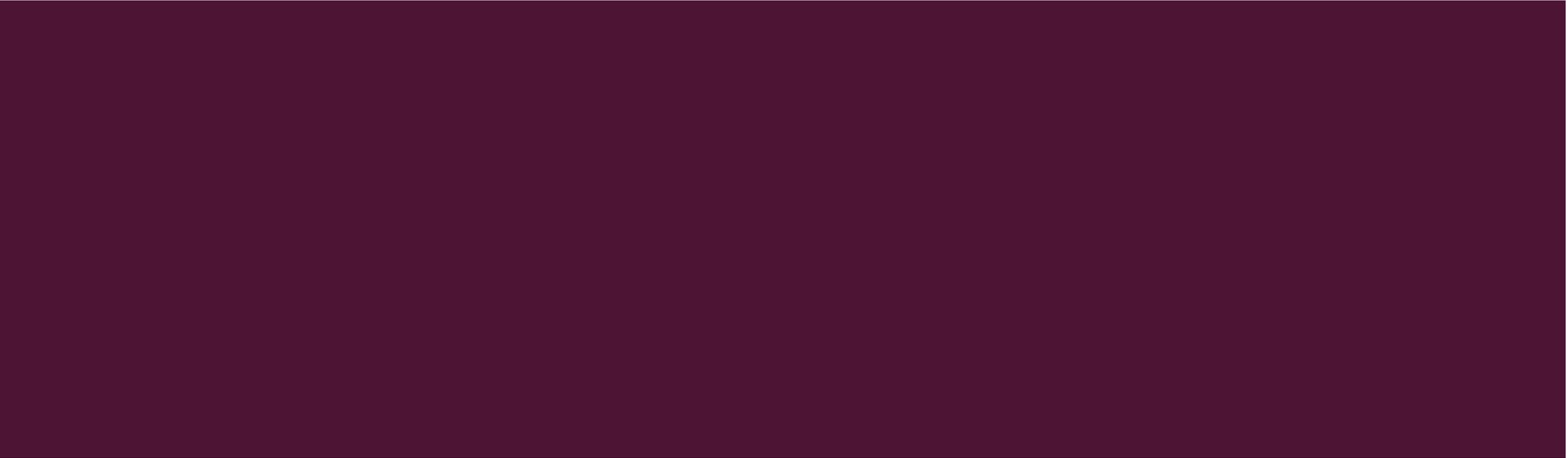




# 2020 BANKRUPTCY UPDATES

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# CARES ACT MODIFICATIONS

- The Coronavirus Aid, Relief and Economic Security Act (“Cares Act”) provides emergency assistance to individuals, families and businesses affected by the Coronavirus.
- Congress Previously enacted, in 2019, the Small Business Reorganization Act, which became effective February 19, 2020 and it was also modified by the CARES Act.
- The Act specifically modified treatment for debtors in bankruptcy

# CHAPTER 7 AND CHAPTER 13 CONSIDERATIONS

- The CARES Act implemented temporary modifications to Chapter 7 and Chapter 13 of the United States Bankruptcy Code.
- For cases under Chapter 7 and 13 the CARES Act modifies the definition of ‘current monthly income’ in 11 U.S.C. § 101(10A)(B)(ii) to expressly exclude payments made under federal law relating to the national emergency declared by the President under the National Emergencies Act.
- Any payments made to individuals under federal law as they relate to COVID-19 do not constitute “disposable income” and are therefore not required to be committed to the Chapter 13 plan under 11 U.S.C. § 1325(b)(2).
- This benefit flows to both current Chapter 13 debtors who did not have confirmed plans as of the date of enactment (March 27, 2020) and future Chapter 13 Debtors.
- This amendment applies to cases commenced before, on or after March 27, 2020 and expires on March 27, 2021.

## CHAPTER 13 WITH CONFIRMED PLANS

- Debtors with plans that were confirmed as of the date of enactment of the CARES Act are authorized to seek modifications of their plan due to COVID-19 related hardships.
- Section 1329(d)(1) was added to permit a debtor to modify a confirmed plan, after notice and a hearing, if the debtor is experiencing a “material financial hardship” due directly or indirectly, to the COVID-19 pandemic.
- Burden of proof is on the debtor to make the showing of financial hardship.

