

THE SECURED FINANCE NETWORK
INDEPENDENT FINANCE ROUNDTABLE

LEGAL UPDATE

AUGUST 17-20, 2021
RENAISSANCE CHICAGO DOWNTOWN

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Subchapter V

Goals

Chapter 11

- Save the business
- Make the business profitable

SUBCHAPTER V (Eff. 2/17/20)

- Same as Chapter 11, plus:
 - Minimize administrative expenses
 - Get out of Dodge fast
 - Provide debtor with financial consulting services through automatic appointment of subchapter v trustee

Trustee

Chapter 11

- Trustee appointed only upon evidence of gross mismanagement, fraud or best interest of creditors

SUBCHAPTER v

- Always appointed in a consulting role
- Makes distributions under the plan (if contested confirmation)
- Party in interest on case status, plan development, negotiations, and confirmation
- Generally not permitted to retain professionals without cause
- Role can be expanded, e.g., to investigate and report on intercompany claims, or for cause, to oust the Debtor-In-Possession and become a trustee in possession

Eligibility

Chapter 11

- No jurisdictional floor or ceiling for assets and liabilities generally

SUBCHAPTER v

- Small business debtor: \$7.5 million cap on liquidated debt, and at least 50% of debt from commercial or business activities, other than owning or operating single asset real estate; excludes public companies and their affiliates, and member of affiliated debtors whose aggregate debt exceeds limit
- Original cap on debt before CARES Act was \$2,725,625
- CARES Act increased cap on liquidated secured and unsecured debt to \$7.5 million, which was recently extended until March 27, 2022, under COVID-19 Bankruptcy Relief Extension Act
- Small business debtor that affirmatively opts in on petition to subchapter V (recent caselaw: no public companies or affiliates of same)

U.S. Trustee Quarterly Fees

Chapter 11

- Paid quarterly
- Sliding scale formula based on prior quarter's disbursements
- Fee ranges from \$325 up to \$15,000

SUBCHAPTER V

- No UST fees payable in Subchapter v cases
- (But Debtor Pays for Subchapter Trustee)

Special Filing Requirements

Chapter 11

- Many districts require a case management summary highlighting essential facts
- Monthly operating reports until final decree;
- Quarterly reports post-confirmation

SUBCHAPTER V

- Status report on plan efforts 14 days prior to 60-day status conference
- No disclosure statement

Income Requirement

Chapter 11

- No income requirement if assets sufficient to fund distributions under a plan

SUBCHAPTER V

- Debtor's sole business cannot be owning single asset real estate
- No less than 50% of income must arise from commercial or business activities of debtor

Common First Day Motions

Chapter 11

- Use of cash collateral or approval of DIP financing
- Retention app for debtor's counsel and financial advisor, if any
- Pre-petition wage motion
- Authorize use of prepetition cash management procedures

SUBCHAPTER V

- Use of cash collateral
- Retention app for debtor's counsel (no disqualification if prepetition claim less than \$10,000)
- Critical vendor motion
- Prepetition wage motion
- Motion to reject lease

Estate Property

Chapter 11

- Sec. 541 Property of the Estate
- Upon confirmation, all estate property reverts to reorganized debtor free and clear of liens, unless plan or confirmation order provides otherwise

SUBCHAPTER V

- Upon confirmation, property acquired post-petition and post-confirmation earnings becomes estate property
- Estate property remains as such until case is closed, dismissed or converted
- Reorganized debtor remains in possession of estate property unless debtor removed as DIP

Creditors' Committee

Chapter 11

- UST solicits 20 largest creditors to form a committee; depends on creditor interest
- Small business debtor case: party in interest can request no committee be formed “for cause”

SUBCHAPTER V

- No committee formed except by court order

Avoidance Actions

Chapter 11

- DIP (or Trustee) has power to pursue Ch. 5 avoidance actions
- Creditors need court order to pursue any avoidance actions, and must first demand that DIP pursue such claims

SUBCHAPTER V

- Same as in Chapter 11

Timing of Plan and Disclosure Statement

Chapter 11

- Plan due in 120 days; deadline can be extended for cause; disclosure statement (DS) is required
- Small Business Debtor: no DS if court finds plan contains adequate information; can solicit based upon conditionally approved DS; due by 180 days from petition date; can be extended only if debtor shows more likely than not it will confirm a plan within a reasonable period of time; order on extension must be entered before deadline terminates
- Small Business Debtor must file plan and DS (if any) within 300 days of petition date; can be extended only if debtor shows more likely than not it will confirm a plan within a reasonable period of time; order on extension must be entered before deadline terminates

SUBCHAPTER V

- No disclosure statement (BUT some courts are applying the “old” Small Business Debtor Rule
- Plan must be filed within 90 days of petition date
- Extension only if “circumstances for which debtor should not justly be held accountable”

Exclusivity to File Plan

Chapter 11

- 120 days to file plan and 180 days to solicit acceptances to plan
- Exclusive period can be extended, but plan exclusivity cannot be extended beyond 18 months from petition date
- Small business debtor: only debtor can file a plan

SUBCHAPTER V

- Only Subchapter V debtor can file a plan

Plan Content (1)

Chapter 11

- Designate classes of creditors/interests
- Specify impaired/unimpaired claims
- Specify treatment for each class
- Provide same treatment for similar claims
- Provide means for implementing the plan
- Pay all administrative claims in full on effective date
- In individual case, commit future income to fund plan payments

SUBCHAPTER V

- Plan must include: brief history of business operations of debtor; liquidation analysis; projections to support plan payments; and commit future earnings to fund plan payments.

