

Not Fake News: Congress Enacts New, Sensible Bankruptcy Reform

Editor's Note: President Donald Trump signed into law several bankruptcy law changes on Aug. 23, 2019: the Family Farmer Relief Act (Pub. L. 116-51), the Honoring American Veterans in Extreme Need (HAVEN) Act (Pub. L. 116-52) and the Small Business Reorganization Act (Pub. L. 116-54). Each law is bipartisan and bicameral, a rare event on Capitol Hill in 2019. Collectively, the legislative package represents the most significant amendment to bankruptcy law since 2005.

ABI was very involved in the development of the package and held a live webinar on Aug. 28 to discuss the laws. The following are excerpts from the webinar, moderated by ABI Executive Director **Sam Gerdano**. The full webinar is available for download at abi.org/newsroom/press-releases/educational-press-briefings.

In addition, this issue features three articles, written by ABI members, that discuss various aspects of the reform: *On Our Watch* (p. 12), *Consumer Corner* (p. 14) and *News at 11* (p. 16). These articles round out a special section on the latest bankruptcy reforms enacted into law.

Gerdano: We're lucky to have with us several ABI members who followed these legislative developments and can help us understand both a reasoning behind their creation as well as the impact for practitioners. **Bob Keach** with Bernstein Shur in Portland, Maine, will discuss the small business legislation. Bob testified for ABI in support of the bill before the House Judiciary Committee recently, and he also served as the co-chair of ABI's Chapter 11 Reform Commission. **Kristina Stanger** of Nyemaster Goode in Des Moines, Iowa, is a member of ABI's Veterans Affairs Task Force and will talk to us about the HAVEN Act. **Joe Peiffer** of Ag and Business Legal Strategies from Cedar Rapids, Iowa, and **Don Swanson** from Koley Jessen in Omaha, Neb., will talk to us about the Family Farmer Relief Act. They each have more than 30 years of experience in bankruptcy and agricultural law issues, and we look forward to their discussion with us about the chapter 12 amendments. So thanks to all of our guests for not only joining us today, but for your support during the legislative process.

Let me start first with the Small Business Reorganization Act.... This has been identified by at least by one commentator as a kind of a "new frontier" for small business cases. What does the law do and why is it important?

Keach: First, it's probably a good idea to just touch briefly on why we needed the bill and then what it does to solve those problems the ABI Commission found through its multiple years of field hearings and testimony. We found that small businesses were not only not succeeding in chapter 11,

but they were actually avoiding filing chapter 11 altogether. Given the relatively simple capital structure of most small businesses, filing a chapter 11 almost certainly resulted in a loss of ownership by the very shareholders or interest-holders who had often founded the company and who were management of the company.



Robert J. Keach



Kristina M. Stanger



Joseph A. Peiffer



Donald L. Swanson

That's because the absolute-priority rule provided that if they did not pay all of their debt in full, they could only maintain their ownership interest with the consent of all their creditors by making a considerable contribution of new value, meaning fresh new money from outside of the business. Obviously, that kind of infusion was seldom available, and often it was not possible to get full creditor consent.

The Small Business Reorganization Act fixes this problem through the debtor's voluntary election to be treated as a subchapter V debtor, effective on Feb. 19, 2020. The debtor has to choose to file under this provision. The SBRA permits the debtor to confirm a plan over creditor objection by dedicating three to five years of net operating income as payment to creditors ... notwithstanding the absolute-priority rule. In other words, the absolute-priority rule will not apply.

The bill also provides for relative simplicity and efficiency. There's an early status conference held by the court to determine the course of the case within the first 60 days, and the plan is going to be filed within 90 days, subject to an extension if the debtor through reasons not within its control needs more time. There is presumptively no creditors' committee and therefore no committee counsel, committee professionals and the accompanying administrative expense.

