IS FOR SUBCHAPTER V OF CHAPTER 11

(The Small Business Reorganization Act of 2019)

ADVISING THE SMALL BUSINESS DEBTOR

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David Dunn Law Offices PC

Allentown PA

Tel: 610-972-2494

Email: AskDave@daviddunnlaw.com

Celebrating 50 Years of Service to the Courts and the Community

See Also

WHY BUSINESSES FAIL, 5th Ed.
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There Are Six Appendices

Introduction and Scope Note

I am an experienced bankruptcy lawyer. This essay outlines the brand new Small Business Reorganization Act of 2019. It includes appendices for reference for the debtor and practitioner alike. It intersperses the report on the new law with some of my anecdotal experience of 50 years in practice with a hint her and there on how to save the sick business.

A Bit of Background [1]

The Financial Panic of 1893 created chaos in the business world. It caused a depression that dragged on four years, and led to the election of William McKinley over the populist William Jennings Bryan. The Bankruptcy Act of 1898 exercised partial federal pre-emption of the law of insolvency. In the late 1930's, the lessons of the Great Depression prompted the Chandler Amendments of 1938. The Bankruptcy Reform Act of 1978 made yet another sweeping update of the law. Known as the "Bankruptcy Code," it abolished former Chapters X and XI under the Chandler Amendments, and put all provisions about rehabilitating the sick business into a consolidated Chapter 11. Many of the cumbersome (and in some cases archaic) reporting and disclosure requirements were carried over to the newer law. In days of yore, under the Chandler Amendments, the debtor and the creditors would hash out a plan of reorganization under Chapter X for a publicly traded company, but the Securities and Exchange Commission would all too often object or appeal, driving everyone back to Square One to find a satisfactory plan. The SEC's usual concern was that a proposed reorganization was not enough to make the representation "not misleading."[2] This was bad for the shareholders, creditors and management

[1] Unless otherwise specified, all citations here are to Title 11, United States Code.
[2] SEE Rule 10b-5, under the Exchange Act of 1934.

alike of publicly traded bankrupts. Never mind what the bankruptcy filing had already done to the market price of the stock.

In the '78 Act, Sec 1109 allows the SEC to be heard in bankruptcy, but abolishes the SEC right to appeal. As a palliative to the legitimate concerns regarding publicly traded debtors, Sec 1125 was put in, requiring a "disclosure statement" from all plan proponents. [3] The "Disclosure Statement" is rough hybrid of a proxy statement and a prospectus, without the precision of either one. The disclosure statement must contain "adequate information." Sec.1125 of the Bankruptcy Code of 1978 defines "adequate information" for a hypothetical investor in the position of a holder of a class of claims as sufficient information "that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan."[4] It is also a time consuming and fee-building exercise for debtors and debtors' counsel. However, in the euphoria surrounding the '78 Bankruptcy Code, the provision under old Chapter XI for small businesses was left behind. And so was its kinder, gentler, and far less expensive approach to debt "arrangement," as old Chapter XI used to call it.

In the 1994 amendments, a bit of mention was made of a "small business." A debt limit was established to define a small business. [5] Specific reporting requirements were added.[6]

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[3] See Sec 1125. The disclosure statement must contain "adequate Information, that is, information such that a hypothetical reasonable investor could make an informed judgment about the plan." In short, the Chapter 11 Disclosure Statement became the kissing cousin of an SEC prospectus, without the required precision.

[4] 11 USC Sec 1125(a)

[5] Sec 101(51D).

[6] Sec 1116

"Conditional approval" of the disclosure statement was allowed. [7] The 2005 BAPCPA amendments dealt mainly with consumer issues, imposing a means test to qualify for chapter 7, among other things.[8]

What is a "Small Business?"

As of the April 2019 COLA updates of bankruptcy dollar amounts, 11 USC Sec 101(51D) defines a small business as follows:

- An individual or entity engaged in business;
- That is not a single asset real estate debtor;
- That has no more than $7,275, 645 in total debt;
- At least 50% of which debt arose from business activity.

Some Salient Features of the New Law

The Small Business Reorganization Act of 2019 was enacted with rare bi-partisan cooperation, with Chairman Nadler of the House Judiciary Committee in charge. It was signed into law by President Trump.

✓ Its effective date is February 19, 2020.

[7] Sec 1125(f)(3)

[8] PL 109-8, basically amending and restating title 11.

- ✓ It adds Section 1181 through 1195 to chapter 11, labeled as "Subchapter V" to Chapter 11.
- ✓ It eliminates the creditors' committee (except in rare circumstances).
- ✓ It drops the requirement of a separate disclosure statement,[9] a substantial cost saving.
- ✓ It does not require the debtor to pay quarterly fees to the United States Trustee, a substantial cost saving.
- ✓ It introduces the office of Subchapter V Trustee,[10] who works on a commission.
- ✓ It requires a status conference in open court during the pre-confirmation stage of the case.[11]
- ✓ Previously, a small business debtor had a 180 day "exclusivity period," during which only the debtor could propose a plan. After that other entities, often the Creditors Committee, could propose a plan.
- ✓ The 2019 Act makes debtor's "exclusivity" absolute.[12] Only the debtor may propose a plan. However, the debtor must file the plan within 90 days of the filing of the voluntary petition in the case.[13] This requires the debtor to move with alacrity.