## CARES ACT MODIFICATION NEW 1329

- **(d)(1)** Subject to paragraph (3), for a plan confirmed prior to the date of enactment of this subsection, the plan may be modified upon the request of the debtor if—**(A)** the debtor is experiencing or has experienced a material financial hardship due, directly or indirectly, to the coronavirus disease 2019 (COVID-19) pandemic; and
- **(B)** the modification is approved after notice and a hearing.
- **(2)** A plan modified under paragraph (1) may not provide for payments over a period that expires more than 7 years after the time that the first payment under the original confirmed plan was due.
- **(3)** Sections 1322(a), 1322(b), 1323(c), and the requirements of section 1325(a) shall apply to any modification under paragraph (1).

## CHAPTER 13 WITH CONFIRMED PLAN

- The amendments to section 1329 also allow for the Debtor to request modification to extend the plan period up to seven years after the first payment under the original confirmed plan became due.
- A bankruptcy court may approve such modification upon request of a debtor.
- Until the amendment sunsets one year from March 27, 2020, Chapter 13 debtors with plans confirmed prior to the enactment date will be able to seek to modify their plans consistent with this provision.
- The Code does not define “material financial hardship” or “indirect hardship” those issues will be determined on a case by case basis.

# CHAPTER 13 MODIFICATIONS

- The Act specifically provides that 1322(b) and 1322(c) apply to any modifications pursuant to 1329(d)(1). Under 1322(b)(2) a plan may not modify rights of claims secured only by the debtor's principal residence. However, under 1322(c)(1) permits a debtor to cure defaults with respect to liens on the residence notwithstanding 1322(b)(2).
- Post-petition arrearages?
- Deferments?
- Insurance, Taxes, Escrow?

## CARES ACT SECTION 4022

- Congress provided forbearance for federally backed mortgage loans for four months following implementation of the CARES Act.
- Many bankruptcy practitioners used this as a means to get forbearance on mortgage loans in Chapter 13 cases.
- Both the Eastern District and Western District of Missouri bankruptcy courts were allowing such forbearance upon application.
- Many lenders were providing the agreement based upon provisions of the CARES Act.

## FORBEARANCE UNDER CARES ACT

(b) FORBEARANCE.— (1) IN GENERAL.—During the covered period, a borrower with a Federally backed mortgage loan experiencing a financial hardship due, directly or indirectly, to the COVID–19 emergency may request forbearance on the Federally backed mortgage loan, regardless of delinquency status, by— (A) submitting a request to the borrower’s servicer; and (B) affirming that the borrower is experiencing a financial hardship during the COVID–19 emergency. (2) DURATION OF FORBEARANCE.—Upon a request by a borrower for forbearance under paragraph (1), such forbearance shall be granted for up to 180 days, and shall be extended for an additional period of up to 180 days at the request of the borrower, provided that, at the borrower’s request, either the initial or extended period of forbearance may be shortened. (3) ACCRUAL OF INTEREST OR FEES.—During a period of forbearance described in this subsection, no fees, penalties, or interest beyond the amounts scheduled or calculated as if the borrower made all contractual payments on time and in full under the terms of the mortgage contract, shall accrue on the borrower’s account.

# FORBEARANCE

(c) REQUIREMENTS FOR SERVICERS.— (1) IN GENERAL.—Upon receiving a request for forbearance from a borrower under subsection (b), the servicer shall with no additional documentation required other than the borrower’s attestation to a financial hardship caused by the COVID–19 H. R. 748—211 emergency and with no fees, penalties, or interest (beyond the amounts scheduled or calculated as if the borrower made all contractual payments on time and in full under the terms of the mortgage contract) charged to the borrower in connection with the forbearance, provide the forbearance for up to 180 days, which may be extended for an additional period of up to 180 days at the request of the borrower, provided that, the borrower’s request for an extension is made during the covered period, and, at the borrower’s request, either the initial or extended period of forbearance may be shortened.

## SUBCHAPTER V OF CHAPTER 11

- Congress determined that small business debtors were continuing to encounter problems trying to reorganize because the Bankruptcy Code Provisions were too stringent for the small business bankruptcies.
- Congress enacted Subchapter V of Chapter 11 in order to streamline small business bankruptcies, reduce legal expenses and establish an expedited schedule for the debtor to reorganize and set out more debtor friendly plan requirements and confirmation standards.

## SUBCHAPTER V ELIGIBILITY

- Only a small business debtor that elects to have Subchapter V apply may be a debtor under the subchapter.
- In other words, the use of Subchapter V is voluntary. Federal Rule of Bankruptcy Procedure 1020(a) provides that a debtor shall elect in their petition whether to proceed under Subchapter V.