Instead, there is a provision for a trustee, or the U.S. Trustee can appoint a standing trustee. It's important to emphasize this is not an operating trustee. This is a debtor-in-possession bill, and the trustee is there largely to supervise the restructuring, to review the debtor's financial information, to make recommendations to the court as

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appropriate, and in general to assist the debtors in complying with the plan requirements so that creditors get paid. Counsel who have been in chapter 12 cases or chapter 13 cases will recognize this role.

There is also presumptively no disclosure statement that goes with the plan. The court will be asked to determine that the plan is feasible and doesn't discriminate unfairly. Also note that with respect to the current controversy regarding quarterly U.S. Trustee fees, these aren't applicable in subchapter V proceedings.

We hope [that] the benefits are efficiency and low costs. We hope that the means to confirm a plan over creditor objection if it's both feasible and meets the other conditions of the law will be a draw to debtors who were staying away from chapter 11. We think [that] it'll save a lot of small businesses that would not have been saved because either they would have forgone the opportunity altogether, or they would have simply failed under the current regime.

Gerdano: We've run some numbers in terms of the percentage of current cases where this would be potentially applicable, and we found that about 40 percent of the chapter 11 cases filed between 2014 and 2018 could have been eligible for reorganization as a small business under subchapter V. And in nearly three-quarters of the judicial districts, at least half of the business chapter 11 cases would be eligible for subchapter V treatment, which is significant.

Keach: I would think it's very significant. And, in fact ... if you look at Commission numbers, which are a slightly older data set than some of the numbers you just provided, that percentage number is ... about 58 percent. So we think this is going to have a material impact.

When it becomes effective, I think debtors' practitioners will love the bill, but frankly ... creditors and particularly secured creditors will come to love this bill as well because ... they will find that it doesn't really impact their interests any more significantly than was previously the case. I also think they're going to find that these are going to be much more efficient and less costly.

I think a lot of us would have liked to have seen the debt limit here a little bit higher, similar to what happened with the level in the chapter 12 bill, but ... as parties use this statute, it wouldn't shock me if it were amended to encompass more.

Gerdano: There's also a provision in the Small Business Reorganization Act which applies to preference actions — providing some potential relief from questionable bankruptcy preference claims. Can you explain those provisions as well?

Keach: Again, the Commission's work revealed a considerable dissatisfaction with the way the preference provisions were operating. The SBRA, consistent with the Commission's findings, does two things. It creates a due-diligence requirement for the party bringing preference actions. So the trustee or debtor in possession or post-confirmation trust to whoever it is has been assigned these causes of action can bring preference action[s] only based on reasonable due diligence, taking into account known or reasonably known

affirmative defenses. That's largely going to mean that discernible defenses like ordinary course and new value have to be looked at by the party bringing the case before they bring the action. This is going to end the practice that some have referred to as "preference factories." Secondly, in order to sue the preference defendant outside of their home district, the preference has to involve an amount at issue of \$25,000 or more, up from current law of about \$13,600. This is a universal reform; it applies to all chapters of the [Bankruptcy] Code where preferences can be brought.

Gerdano: How will the small business trustee be compensated?

Keach: The trustee has to be compensated from assets of the estate. I think in the case of conversion, those trustees will be compensated the way they've always been compensated: either out of a set amount paid out of filing fees, or as a consequence of the assets of the estate. As we know in conversion, trustees have the burial expenses priority and have a first administrative claim on any free assets.

I know that the U.S. Trustee's office is hard at work already and really started work examining how they're going to staff the trustee position. I know they'll soon actively look for what could be hundreds of capable people to do this.

I personally have a preference for this position being filled by financial advisory types as opposed to lawyers ... to assist debtors in the preparation of their plans and their business plans. So it may have some elements of the estate fiduciary concept that the Commission identified. I think the position will evolve....

Gerdano: I want to move to talk about the chapter 12 provisions. This has the virtue of being the simplest bill, simply with respect to raising the debt limit. [Joe and Don will] comment on what they think the impact will be, since both of you are in heavy [agriculture] states, indeed really every state with agriculture.