[9] Sec 1182

[10] Sec 1183

[11] Sec 1188

[12] Sec 1189(a)

[13] Sec 1189(b)

The Subchapter V Trustee

The Subchapter V Trustee is directed by the statute to "facilitate a consensual plan." [14] In the not-so-small business situation, the creditors' committee would negotiate a plan with the debtor, leaving the secured creditors on their own.[15] Priority creditors are usually just "along for the ride," assured of some recovery if the plan is confirmed.[16,] The trustee is fiduciary for all creditors. Therefore, he (she) cannot be considered a surrogate for a committee of unsecured creditors. That would be unfair to the secured and priority creditors. Nevertheless, the function of "facilitating" clearly suggests (but does not necessarily require) some "shuttle diplomacy" by the trustee between the debtor and creditors of all classes. The plan proposed by the debtor must include a liquidation analysis, and a projection of cash flow to prove that the plan will work. In addition to the statutory reporting requirements, and the needs of the Department of Justice regarding case administration. It would be advisable for the Subchapter V Trustee to do a liquidation analysis of the trustee's own, and utilize the recent trend of the debtor's business, together with debtor's idea of how to improve fiscal efficiency, to see if debtor's cash flow projections are realistic. "Hockey stick" projections[17] by the debtor should be discouraged.

The trustee performs the same basic administrative duties of chapter 7 trustee, except for liquidation of property of the estate.[18] The trustee must perform the investigative and post-confirmation duties of a non-small business chapter 11 trustee.[19] He or she must attend and be

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[14] Sec 1183(b)(7)

[15] Sec 1103

[16] See Sec 507

[17] A "hockey stick" projection shows a sudden drastic, usually unrealistic, upward turn in finances.

[18] Sec 1183(b)(1)

[19] **Sec. 1106 (a)**A trustee shall …

heard at the status conference at US Trustee's office. The US Trustee has indicated that UST will preside at the meeting of creditors. The Subchapter V trustee must attend and be prepared to participate at the meeting of creditors. The Subchapter V Trustee must also appear at any hearing that

- Concerns any property subject to a lien,
- Confirmation,
- Modification of a plan, or
- Sale of any property of the estate.
- The trustee must ensure that the debtor commences making timely payment required by a confirmed plan; and
- If debtor ceases to be a debtor in possession perform the duties of a trustee required under Secs. 708(a) (8),[20] and 1106(a) (1) (2) and (6).[21]

What is distinct here is that the Subchapter V Trustee may operate debtor's business, a function not done under chapter 7.[22] In practice, liability exposure to the trustee from post-

(3) except to the extent that the court orders otherwise, investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan;

(4) as soon as practicable—

(A) file a statement of any investigation conducted under paragraph (3) of this subsection, including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate; and

(B) transmit a copy or a summary of any such statement to any creditors' committee or equity security holders' committee, to any indenture trustee, and to such other entity as the court designates;…

(7) After confirmation of a plan, file such reports as are necessary or as the court orders…

[20] Determining and reporting regarding tax liabilities of an operating business.

[21] The usual duties of a chapter 7 trustee.

[22] While Sec 706 permits operation of a debtor's business by a chapter 7 trustee, the sensible policy of the US Trustee forbids it. For example, the trustee could be sued for tort liability while operating the business. . That strict UST policy may well continue under Subchapter V.

petition suppliers or tort plaintiffs may preclude continued operation of a debtor's business, once debtor is removed as debtor in possession. The trustee must also notify the holder of a domestic support claim and any state agency of the existence and status of the bankruptcy and an explanation of the rights of such holder or agency.[23]

The trustee's service is terminated once the debtor files with the court a notice of substantial consummation of the plan. The debtor has a duty to file that notice within 14 days of substantial consummation (as defined pursuant to Sec 1101). According to the statute, the trustee should "ride herd" on the debtor to get that done, because that notice triggers the trustee's exit, reporting to US Trustee, and possibly compensation. The US Trustee has determined pursuant to 28 USC Sec 586(e) that the Subchapter V trustees will receive a flat commission of 5% of the funds handled. If the debtor crashes early on, having made no payments, the commission due the Subchapter V trustee is Zero.

If the case converts to chapter 7, a standing Subchapter V Trustee would deduct the applicable commission, and expenses if any, and turn the remaining funds over to a chapter 7 panel trustee. If the case converts where the Subchapter V Trustee is a panel trustee, the trustee may continue as the chapter 7 trustee. If that occurs, it is unclear to date whether, on conversion, the trustee commission continues at 5%, or switches to the formula prescribe pursuant to Sec 326.24 If the case is dismissed, the Subchapter V Trustee deducts costs and trustee commissions,

[23] All the above is included in Sec 1183

[24] In the Eastern District of Pennsylvania, there will initially be a panel of 4 Subchapter V trustees.

and refunds the remaining money to the debtor. The official word is that the US Trustee intends to appoint a panel of four Subchapter V trustees. I strongly recommended that the Subchapter V trustee run a liquidation analysis of his or her own, to compare it with the liquidation analysis submitted by the debtor, and discuss with debtor and debtor's counsel (and accountant) any discrepancies between the projections.

Property of the Estate

Sec 1186 provides as follows:

(a) Inclusions --

If a plan is confirmed under Sec 1191(b) of this title, property of the estate includes, in addition to the property specified in section 541 of this title [25]

(1) All property of the kind specified in that section (541) that the debtor acquires after the date of commencement of the case but before the case is closed, dismissed or converted to a case under chapter 7,12, or 13 of this title, whichever occurs first; and

(2) Earnings from services performed by the debtor after the date of commencement of the case but before the case is closed, dismissed or converted to a case under chapter 7, 12, or 13 of this title, whichever occurs first.