Plan Content (2)

Chapter 11

- Impair or leave unimpaired classes of claims
- Assume or reject leases/executory. Contracts
- Settle or adjust claims or interests
- Designate a convenience class of general unsecured creditors
- Provide for sale of estate property
- Modify secured claims, except mortgage on principal residence of individual debtor

SUBCHAPTER V

- Plan may pay administrative expense claims over term of plan
- To be deemed fair and equitable, plan must commit debtor's projected disposable income for 3-year period up to 5 years to make payments under plan
- If court confirms consensual plan, debtor disburses funds under plan; if court confirms nonconsensual plan, Subchapter V trustee makes distributions under the plan

Amendment of Plan

Chapter 11

- Plan may be amended; not common to see more than a couple of amendments
- Amendment must occur prior to substantial consummation

SUBCHAPTER V

- Plan may be amended until confirmation; after confirmation and before substantial consummation if court finds that circumstances warrant modification and modified plan is confirmed
- After substantial consummation, plan can be modified if it doesn't discriminate and is fair and equitable for nonconsenting claims

Voting

Chapter 11

- Creditors who are impaired vote on the plan
- Creditors can (and do) object to the plan

SUBCHAPTER V

- Creditors who are impaired vote on the plan
- Creditors may file an objection to plan

Absolute Priority Rule

Chapter 11

- Rule applies
- Business debtor: no junior class/interest can receive a distribution unless senior classes are paid in full
- Individual debtor: must commit disposable income for 5 years post-confirmation to distributions under plan in order to retain assets

SUBCHAPTER V

- No absolute priority rule applies, which means court can approve plan in absence of impaired accepting class if plan is fair and equitable
- All disposable income for 5 years must be committed to fund plan distributions

Plan Confirmation

Chapter 11

- Confirmation hearing held on 28 days' notice
- Plan must meet requirements of Sec. 1129; most critical is feasibility and best interests of creditors
- Debtor can cram down plan over dissenting class(es) so long as there is one accepting, impaired, non-insider class of claims

SUBCHAPTER V

- Plan meets requirements, except no consenting impaired class needed to cram down, plan does not discriminate unfairly, and plan is fair and equitable
- Plan is fair and equitable if: 1) secured creditor treatment complies with 1129(b)(2)(A); 2) all disposable income for term of plan is committed to plan payments; and 3) reasonable likelihood debtor can make plan payments
- Again, no absolute priority rule

Discharge

Chapter 11

- **Business debtor: discharge occurs at confirmation, except as provided in plan or confirmation order**
- **Individual debtor: court grants discharge upon completion of plan payments (no discharge of nondischargeable claims); hardship discharge may be available**
- **No discharge if liquidating plan, sale plan under which debtor suspends its business, or grounds for denial of discharge under Sec. 727**

SUBCHAPTER V

- **If consensual confirmation, discharge at confirmation**
- **If nonconsensual confirmation, discharge when all plan payments are made**

So, What's In It for Us?

- **DIP Financing**
- **Exit Financing**
- **Enabling Our Clients to Clean Up Their Balance Sheets and Make Them Financially Stronger – and Better Borrowers/Clients**

Evolution of Licensing and Disclosure Statutes

California

- **California Lender's License**

- Required of all finance lenders that make more than 1 loan per year other than other regulated lenders (banks, savings and loan institutions, credit unions, pawnbrokers, check cashers)

- **California Commercial Financing Disclosure Law**

- Likely to go “live” in the Fall 2021
- Exemptions: banks, trust companies, licensed industrial loan companies, federally chartered savings and loan associations etc.
- Affects Loans \$500,000 or less
- Disclosure to be made at time of offer and signed by borrower
 - (1) An amount financed.
 - (2) The total dollar cost.
 - (3) The term or estimated term.
 - (4) The method, frequency, and amount of payments.
 - (5) A description of prepayment policies.
 - (6) The total cost of the financing expressed as an annualized rate.

New York

- **New York Commercial Financing Disclosure Law**
 - Effective January 1, 2022 (NY DFS still working on regs; no disclosure yet)
 - Exemptions: banks, trust companies, licensed industrial loan companies, federally chartered savings and loan associations etc.
 - Affects Loans of \$2.5 million or less (originally, \$500,000 or less)
 - Commercial Finance Disclosure (similar to Federal Truth in Lending Act)
 - Maximum amount of credit
 - Finance charge
 - APR
 - Total repayment amount
 - Term
 - Payment frequency/schedule
 - Description of all other fees
 - ETF
 - Collateral Requirements

New York

- **New York Commercial Financing Disclosure Law (continued)**
 - Factoring Disclosure
 - Amount of receivables purchase price to be disbursed to seller
 - Finance charge
 - Estimated APR calculated according to TILA, Reg Z
 - Total payment amount (purchase price plus charges)
 - Description of all potential fees including fees that can be avoided
 - Description of the receivables purchased
 - Description of any additional collateral requirements or security interests

Other States

- **Similar bills have been sponsored in:**
 - Connecticut
 - Ohio
 - New Jersey
 - North Carolina

PPP, EIDL and Bankruptcy

Intercreditor / Participation Litigation Update



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