Peiffer: I think the impact will be to open the floodgates, and ... will be very good in the long run. Increasing the debt limit to \$10 million will allow many of the farmers that previously did not qualify to qualify for chapter 12. It allows the family farmer to have the opportunity to maintain assets and also minimize taxes because of the special tax provisions in chapter 12 that are not available in any other chapter of the Bankruptcy Code.

Gerdano: Since chapter 12 was added to the Bankruptcy Code in 1986, more than 30,000 cases have been filed. In the most recent 12-month period ending June 30, 2019, there were 535 chapter 12 cases filed, which was up 13 percent from the prior year. These are spread around the country, [with] Wisconsin being the top filing state, but other states in the midwest like Kansas and Minnesota had high numbers of filings, as did Georgia, with 29 cases. But even California, New York and other states in different parts of the country showed an increase in filings. Interestingly, the House sponsor of the chapter 12 bill is Congressman [Antonio] Delgado

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from upstate New York, where dairy farms in particular are under duress. Don ... I know you've been involved in a lot of these cases in Nebraska; more cases have been filed there than any other state since 1986. What do you see as the impact of the higher debt limit?

Swanson: The impact will allow the purpose of chapter 12 to stay relevant for career farmers. Until last week, a farmer with \$5 million of debt was stuck in chapter 11. In the 1980s, a \$1.5 million of debt worked. But farming during that time ... changed dramatically. It had gone from two-wheel drive tractors to monster machines pulling wide, wide swaths of equipment with GPS precision. So today's \$10 million limit is basically today's equivalent of \$1.5 million back in 1986. So it makes the purpose of chapter 12 continue to be relevant...

It's effective immediately, so it changes your counseling to small business. If you're dealing with a situation where bankruptcy perhaps wasn't an option, now it could impact the bargaining and negotiating lenders. The reason [that] chapter 12 came into existence is because the absolute-priority rule gave creditors a veto over the case. You could have cash flows that worked and projections that were great, but you could never get a plan confirmed because a dominant creditor said "no." It's still the situation for those who do not qualify for chapter 12, where the first thing you do as an attorney sitting down with a farmer not eligible for chapter 12 is saying, how are we going to deal with the absolute-priority rule?

Now the question is, what will cash flow here? We have to pay basically the value of what we're keeping. That is a world of difference.

Gerdano: During the legislative process, the American Bankers Association submitted testimony to the House Judiciary Committee suggesting that it would reduce access to credit or increase the cost of credit. What do you make of those assertions?

Peiffer: There is an assumption that the alternative to reorganization in chapter 12 is paying creditors, but that's not the reality at all. What the 1980s farm crisis teaches us is that the reality of the alternative to reorganization in chapter 12 is a forced liquidation after a failed chapter 11.

Gerdano: I want to get to the HAVEN Act now and ask Kristina about this fix to a problem for disabled veterans under the Code.

Stanger: The HAVEN Act came from a drive based on epidemic rates of suicide among our military, arising in part because of financial distress. There are about 19 million veterans in the United States, and 25 percent of them were receiving disability. But we found that disabled veterans were treated differently in the Bankruptcy Code.

Benefits paid by the Department of Veterans Affairs and Department of Defense were included in the calculation of the debtor's disposable income under the 2005 means test, making many ineligible for bankruptcy relief. This was not because of a policy change, but rather a legislative oversight. The HAVEN Act now excludes disability and death-related benefits to veterans and their survivors, the same way it

applies to Social Security benefits. It's effective immediately, so we're starting to see the impact on veterans and veterans' families even as early as tomorrow.

Gerdano: What was the role of the ABI Veterans Task Force in raising awareness on this issue?

Stanger: That was the beauty of bringing a number of diverse folks together. Essentially, a band of bankruptcy brothers and sisters came together through ABI [that] included attorneys, professors, judges and those with patriotism in their heart.... We were fortunate to team up with Mrs. Holly Petraeus, who ... was a leader in the Consumer Financial Protection Bureau in the Office of Service Member Affairs. In a military operation, we'd call this a tiger team of devoted individuals who, through a grassroots campaign, made calls or emails or office visits to talk about updating this law and bringing parity to disabled veterans.