[25] Sec 541 includes everything in which debtor has an interest or which is liable for a claim against the debtor at the time the case is filed , plus, inheritances, property settlements or life insurance proceeds received within 180 days after the commencement of the case, but does not include post-petition earnings, pension funds held by employer and the like. Sec 1186 includes all these items in the estate.

The Debtor

Before enumerating debtor's statutory rights and duties, let's take a look at what went wrong that got him into Chapter 11, Subchapter V in the first place. A number of experts say that the most common cause of business failure is that the debtor ran out of cash. That is an inadequate explanation. Running out of cash is a symptom, not a cause. Failure to plan, failure to adapt to the unexpected, undercapitalization are among the leading causes of failure. It behooves the debtor, and debtor's counsel, to make a retreat, to engage in a soul-searching skull session, to analyze the trend, develop fixes where needed, and then to make a credible projection of how much it will cost, and how long it will take to dig the debtor out of the hole. These things are mandatory parts of the plan anyway. In my monograph, entitled **WHY BUSINESSES FAIL, 5th Ed.** © 2018, I list, based on substantial anecdotal experience, the most common causes of business failure:

- Failure to plan, including not using a plan that was initially well put together;
- Paying too much for a going business, or undercapitalization at the beginning;
- Inadequate record keeping. One must remember that the checkbook management software cannot think for itself. The business owner must know how to read the numbers and what they portend. Debtor's principal often does not know the difference between direct expenses and fixed overhead, and how they affect the break-even point in a business.
- Poor credit practices. One cannot pay the bills from accounts receivable.
- Mismanagement of cash flow. "Yes, but it was on sale!"

- Owner incompetence. A good sales person may not spend enough time on the books. A good bean counter may spend too little time cultivating the customers.
- Operational inefficiency. "Chaotic" and "slipshod" are not a recommended management styles.
- Fraud or contract disputes. Sometimes somebody steals, or cheats, or does not live up to a promise. This is one area where business failure may not be entirely the fault of debtor's management.
- Mismanagement of change. Once upon a time, there was a company that made the best buggy whips ever.
- Lack of discipline. A good manager must have a virtually ironclad workday routine.[26] Also, when considering the acquisition of capital goods, the debtor's principal must determine the difference between a needed tool and an ego-boosting toy.

My little "Why Fail" monograph also includes a number of ideas for the business owner how to avoid or cure these pitfalls, as well as an approach to business valuation that may assist in preparing a liquidation analysis.

Debtor in Possession

The voluntary case begins with the debtor as "debtor in possession." Debtor in possession is defined as the debtor in a chapter 11 case, unless a bonded trustee is serving.[27] The powers of a debtor in possession are as follows:

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[26] WHY BUSINESSES FAIL David Dunn, © 2019, is available as follows: GO to www.daviddunnlaw.com, Click on "SHOP," peruse and download the book, if you wish.

[27] See Sec 1101(1).

> Subject to such limitations or conditions as the court may prescribe, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all functions and duties, except the duties specified in paragraphs (2), (3), and (4) of section 1106(a) of this title, of a trustee serving in a case under this chapter, including operating the business of the debtor.[28]

A good description of the situation of the debtor in possession is that debtor has the ball, first and ten, on its own 25 yard line. Debtor in possession is a fiduciary to the whole world: creditors, shareholders, customers, suppliers, everyone. Debtor must operate the business under bankruptcy protection, but also under the supervision and oversight of the Subchapter V Trustee. Debtor must attend an orientation meeting conducted by the US Trustee.

A debtor can be removed as debtor in possession for cause as enumerated in Sec 1185, for such things as fraud, dishonesty, incompetence or gross mismanagement, or failure to perform the duties of the debtor under a confirmed plan. Otherwise, the debtor remains in possession. [29]

Initial Filing Requirements

These are the case-originating documents:

- Petition. Be sure to check the box indicating "Small Business." (See NBR 1020)
- Schedules
- Statement of Financial Affairs;

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[28] Sec 1184
[29] Sec 1186(b)

- Corporate resolution where applicable;
- Creditor matrix;
- List of 20 Largest Unsecured Creditors;
- Declaration whether there is cash collateral, and where applicable, the names and contact information of holders of cash collateral; [30]
- Declaration whether a pre-petition committee of creditors has been formed with names of committee members, contact information, and results of the committee's efforts;[31]
- Statement and list of equity security holders;[32]
- Statement of No Prior Filed Cases.[33]
- For individuals filing under Subchapter V:
    - Statement of Social Security Numbers;
    - Statement of Current Monthly Income; and
    - Since the majority of debt must be business related, the individual will check the box on the petition that the debts are primarily business debts. This excuses prepetition counseling and post-petition debtor education.

[30] This triggers a notice to holders of cash collateral pursuant to LBR 1007-1

[31] LBR 1007, Eastern District of PA Bankruptcy Court

[32] See NBR 2002(g)

[33] LBR 1007

Suppose the case is filed in an emergency, such as an impending sheriff sale or other execution event. The Petition, corporate resolution and creditor matrix must absolutely be filed immediately. The other documents must be filed within14 days of filing. Upon application filed within the 14-day deadline, the court may grant an extension to file case documents.[34] There is more. Sec 1187 imposes duties and requirements on the debtor. Within 7 days of the order for relief debtor shall file with the court its most recent:

- Balance sheet;
- Statement of operations; (a/k/a P & L)
- Cash flow statement; (a/k/a Statement of Changes in Working Capital; a/k/a Reconciliation of Net Worth)
- (Current) Federal tax return; OR
- A statement under penalty of perjury that one or more of these has not been prepared, and the federal income tax return has not been filed.[35]

First Day Orders

Debtor should seek “first day orders:”

- Applications to approve retention of professionals;

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[34] See NBR 1007{c}

[35] Sec 1116(1). Note, in Sec 1181 Sec 1116 is excluded from Subchapter V, but not Sec 1116(1).