## SUBCHAPTER V DEBT LIMITATIONS

- In order to qualify as a “small business debtor” a business must have had non-contingent, liquidated debts (secured and unsecured) totaling not more than \$2,725,625 ( 11 U.S.C. § 1182(1) and 11 U.S.C. § 101(51D)).
- The CARES Act modified these provisions for one year to raise the threshold to \$7,500,000 in debts excluding insider and affiliate debt.
- In March of 2021 that debt limitation will revert back to \$2,725,625 unless adjusted by Congress.
- This should give small busines a boost during the pandemic.

## SUBCHAPTER V ELIGIBILITY

- In addition, at least 50% of the debtor's pre-petition debt must have been generated from commercial or business activities.

# SUBCHAPTER TRUSTEE

- The United States Trustee will appoint a Chapter V trustee
- The Subchapter V Trustee will have a role in monitoring the estate and the timelines for filings
- The Subchapter V Trustee can be responsible for distributions and serve in a supervisory role
- The Subchapter V provisions retain the concept of the debtor in possession who manages its own affairs with supervision see 1184
- The Trustee will not take possession of the debtor's assets and has no ability to sell them. Rather, the Trustee will serve a role akin to a Chapter 12 Trustee or Chapter 13 Trustee in disbursing plan payments. (11 U.S.C. § 1194.)
- The Trustee's role is to be a facilitator between the debtor and their creditors. Their duties specifically include helping the debtor formulate a consensual reorganization plan. (11 U.S.C. § 1183(b)(7)).

## SUBCHAPTER V TRUSTEE

- Section 1183 specifies the duties of the Subchapter V Trustee
- Appear at the status conference
- Ensure the debtor commences making timely payments
- If the debtor ceases to be a debtor in possession to take over certain duties
- Verify domestic support obligations are paid
- Facilitate the development of a consensual plan of reorganization

## SUBCHAPTER V CREDITOR'S COMMITTEE

- Pursuant to 11 U.S.C. § 1102(a)(3) an unsecured creditor's committee will not be appointed unless ordered by the court for cause.

## SUBCHAPTER V STATUS CONFERENCE

- The provisions of the Bankruptcy Code now require the small business debtor to hold a status conference within 60 days of the date of the petition to determine how best to proceed with the case in an expeditious and economical manner.
- This date can be extended but only if the need for the extension is attributable to circumstances for which the debtor should not be justly held accountable.
- See 11 U.S.C. § 1188(b)

# STATUS CONFERENCE

- Not later than 14 days before the date of the status conference the debtor shall file with the Court and serve on the trustee and all parties in interest a report that details the efforts the debtor has undertaken and will undertake to attain a consensual plan of reorganization

## SUBCHAPTER V PLAN OF REORGANIZATION

- A plan of reorganization must be filed within 90 days of the petition date. The Court can extend the deadline if circumstances outside the control of the debtor merit an extension. Otherwise, a failure to timely file will result in conversion or dismissal.
- Only a debtor may file a plan.
- The Debtor should seek a claims bar date as soon as possible, because of the quick time frame to file a plan.
- No disclosure statement is required. Even though no disclosure statement is required, a plan must contain some information for analysis by creditors.
- Limited information would include a liquidation analysis and projections for debtor's ability to make payments under the plan which is usually required in a disclosure statement.
- The plan must contain adequate information
- See 11 U.S.C. § 1189.

## SUBCHAPTER V PLAN PROVISIONS

- In a Chapter 13 case the debtor is unable to modify the rights of a secured creditor with a lien on the Debtor's residence.
- Subchapter V of Chapter 11 allows for a plan to modify the rights of a secured lender with a lien on the principal residence of the debtor if the "new value" received from the loan was not used primarily to acquire the residence and was used primarily in connection with the small business. See 11 U.S.C. § 1190.
- Modifications of such a loan is otherwise prohibited. See 11 U.S.C. §1123(b)(5).

# CONTENTS OF THE PLAN

- Section 1190 indicates that the plan shall include:
- A brief history of the business operations of the debtor
- A liquidation analysis
- Projections with respect to the ability of the debtor to make payments under the proposed plan

# CONTENTS OF PLAN

- A plan shall provide for the submission of all or such portion of the future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan

## SUBCHAPTER V AND THE ABSOLUTE PRIORITY RULE

- Prior to the SBRA a plan could not be confirmed if the debtor retains ownership and the creditors are not paid in full. [The absolute priority rule].
- The SBRA makes it easier for a debtor to confirm a plan and maintain ownership of its business.
- The SBRA abrogates the absolute priority rule and provides that existing owners of a business may retain their full ownership without providing any new value **but only** if the plan provides for the debtor to distribute all of its projected disposable income over at least three years and no more than five years from the first payment date under the plan.
- 11 U.S.C. § 1191