Gerdano: We do have a couple of questions from our audience. One is on the dollar amount limit for eligibility under the small business law. The new law adopts the existing small business definition, so that is currently \$2,725,625. This number does get adjusted for inflation every three years. As Bob noted, the Commission recommended a higher number of \$10 million and the National Bankruptcy Conference recommended \$7.5 million. And I think the idea here is that Congress would be interested in seeing what the experience is over the next year or so to see if that number should be should be adjusted. Also ... we had a question about the U.S. Trustee quarterly fee exception...

Keach: That's ... extraordinarily impactful, as a benefit for the subchapter V debtors. The new law amends 28 U.S.C. § 1930(a)(6) to exclude these cases from the statutory obligation to pay quarterly fees.

Gerdano: We have an audience question on the HAVEN Act's application to pending cases in chapter 13 cases that might have been eligible for conversion or modification. Kristina, any thoughts on retroactive application to those cases that are pending in chapter 13?

Stanger: This is a great question because ... we're already working through and using the new law to help out veterans in a particular case that we know is pending tomorrow. I would say take a look at § 1325(b)(1)(B), which addresses confirmation of plans. It relies on that definition of disposable monthly income, which ... now incorporates the change in current monthly income with respect to disabled veterans' benefits.... I would submit to you that you can incorporate and exclude those veterans' benefits now ... so I definitely encourage our practitioners to take a look at even plans that are confirmed and consider modification where appropriate. And if not, you can perhaps dismiss and refile.

Gerdano: What about a chapter 11 farm case that's pending in that chapter because of the former lower debt limit? Can you now convert it to the new chapter 12, or do you dismiss and refile?

Peiffer: Since eligibility for chapter 12 is determined as of the date of filing, I think you'll have a problem with doing a conversion. So you're probably going to be stuck having to

dismiss and refile. However, if you file a motion to convert and it's granted, I think you're home free.

Gerdano: We have another question about payment of the standing trustee under the SBRA.... Bob, you may have mentioned this earlier that we believe that the practice will be similar to the way standing trustees are paid in chapter 12 case.

Keach: I think that's right. If it's a standing trustee, it will be similar to where they're paid in chapter 12 cases. If it's not a standing trustee, I think they'll be paid the way appointed trustees are paid, which is out of the available assets of the estate.... [T]hat's why it's important to remember that the trustee here is not an operating trustee. This should be a relatively light touch similar to what is done by chapter 13 and chapter 12 trustees. In cases that are well run from all sides, their role can be modest, although significant.

Gerdano: In terms of the effective date, we mentioned earlier that this was a 180-day lead time, which would mean that the SBRA will become effective on Feb. 19, 2020, for cases filed on or after that date, and that the U.S. Trustee will appoint a trustee for each subchapter V case.

Keach: Correct, and unless and until it decides to use a standing trustee format in any particular district, that'll obviously be within the discretion of the U.S. Trustee's office. I'm sure they'll be a period of monitoring the cases and seeing how they work to see whether it evolves to a standing trustee, and that will obviously depend on parties being willing to fill those roles and performing them capably. The timing of that is also subject to the U.S. Trustee's office's discretion.

Gerdano: What happens to income earned during the subchapter V proceeding?

Keach: There's a definition of "property of the estate" that includes post-petition income of the estate ... the statute provides that the plan provides for all the projected disposable income of the debtor received in the three-year period — in other words, three-year period post-petition or such a longer period not to exceed five years as the court may fix. You may have a situation where, just due to particular debtor circumstances, the three-year period doesn't produce meaningful payout or ... otherwise comply with the feasibility requirements. The court may decide, perhaps at the urging of a creditor, to extend the period. This is typical to what is now allowed under chapter 13, for example, or individual chapter 11, where the time period can be expanded by the court.