    - Attorney
    - Accountant

- To set a deadline for filing proofs of claim;
- For use of existing bank accounts;
- For compensation of employees, especially where the filing date comes in the middle of a payroll period; and
- For continuation of payments of key suppliers in the ordinary course. Without a "key supplier order," the supplier would be required by law to close out the debtor's account, and open a new account for the debtor in possession. That could well be a sufficient pain in the neck to make the supplier give up, and discontinue deliveries of key supplies.
- Recommended: Disclosure of executive compensation. Include this in a motion to pay wages. Where the boss has not taken a salary in an effort to prop up the company finances, the boss should disclose his or her stated salary on the record. The US Trustee reporting forms (see <u>Appendix Five)</u> require monthly disclosure of executive compensation.

More Duties of the Debtor, Some New

In addition to the orientation meeting in the office of US Trustee, the debtor must attend the meeting of creditors prescribed by Sec. 341. The debtor must attend the newly mandated Status Conference before the judge, in open court. See Sec. 1188. No less than 14 days before

the status conference, debtor must file a report on the progress made to formulate a consensual plan.[36]

Further Reporting Requirements

Debtor must file an initial report to with the US Trustee. This checklist is more comprehensive than Sec 1116(1). These are to be submitted to the US Trustee (or the Subchapter V Trustee, or both) within 14 days of filing. They include:

1. Latest fiscal year financial statements and tax returns;
2. Balance sheet as of month ending immediately before filing;
3. Profit and Loss Statements for the month and the year ending immediately before filing;
4. Proofs of insurance:
    a. General liability;
    b. Property (fire, Theft, etc.);
    c. Workers' compensation;
    d. Vehicle insurance;
    e. Other insurance.

[36] Sec 1188[c]

5. Projected revenue, expense and cash flow for 1st 180 days after filing;[37]

6. Name & Address of financial institution, account number and sample voided check for each debtor-in-possession bank account

   a. General account;

   b. Tax account (if required)

If at all possible, have all these items teed up and ready to go as of the date of filing. Debtor must also file monthly operating reports, a single entry income statement, including a questionnaire, comparative balance sheets, statement of accounts receivable, statement of prepetition liabilities and statements of monthly income. Specimens of these US Trustee forms are located in Appendix Five.

Counsel for the Debtor

Attorneys take notice:

- ✓ Do not dabble. If you are not comfortable with the second most user unfriendly statute on the books, stay away.[38]
- ✓ Listen carefully to the client's principal. Determine whether you think he or she has correctly assessed the problem.

[37] Be realistic!

[38] The internal Revenue Code is the un-friendliest. Also, my contact information is readily available for a referral.

- ✓ Become as much of an expert on your client's business as time permits. Visit the client's place of business. Talk to the people there. Get a feel for the corporate culture, the overall "vibe."

- ✓ Take a hard-nosed look at your client's record keeping. In one of my cases, the client did not know the difference between fixed overhead and direct operating costs. The case folded into chapter 7. In another, the client had completely muddle the chart of accounts. I found six account titles for the same supplier. The business folded.

- ✓ Run a liquidation analysis of your own. If you are unfamiliar with the process, there are some free downloads on my website. There are also a number of places on the internet where you can track down the values of all kinds of used vehicles, machinery and equipment.

- ✓ How do you as, counsel for debtor, get paid? See Sec 330.

As one of the First Day Orders, debtor files an application to engage counsel on general retainer, signed by the debtor, together with counsel's own affidavit that counsel is not an insider, has no conflict of interested, etc. Previously, counsel must also have been a "disinterested person," that is, the debtor did not owe counsel for unpaid prepetition legal fees. Sec 1195 gives some leeway. Under this new provision, a professional person is not disqualified from representing the debtor if the unpaid prepetition amount does not exceed $10,000. Counsel files a fee application, usually no more often than 120 days after filing, with at least 120 days between fee applications. The speed of Subchapter V may obviate the need for a second fee application. All the work may be done within those hectic first 120 days. The rules prescribe a particular format for itemizing the fees. The US Trustee requires the fees be sorted by specific "categories" in the fee

application. The fee application is ripe for consideration by the court after 21 days' notice to all creditors and hearing. The framers of Subchapter V eliminated the requirement of a disclosure statement, which is a laborious, and time-consuming chore, subject to persnickety quibbling over what constitutes "adequate information." [39] Also, under Subchapter V, there are no quarterly fees payable to the Office of United States Trustee. That usually means a saving of at least $750.[40] Other than that break, the work for debtor's counsel under Subchapter V does not appear to be diminished. There is no prohibition against putting anticipated counsel fees into the plan, similar in practice to chapter 13. Nevertheless, it is important not to price the small business debtor out of the market when it comes to reorganization under Subchapter V.