## SUBCHAPTER V CONFIRMATION

- A court can confirm a debtor's plan without the vote of any impaired accepting class so long as the plan does not discriminate unfairly and it is "fair and equitable."
- The term "fair and equitable" is modified such that, to be fair and equitable a chapter 11 plan must provide that all of the debtor's disposable income received during the length of the plan will be applied to make payments under the plan for a period of three to five years.
- The five-year *maximum* commitment period in a Subchapter V case is the same as the longest *minimum* commitment period under the chapter 11 and above-median chapter 13 tests

## SUBCHAPTER V DISPOSABLE INCOME

- 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.

## SUBCHAPTER V ADMINISTRATIVE EXPENSE CLAIMS

- The debtor will not incur quarterly U.S. Trustee fees in a Subchapter V case. (28 U.S.C. § 1930(a)(6)(A).)
- In addition, administrative expense claims may be paid over-time through the debtor's plan rather than as a condition to confirmation. (28 U.S.C. § 1191(e)).

## SUBCHAPTER V CONFIRMATION

- There are two ways to confirm a Subchapter V plan: consensually (11 U.S.C. § 1191(a)) and non-consensually (11 U.S.C. § 1191(b)).
- The court may confirm a non-consensual plan of reorganization if it does not “discriminate unfairly” and is “fair and equitable” as to each class of impaired creditors that has not accepted the plan, so long as the debtor commits all projected disposable income to making payments under the plan over a three- to five-year period.
- This projected disposable income commitment substitutes for the absolute priority rule, meaning the SBRA has eliminated the absolute priority rule with respect to unsecured creditors in a nonconsensual plan (11 U.S.C. § 1191(b) and (c)).
- This makes it easier for business-owner debtors to retain their stake in the business.

## SUBCHAPTER V DISCHARGE

- In a confirmed consensual plan, the debtors receive a discharge at plan confirmation; but, in a confirmed nonconsensual plan, the debtor's discharge is delayed until after all plan payments are made. (11 U.S.C. §§ 1141(d), 1181(c), 1192).
- There is no “hardship” or early discharge in a Subchapter V confirmed non-consensual plan, although a debtor may seek to modify a confirmed non-consensual plan. (11 U.S.C. § 1193(c).)

## SUBCHAPTER V AND PREFERENCE ACTIONS

- The SBRA made changes to preference law that are applicable in all cases.
- A debtor or trustee now must perform “reasonable due diligence” under the circumstances and take into account a party’s “known or reasonably knowable affirmative defenses” before commencing a preference action. (11 U.S.C. § 547(b).)
- Second, the SBRA has amended the law regarding the proper venue for preference cases.
- As amended, claims under \$25,000 must be brought in the district where the defendant resides (as opposed to where the bankruptcy case is pending). (28 U.S.C. § 1409(b).) The threshold amount to bring claims where the bankruptcy case is pending had been \$13,650.

# TRANSACTIONS WITH PROFESSIONALS

- In a SBRA case a person is not disqualified for employment under section 327 by a debtor solely because that person holds a claim of less than \$10,000 that arose prior to the commencement of the case.
- See section 1195

# APPLICATION OF OTHER CHAPTER 11 PROVISIONS

- New section 1181 (11 U.S.C. § 1181) lists the sections of chapter 11 that are completely inapplicable and others that are inapplicable unless the court orders otherwise.
- **§ 1181.**
- **Inapplicability of other sections**
- **(a)**
- *In General.*—
- Sections 105(d), 1101(1), 1104, 1105, 1106, 1107, 1108, 1115, 1116, 1121, 1123(a)(8), 1123(c), 1127, 1129(a)(15), 1129(b), 1129(c), 1129(e), and 1141(d)(5) of this title do not apply in a case under this subchapter.
- **(b)**
- *Court Authority.*—
- Unless the court for cause orders otherwise, paragraphs (1), (2), and (4) of section 1102(a) and sections 1102(b), 1103, and 1125 of this title do not apply in a case under this subchapter.
- **(c)**
- *Special Rule for Discharge.*—
- If a plan is confirmed under section 1191(b) of this title, section 1141(d) of this title shall not apply, except as provided in section 1192 of this title.

# CARES ACT CODE AMENDMENTS

- Section 1113 of the CARES Act amends 11 U.S.C. §§ 101, 103, 347, 1182, 1325 and 1329.
- The Act's effective date is March 27, 2020.