Gerdano: So much of this new law is based on a chassis of procedure that is well-known to the Bankruptcy Code. Perhaps not in chapter 11 so much, but certainly chapter 12 and chapter 13, in terms of treating disposable income concepts which will be new for the chapter 11 bar. But again, we're talking about a different type of case here. These are \$2.7 million cases.

Keach: Again, one of the things [that] the Commission recommended in its own version of this is that the initial status conference to be held in the first 60 days of the case is intended to be significant and substantive in charting the course of the case, including when the plan will be filed [and] what the plan will look like. It's intended to be more than just a check-in. It's really intended to be a session that

determines the course of the chapter 11 case and provides for its efficient exit.

Gerdano: In terms of eligibility, will this apply to single-asset real estate cases?

Keach: No, single-asset real estate cases are excluded. And in addition to the dollar amount requirement, there is a requirement that 50 percent of the revenue arise from commercial and business activity as well.... So we really are talking about Main Street businesses.

Gerdano: And for them, chapter 11 is the bell that doesn't ring because it's just simply too expensive and the loss-of-control issues are just too significant. This is where the SBRA could really be a new frontier for small business cases.

Keach: Absolutely; under the current provisions, whether it's ... small business or even regular chapter 11 for slightly larger small businesses, if you inform your clients that filing means they'll likely lose control of their business and they will be liquidated, and that they may be the only party not eligible to attempt to purchase it, that's not a great advertisement for filing. That advice will change, and I think the early reaction from the bar and from practitioners is that the SBRA will really help. Obviously the future will tell, but we're optimistic about that.

Gerdano: One more practical question ... that just came in points to § 1195, which provides that estate professionals can have a pre-petition claim of less than \$10,000 and still be considered disinterested for purposes of Code § 327.

Keach: It provides that a person is not disqualified for employment under § 327, which is where the disinterestedness test is embodied, solely because that person holds a claim of less than \$10,000 that arose prior to commencement of the case. Current practice would require that a pre-bankruptcy counsel for the debtor who was unpaid at the time of filing would have to waive that claim in order to be disinterested. And this provision provides that the claim does not need to be waived and that may result in counsel having more incentive again to file the case ... again, it goes to the relative efficiency and cost by not having to change counsel and being able to use your pre-petition counsel.

Gerdano: One final question on the preference provision ... again note that these apply across the board in chapter 11 cases, not just in subchapter V cases. With respect to the requirement that statutory defenses be considered before filing a demand letter, how effective will this be to weed out some unworthy complaints?

Keach: What the statute says is reasonable diligence in the circumstances of the case, taking into account the parties known or reasonably knowable affirmative defenses. Obviously, you know many times the trustee is at the mercy of the state of the debtor's records. And, as we all know, many businesses, even large businesses, often don't have great business records.

I'm sure that'll be taken into account. But remember, particularly in larger cases, trustees have Rule 2004 at their disposal and have the ability to do due diligence. I think the onus here is going to be on starting the process early — not starting it just before the filing deadlines. The statute doesn't

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prescribe sanctions, but the section (a) that we're talking about here that contains the diligence provision will be an amendment to § 547(b)'s preamble, [which] stated, as a precondition to filing the case as opposed to sanctions available to a court, everything including dismissing the case as being improvidently brought. So I think that trustees and debtors and liquidating trustees and others are going to have to take this very seriously. And, if for any reason they were unable to do the due diligence, they may want to seek guidance from the court before the time runs out.

Gerdano: I want to thank you all for joining us for this webinar on the new bankruptcy laws and especially thank our guests for taking the time to help us understand the laws and their impacts. Follow the ABI website [abi.org] for more details and programming activities about the new laws. They will be in focus at the Winter Leadership Conference coming up in December in California. **abi**

Editor's Note: *For more information on ABI's Winter Leadership Conference, visit abiwlc.org.*