The Accountant

Sec 1195 is well and good, and does not require the debtor's accountant to step aside over an unpaid balance of less than $10,000. However, the accountant must make a sound business judgment. By serving as accountant to the Debtor-in-Possession, is the accountant throwing good billable hours after bad? Once engaged, the client ledger is changed. No longer accountant for the client, he or she becomes accountant for the "Debtor-in-Possession." The pre-petition balance is set aside for the time being, and a new balance is begun at Zero. Does the accountant see a path to successful reorganization? If so, will the accountant have a loyal client for all time? Yes, the accountant can file a proof of claim, and with luck, get some percentage of the prepetition balance back as a creditor's "dividend." Professionals are compensated pursuant to Sec 330. Here is the drill (the same for accountants as for lawyers):

[39] See Sec 1125(a)

[40] Minimum quarterly fee is $325. Case will be pending for at least two quarterly periods. See table of US Trustee Fees, *Infra, Footnote in "Conclusion."*

(1) At the beginning of the case, debtor files an application and gets a court order appointing one as accountant for the Debtor-in-Possession on general retainer.

(2) After 120 days, file a fee application, for fees and expenses, using the detailed form prescribed by the bankruptcy rules.

(3) Give 21days notice of the fee application to all creditors and parties in interest. If there is an objection, the court will schedule a hearing, another few weeks down the road. If there is no objection, the accountant can certify "No Response," and request an order approving fees and expenses.

(4) Submit the order to Debtor-in-Possession, and get paid.

What does an accountant for the Debtor-in-Possession do? First of all, the plan is repaid in a manner similar to chapter 13: monthly installments over 3 years, and if the court allows it, over 5 years. The trustee gets a 5% commission. That means that the accountant is figuring a partial repayment, (called a "dividend" in Bankruptcy-Speak) with 95 cent dollars.

The accountant does or may do some or all of the following:

- Assist or prepare outright the initial financial reports.
- Prepare the monthly reports.
    - Month-to-month post-petition balance sheets;
    - Accounts receivable analysis;
    - Report and monthly update of post-petition liabilities;
    - And, by the way, monthly profit and loss reports.

(Clearly, the monthly reports, both in their format as well as in their purport f importance, were designed by a committee of lawyers.)

- Prepare the liquidation analysis that goes into the plan.
- With counsel, figure out how much of a dividend the debtor can pay in the 3 year period for monthly plan payment, and whether to ask the court for a 5 year repayment period.
- Prepare the financial projection that goes in the plan, a projection which proves that the debtor can survive, and make all the plan payments.
- In sum, the accountant has the expertise (and the laboring oar) in doing the numbers to show that the Debtor-in-Possession deserves to survive.
- While the lawyer does the negotiating for the plan, the accountant keeps the lawyer form promising too much.
- The accountant does not have to attend court.

That's right. Chapter 11 is largely a numbers game. The numbers will likely dictate the outcome.

Suppose that the court approves fees for the accountant, but the debtor converts to chapter 7 before the accountant gets paid. Sec 503(b) (4) allows administrative expenses incurred during the chapter 11 phase of the case, but only after administrative expenses of the chapter 7. The allowed fees may be pro-rated, if there is not enough in the chapter 7 estate. At last, it comes down to a business judgment. Is the accountant throwing good dollars after bad?

Time is of the Essence

Suppose that the debtor comes to counsel on the eve of the sheriff sale. The barebones minimum filing must include

- A petition,
- Corporate resolution, or individual counseling certificate,[41]
- Matrix of creditor addresses,
- Declarations regarding
  - Whether there is cash collateral,
  - Whether there have been pre-petition committees, and
  - Disclosure of prior filed cases.[42]

The debtor then must file all the schedules and the rest of the initial filing documents, *supra,* within 14 days, unless the court grants an extension upon application timely filed. Debtor must attend an orientation meeting at the offices of the United States Trustee shortly after filing, and before the meeting of creditors. Counsel for debtor must also attend. Sec 341(a) calls for a meeting of creditors within a "reasonable" time after filing. Rule 2002(a) requires 21 days' notice to all creditors of the date, time and place for the meeting of creditors. Counsel must also attend. There is a status conference is within 60 days of filing, and the debtor must file a report 14 days before the hearing, disclosing the progress, if any, in developing a consensual plan. Counsel must attend. Debtor must file a plan within 90 days of filing. Counsel, with the capable input of the accountant, must prepare the plan.

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[41] See Sec 109(h)
B
[42] See LBR 1007, 1007-1

What if there is no accountant? Any chapter 11 case is "number-intensive." Without an outside accountant, counsel must make double-sure that the numbers generated by the debtor will stand up to close scrutiny.

The Plan

The new statute refers to the confirmation of a "consensual plan." What is that? A consensual plan is that plan which is confirmed by the vote of a super-majority of creditors in each class: A majority in number of the creditors holding 2/3rd in dollar amount of each and every class must accept the plan.[43] Classification of claims is a bit of an art. The so-called "conventional wisdom' suggests that each secured creditor be in a class of its own, so as to customize the treatment of each secured claimant. Also, debtor may create a "convenience" class, usually small claimants who will be paid promptly on confirmation, rather than have their dividend in piddling small monthly amounts. The convenience class, it is hoped, would accept the plan, leaving the debtor a path toward "cram-down" confirmation, should one or more of the classes fail to vote acceptance of the plan.

Debtor is the only party to the case who may file a plan. The catch is that the plan must be filed no later than 90 days after filing the case.[44]

Here is what must be in the plan:

[43] See Sec 1129

[44] Sec 1189.

- A brief history of the business operations of the debtor;[45]

- A liquidation analysis;[46]

- Projection with respect to the ability of the debtor to make payments under the proposed plan.

- The plan shall provide for the submission of all or such portion of the future earnings or \other future income[47] to the debtor to the trustee for completion of the plan.

