured by mortgages on a debtor's principal residence)
- The Court can confirm a plan even if all classes reject it!

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Eligibility

Who is eligible? 11 USC 1182

- A person *engaged in* commercial or business activities (including an affiliated ch. 11 debtor)
- With aggregate noncontingent liquidated secured and unsecured debts in an amount not more than \$7,500,000
- At least 50% of debt is from the commercial or business activities of the debtor

Who is not eligible

- Debtor whose primary business activity is OWNING Single Asset Real Estate businesses are explicitly excluded.
- Businesses cannot be publicly traded
- Businesses cannot be an “affiliated issuer”

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Eligibility 11 U.S.C.A. § 1182 pre-2020 and post 3/27/22:

§ 1182 In this subchapter:

(1) Debtor.--The term “debtor” means a small business debtor.

§ 101(51D)(A) The term “small business debtor”—

(A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than \$2,725,625* (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor;

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Eligibility 11 U.S.C.A. § 1182(1)(A) as amended 3/27/2020

In this subchapter:

(1) Debtor.--The term "debtor"--

(A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than \$7,500,000* (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor;

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Eligibility Issues Opinions

- In re Quadruple D Trust, 2022 WL 819297 (Bankr.D.Colo.2022)
- In re Offer Space, LLC, 2021 WL 1582625 (Bankr. Utah 2021)
- In re Johnson, 2021 WL 825156 (Bankr. N.D. Tex. 2021)
- In re Vertical Mac Constr., LLC, 2021 WL 3668037 (Bankr. M.D. Fla. 2021)
- In re 218 Jackson LLC 2021 WL 3669371 (Bankr. M.D.Fla.2021)
- In re Family Friendly Contracting LLC, 2021 WL 5540887 (Bankr.D.Md.2021)
- In re Rickerson 636 B.R. 416 (Bankr. W.D.Pa. 2021)
- In re McCune, 635 B.R. 409 (Bankr.D.N.M.2021)
- In re Mongeau 633 B.R. 387 (Bkrtcy.D.Kan.2021)
- In re Blue, 630 B.R. 179 (Bankr. M.D.N.C. 2021)
- In re Offer Space, 629 B.R. 299 (Bankr. D. Utah 2021)
- In re Port Arthur Steam Energy, L.P., 629 B.R. 233 (Bankr. S.D.Tex. 2021)
- In re Ikalowych 629 B.R. 261 (Bankr. D.Colo.2021)
- In re ENKOGS1, LLC 626 B.R. 860 (Bankr.M.D.Fla. 2021)
- In re McGrath, 2021 WL 1784079 (Bankr. M.D.Fla. 2021)
- In re Thurmon, 625 B.R. 417 (Bankr. W.D. Mo. 2020)
- In re Blachard, 2020 WL 4032411 (Bankr. E.D. La. 2020)
- In re Two Wheels Properties, LLC. 625 B.R. 869 (Bankr. S.D.Tex. 2020)
- In re Seven Stars on the Hudson Corp., 618 B.R. 333(Bankr. S.D. Fla. 2020)
- In re Ventura, 615 B.R. 1 (Bankr. E.D.N.Y. 2020)

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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.
- Not an operational trustee and only operates the debtor's business if the debtor is removed as a DIP.
- Trustee's service terminates upon substantial consummation of a plan unless reappointed by U.S. Trustee to modify a plan after confirmation or if debtor is removed as DIP
- Trustee will provide to the UST a "verified statement" that they are disinterested, stating their rate of compensation and accepting the appointment.

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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;
- (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.

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Duties of the Trustee § 1183

- Appear at §1188 status conference and at any hearing concerning (a) value of property subject to a lien, (b) confirmation of a plan, (c) modification of a plan post-confirmation, (d) the sale of property
- Account for all property received, examining proofs of claim, opposing a debtor's discharge where "advisable", furnishing information about the estate to any party in interest, and filing a final report and accounting.
- If ordered (a) investigate debtor's acts, conduct, assets, liabilities, financial condition and operations of the debtor, whether the business should continue, and "any other matter relevant to the case or to the formulation of a plan"; (b) furnish information to taxing bodies for any year where debtor did not file a tax return, and (c) filing post-confirmation reports as necessary or as ordered by the Court
- Ensure debtor makes timely plan payments
- Provide domestic support obligation notices per §704(c)(1)
- Help in the development of a consensual plan

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Compensation Owed to The SBRA Trustee

- Should a Chapter V trustee be able to get a wage attachment? Section 105?
- How can a trustee make sure she gets paid other than getting the plan confirmed?
- Compare chapter 13 wage deduction orders.
- Should a cash collateral order contain provisions for counsel to escrow fees for the trustee fees incurred through confirmation?
- 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.