- The plan may modify the rights of the holder of a secured claim on an individual debtor's primary residence, if the debt was not purchase money debt, and the loan was used primarily for debtor's business.[48]

The court may confirm the plan under two circumstances: Either it is consensual and conforms to Sec 1129(a) other than Sec 1129(a) (15);[49] or (notwithstanding any subordination agreement), the plan conforms to Sec 1129(a) other than Subsections 1129(a) (8),[50] (a) (10),[51] and (a) (15)[52], where the plan does not discriminate unfairly and is otherwise fair and equitable regarding the dissenting class or classes of claims.

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[45] It is suggested that a paragraph or two focusing on "problems leading to reorganization" be included. Tell the creditors what went wrong, and lay out what managerial steps have been taken to correct the situation

[46] Sec 1190(1)(B)

[47] Sec 1190(2)

[48] Sec 1190(1)

[49] Sec 1191(a). Subsection 1129(a) (15) defines disposable income for purposes of chapter 11. Subchapter V has its own definition.

[50] The class has accepted the plan or is unimpaired.

[51] At least one impaired class has accepted the plan

"Fair and Equitable"

What is "fair and equitable?"

- Holders of liens retain their liens and receive over the term of the plan at least the value of their collateral
- The plan commits all disposable income over the 3 year plan period (5 years if the court approves) to the plan; or
- The value of property to be distributed is equivalent to the disposable income over the plan period.
- The debtor will be able to make the payments or there is a reasonable likelihood of the ability to pay.
- The plan includes safeguards, such as liquidation of non-exempt assets, to cover (or almost cover) the cost of the plan.[53]

Rule of "Strict Priority" Eliminated

A plan must be "fair and equitable to be eligible for "cram-down" confirmation under traditional chapter 11 procedures. See Sec 1129(b) (2) (B) (ii). Under that provision, a plan is not fair and equitable if the holder of a claim or interest junior in priority receives a distribution before the holders of claims senior to it are paid in full. In other words, in a non-small chapter 11 case,

[52] See Note 27, supra

[53] Sec 1191[c]

where the plan is not a 100% plan, the shareholders are flushed away. This was the rule under the equivalent provisions of the prior law, Sec 77B of the Bankruptcy Act. There had been a loophole, called the "new value rule." In ***Case v. Los Angeles Lumber Products Inc***., *308 US 206 (1939),* the Supreme Court held that where the shareholders of a company in reorganization contributed substantial new value, they could keep their equity interest. Following the enactment of the 1978 Bankruptcy Code, Subsection 1129(b) (2) (B) (ii) imposed the rule of strict priority for a cram-down reorganization. In ***Bank of America v. 203 N. LaSalle Street Partners,*** *526 US 434 (1999*), the Supreme Court modified (and perhaps scuttled) the new value exception. In ***LaSalle****,* the debtor's proposed plan provided that only the existing equity holders were allowed to contribute new capital. In an 8-1 opinion, the Court held that the restriction of opportunity only to existing investors was not fair and equitable, because no other persons were allowed to invest. As a practical matter who in the wide world might that be? The company is in trouble. Its owners are willing to pitch in. Who else would even consider putting in new money to rescue the business? The grumpy consensus in the bankruptcy bar following ***LaSalle*** is that the proposed "new value" must be to some sort of a "market test," such as a comparison of the proposed infusion of "new value" to similar investments in similar entities. Fortunately, the Small Business Reorganization Act of 1029 eliminates the strict priority rule for small business debtors.[54]

There are no special Subchapter V procedures for use of cash collateral [55] sales of assets[56] or borrowing.[57] Therefore, follow the main body of the Code for these issues.

[54] Sec 1181(a), eliminating applicability of Sec1129(b)

[55] See Sec 363(a)

[56] See Sec 363(g)

[57] See Sec 364

How an Individual Subchapter V Debtor Keeps Non-Exempt Assets

Suppose that the debtor is an individual. Suppose further that he or she has $20,000 in "tools of the trade," machinery and equipment used in the business. Sec 522(d) (6) allows an exemption for "tools of the trade" of $2,525.00. Sec 1181 eliminates applicability of Sec 1129. Under this set of circumstances, an individual small business debtor will be able to retain the non-exempt "tools of the trade," due to the abolition of the strict priority rule in Subchapter V. Debtor may have to prove that the non-exempt machinery is essential to debtor's business operation. Debtor's counsel should research this potential dispute over what equipment debtor keeps, and be and factually ready to go upon filing of the petition. The plan requirement for a liquidation analysis should address this issue. This may discourage objections by creditors.

How an Individual Debtor May Cram-Down a Residential Mortgage

Sec 1190(3) permits an individual business debtor to do a partial "cram-down" on his or her residential mortgage. The plan may limit the mortgagee to receive only the fair market value of the home, provided that the loan was not a purchase money loan, and that the proceeds of the loan were used for debtor's business. In many cases the business loan will be a supported by a second mortgage. It is a likely winning argument that the creditor's recovery will be limited to the

debtor-homeowner's equity as against the first mortgage, but don't quote me just yet. Cram-down on a residential mortgage is not available under chapters 7 [58] and 13, unless --

(a) The lien is secondary in seniority, and

(b) The total of the lien or liens senior to the junior lien in question exceeds the fair market value of the home.[59] By contrast, under Subchapter V, the lien may be stripped away, at least in part. The mortgagee is limited in its recovery to the debtor's equity in the home after satisfaction of the first mortgage.

Suppose that the debtor under Subchapter V is a one-person LLC or S Corporation, and suppose further that debtor's principal and debtor's spouse have guaranteed the loan, and have backed their unconditional suretyship with a mortgage on their primary residence. Suppose further that the guarantors have been given a co-debtor stay pursuant to Sec 105(a), so the lender may not immediately foreclose. Is the lien on the guarantors' mortgage subject to cram-down? The new statute doesn't say "Yes," but it never hurts to ask. A better question might be: "Who should be the debtor?" Suppose we refer to the definition of "insider."[60] If the object is to cram down an under-secured second mortgage secured by a personal guarantee, can the individual, as an insider, invoke the 1190(3) cram-down? Maybe. Let the individual file as debtor, using the

[58] See ***Dewsnupp v. Timm,*** *502 US 410 (1992).*

[59] Sec 1322(b)(2)

[60] Sec 101(31)(A(iv): where debtor is an individual defines an insider (i) a relative of debtor; or corporation of which debtor is an officer, director, partner or person in control of a corporate debtor. Sec 101(31)(B): where debtor is a corporation, a partner, officer director, or person in charge of debtor, or a relative of a general partner, director officer or person in charge of debtor.

corporation as insider. Let the individual debtor get a Sec 105(a) co-debtor stay in favor of his insider (the corporation or LLC). Can the individual cram down using 1190(3)? If the majority of the individual's debt is business related, and less than the statutory debt limit, "Yes," for sure.

Disposable Income

What is disposable income? As defined in Sec 1191(d) disposable income is that income which is received by the debtor and that is not reasonably necessary for the maintenance or support of the debtor or a dependent of the debtor; or a post-petition domestic support obligation; or for the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor.[61] Do not be surprised by an argument over what is necessary to preserve and protect the business. Debtor and counsel must be prepared and armed to the teeth with factual arguments on what are and are not necessary expenses. The Subchapter V debtor may have to give up entertaining customers on his boat (and maybe should sell the boat.) You will undoubtedly have trouble keeping a "no-show" job and salary for the principal's spouse or other relative. Yes! Debtor should resign from the Country Club.

Plan Drafting Tips

The plan should include the traditional format for classification of claims as provided in Sec 1122, and the mandatory provisions required by Sec 1123.[62] If these are present, then the

[61] In a case where debtor's principal has not been taking a regular paycheck, a debtor is well-advised to disclose in the plan (i) what his or her executive compensation will be; (ii) that it will cover his or her living expenses, (iii) that it will be reasonable for the job description, and (iv) to be mindful of the potential pitfalls arising under Sec 503[c].

debtor has bought “insurance” for a possible cram-down confirmation, where, as may be likely, the creditors don’t bother to vote one way or the other.

Make each secured claim a class of its own. That gives the debtor the leeway to customize the treatment of each secured claim to the likes of the creditor.

Also, if practicable, the plan writer may wish to designate a “convenience class,” usually made up of smaller creditors, who will receive a dividend less than 100%, but where the dividend will be repaid immediately upon confirmation. Do this even though the “accepting impaired class” requirement for cram-down does not apply. [63] Why? Creditors in this class, if they vote, are more likely to vote to accept the plan. This puts a little insurance toward confirmation on the side of the debtor, and encourages the judge to lean a little more toward an order confirming the plan.

The plan voting procedures provided pursuant to the main body of chapter 11 appear not to have been changed. Therefore, a motion to confirm and to approve plan ballot should be submitted along with the plan. Use the officially approved form of plan ballot.[64] Notice of the confirmation hearing is 28 days.[65]

The plan may be modified if necessary, pursuant to the provisions of Sec 1193. If modification is needed after confirmation, the provisions of Sec 1122 requiring proper

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[62] These provisions are set out in Appendix Four.

[63] See Appendix Three, Sec 1129(a)(10)

[64] National Bankruptcy Form B 314

[65] Rule 2002(b)

classification of claims, and 1123, which dictates mandatory plan provisions (more than those needed under Sec 1190) will apply, in order to get court approval.[66]

If the case began as an involuntary proceeding, refer to Sec 1191(e).

National Bankruptcy Form B425A is clearly obsolete, and ought not to be relied upon in drafting a plan. Form B425B gives a sample of the former disclosure statement, and is clearly defunct. Nevertheless, these two relics may offer helpful suggested wording to assist the person drafting the plan. Rumor has it that standardized forms will soon appear. Look for them. Use them. As one of my mentors said long ago, make yourself a slave to the language of the law, the rules, and the official forms. Until the official forms appear, use the plain language of the statute and the usable language of the old forms as your guideposts.

Creditors

First of all, creditors must be mindful (or be reminded) of the automatic stay.[67] Second, they must be made aware of the "fair and equitable" [68] concept. Then they need to work with the trustee and the debtor to establish a consensual plan. In other words, creditors should buy into the

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[66] See Appendix Four

[67] 11 USC Sec 362.

[68] "Fair and equitable" in plain language means, among other things, that creditors in a class are treated alike, all to receive the same dividend, without favoritism toward one creditor at the expense of others.

reorganization process, to assure that they will get some of their money back, rather than lose all or most of it in a chapter 7 liquidation. Subchapter V is designed to let the debtor work off the creditors' dividend on a monthly installment arrangement over a 3 to 5 year period.[69] Creditors should be encouraged to run a liquidation analysis of their own. A shrewd creditor may use its own liquidation analysis as a bargaining tool. There should be free software available on-line to run the analysis, without running up a tab. In short, creditors should be encouraged to act as in unofficial "committee." Unfortunately, the usual response in small business cases prior to the enactment of Subchapter V, has been almost universal creditor apathy. This pattern of non-participation can put a burden on the Subchapter V Trustee to motivate, coax, cajole, and otherwise "facilitate." Debtor should run its own "facilitation," without involving or entangling the trustee.