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11 U.S.C.A. § 1194 Payments.

(a) Retention and distribution by trustee.--Payments and funds received by the trustee shall be retained by the trustee until confirmation or denial of confirmation of a plan. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan. If a plan is not confirmed, the trustee shall return any such payments to the debtor after deducting--

- (1) any unpaid claim allowed under section 503(b) of this title;
- (2) any payment made for the purpose of providing adequate protection of an interest in property due to the holder of a secured claim; and
- (3) any fee owing to the trustee.

(b) Other plans.--If a plan is confirmed under section 1191(b) of this title, except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan.

(c) Payments prior to confirmation.--Prior to confirmation of a plan, the court, after notice and a hearing, may authorize the trustee to make payments to the holder of a secured claim for the purpose of providing adequate protection of an interest in property.

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The Disclosure Statement and Plan

- The debtor does not need to file a separate disclosure statement, but the plan must set out a history of the debtor's operations, a liquidation analysis and a feasibility analysis (*i.e.*, debtor's analysis and projections of debtor's ability to perform under the plan and make payments). Section 1181.
- If Court orders compliance with section 1125, then under 1187(c) expedited procedures of section 1125(f) apply.
- Only the debtor may file a plan. Section 1189(a). There is no competing plan challenge under the SBRA.
- Section 1190 sets out the required contents of a plan.

The Plan

- Plan must be filed within 90 days, time may be extended if the extension need is attributable to circumstances for which the debtor should not justly be held accountable. §1189 (b)
- In PAWB you must use the Court approved form available on PAWB website: <http://www.pawb.uscourts.gov/sites/default/files/staorders/so20-221.pdf>
- Plan shall be no less than 3 no more than 5 years.
- An individual debtor can modify a non-purchase money mortgage on principal residence, where the loan was used primarily in connection with the debtor's business. §1190(3)
- Administrative expense claims can be paid over the life of the plan. §1191(e)
- Absolute priority rule eliminated: existing equity can retain their interests even though creditors are not paid in full. §1181
- Trustee distributes payments to creditors §1190(2); § 119

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Plan Confirmation-Fair & Equitable

- A plan is fair and equitable if the plan commits all projected net disposable income for a period of three to five years to payments under the plan (the "best efforts test"). § 1191(c)(2).
- Disposable income defined in 1191(d) – essentially same as before SBRA – everything but maintenance, DSO, necessary business expenses
- The debtor must demonstrate a "reasonable likelihood" that it will be able to make all payments under the plan, and the plan must provide "appropriate remedies, which may include the liquidation of nonexempt assets" to protect creditors if the debtor fails to make plan payments. § 1191(c)(3)(A)(i).

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Confirmation: Disposable Income

Issues:

- How is disposable income calculated for the debtor for plan funding purposes?
- How do you litigate it and with what professional (financial consultants)?

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11 U.S.C.A. § 1191(d).

(d) Disposable income.--For purposes of this section, the term "disposable income" means the income that is received by the debtor and that is not reasonably necessary to be expended--

(1) for--

(A) the maintenance or support of the debtor or a dependent of the debtor; or

(B) a domestic support obligation that first becomes payable after the date of the filing of the petition; or

(2) for the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor.

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Removal of the DIP

- **Issue: What are grounds for removal of the DIP in subchapter V?**
- *In re Neosho Concrete*, 2021 WL 182144 (Bankr. W.D. Mo 2021)- allegation that DIP made preferential payments to insider not enough.
- *In re Ozcelebi*, No. 20-70295, 2022 WL 990283, at *1 (Bankr. S.D. Tex. Apr. 1, 2022) ““Falsehood flies, and the Truth comes limping after it” Case converted.
- *In re Pittner*, 2022 WL 348188, at *1 (Bankr. D. Mass. Feb. 4, 2022) “finding cause to convert or dismiss, but also finding that removal of the Debtor from possession pursuant to 11 U.S.C. § 1185(a) is in the best interest of creditors and the estate, shall remove the Debtor from possession based on the Debtor's failure to comply with court orders. As a result of the Debtor's removal from possession, . . . the subchapter V trustee in this case, shall perform the duties specified in 11 U.S.C. § 1183(b)(5), including operating the business of the debtor.” Serial filer’s case justifies removal of DIP

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11 U.S.C.A. § 1185.

Removal of Debtor in Possession.

(a) In general.--On request of a party in interest, and after notice and a hearing, the court shall order that the debtor shall not be a debtor in possession for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after the date of commencement of the case, or for failure to perform the obligations of the debtor under a plan confirmed under this subchapter.

(b) Reinstatement.--On request of a party in interest, and after notice and a hearing, the court may reinstate the debtor in possession.

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