Selling the Plan to Creditors

The rule against solicitation of plan voting before approval of a disclosure statement is now gone.[70] How to approach creditors in the early stages of a small business case is virgin territory. Should the debtor send out financials in favor of the plan? Sales brochures? Videos? Text messages? Personal visits? A chapter 11 website? What appears here is a virtually limitless horizon for tasteful, ethical marketing by the debtor and debtor's counsel. NOTE HOWEVER: **<u>Any means of communication must be universal</u>**. Every creditor must get the same video clip, the same text message, and debtor (and debtor's counsel) must be able to prove it. Debtor should

[69] The subchapter, as worded, requires judicial approval of an extension of the plan term to 5 years. It is suggested that if a debtor needs 5 years to pay a half-decent dividend, that debtor file along with the plan a motion to extend the plan term to five years. If the Court later says that isn't necessary, fine. But the debtor is well-advised not to take that chance.

[70] Sec 1181(b)

not be allowed to visit creditors on his or her own. A salesman-like slip of the tongue could raise unrealistic expectations by creditors that just might scuttle the entire rescue effort.

For myself, I have my own proprietary valuation software to evaluate the debtor's chances. It that analysis shows promise, I will see to it that all creditors get the encouraging news. If not, I will counsel debtor's principal on the least onerous exit strategies available. Every debtor's lawyer should do likewise. I will seriously consider use of social media and Email technology as a means of selling a debtor's plan, as long as everyone gets the Email or text message. Use of an Email "blast list" that everyone can see may well be advisable. Marketing experts recommend concealment of the blast list, so the recipient thinks he is getting individualized special treatment. A visible "blast list" proves that everyone is getting the same message. You are not looking for marketing skills. You a looking for lawful compliance, to avoid the appearance of improper "unfair discrimination." Debtor wants the creditors to have affirmative input. Why? The creditor who has input will be psychologically "invested" in the plan's success.

The two biggest hurdles to overcome in seeking creditor participation are:

(1) Hostility; and

(2) Apathy.

Is the debtor the bum who didn't pay, or the protagonist in a Greek tragedy? Is the debtor's business a fly-by-night, or a community treasure? Remember, at all times, on the motion

of a party in interest, the debtor may be removed as debtor-in-possession, for cause, such as fraud or incompetence.[71] Not giving everyone the same communication could be construed as fraudulent. Too flashy a sales pitch may be regarded as incompetent. Such a motion to remove debtor from Debtor-in-Possession status might come from a creditor with a grudge, or no sense of humor. Do not get carried away with salesmanship in advocacy to gain acceptance of the debtor's plan. Just be sure that every creditor gets the same sales pitch and in the same manner and as simultaneously as practicable.

Conclusion

There is Zero experience with this new law.

I have expressed my views here based on how the statute appears to read, and from my 50 years of experience as a practicing lawyer. Any views expressed here are solely those of the author, and do not reflect the views, rules, policies or guidelines of the Court, the Department of Justice, Office of US Trustee.

A number of my colleagues in the bankruptcy bar have expressed skepticism whether the new law will work at all. Why? Here are some pluses and minuses to consider:

- Well, for openers, the small business debtor is in trouble most often because he or she has messed up on the fundamentals of management, concentrating on his or her skills at doing the job itself, and spending too little time running the administrative end of the job.

[71] See Sec 1185

- A certain amount of tutoring is almost always indicated.
- In a proper case, counsel (with the capable input of the accountant) can "impose" management systems and provide training that will address the problems encountered.

- The filing fee, $1,717.00, is too high.

- There are no quarterly fees to the US Trustee, a nice saving.[72]

- The elimination of the disclosure statement will save many hours (and dollars) on the attorney time sheet. Another saving!

- The professional work required at the outset of the case may prove daunting to counsel, and an annoyance to debtor, who has to keep coming up with information upon information upon further information.

[72] Schedule of US Trustee Fees, based on cash expended in each calendar quarter

Quarterly Disbursements	Fee
$0 to $14,999.99	$325 minimum
$15000 to $74,999.99	$ 650.00
$75,000 to $149,999.99	$ 975.00
$150,000 to $225,999.99	$ 1,675.00
$225000-299,999.99	$ 1,950.00
$300,000 to $999,999.99	$ 4,875.00
1,000,000 or more	1% or $250,000, lesser

- The new law is still a "bankruptcy;"
    - It is still complicated, it is still burdened with a bad rap as some sort of bad thing to be in or to do.
    - Not really! Debt relief is not evil. It is in some cases even righteous. [73]
    - The purpose of bankruptcy is to give relief to one over-burdened with debt and a fresh start in life (or business).[74]

The Small Business Reorganization Act of 2019 brings back some of the "kinder, gentler" aspects of the Chandler Amendments without disturbing the more efficient methods set forth in the'78 Code. A nodding acquaintance with Chapter 12 may well be of help. A working knowledge of chapter 13 is essential. I hope this little monograph will assist business owners and professionals alike in making the heavy decision whether to seek bankruptcy protection while rehabilitating the sick business.

Again, the effective date of the law is February 19, 2020.

Allentown PA, December 26, 2019;

David F. Dunn

FOR USERS OF OUR WEBSITE: (See Next Page)

[73] See Leviticus 25:25

[74] *Local Loan Co. v. Hunt,* 292 US 234 (1934)

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