SMALL BUSINESS BANKRUPTCY

By Bruce L. Weiner
Rosenberg, Musso & Weiner, L.L.P., Brooklyn, New York

A. Definition

11 U.S.C. §101(51C) "Small Business Case"

§ 101. Definitions
In this title the following definitions shall apply
(51C) The term "small business case" means a case filed under chapter 11 of this title in which the debtor is a small business debtor.

11 U.S.C. §101(51D) "Small Business Debtor"

§ 101. Definitions
In this title the following definitions shall apply:
(51D) The term "small business debtor"—
(A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning or operating real property or activities incidental thereto) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the petition or the date of the order for relief in an amount not more than $ 2,190,000 (excluding debts owed to 1 or more affiliates or insiders) for a case in which the United States trustee has not appointed under section 1102(a)(1) [11 USCS § 1102(a)(1)] a committee of unsecured creditors or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor; and
(B) does not include any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $ 2,190,000 (excluding debt owed to 1 or more affiliates or insiders).

A small business bankruptcy case is a chapter 11 case involving a small business debtor, which the Bankruptcy Code defines as a person engaged in commercial or business activities other than owning or operating real estate with debt no greater than (as of December 28, 2009) $2.19 million, not including debt to insiders and affiliates. If the debtor has less than $2.19 million in debt, but is part of a group of affiliated debtors that has more than $2.19 million in

unaffiliated debt, that debtor is excluded from the definition, and is not eligible to be a small business debtor. The dollar amounts are likely to go up sometime in 2010. There is one further qualification, the debtor is ***not*** a small business debtor in a case in which the United States trustee has appointed under section 1102(a)(1) a committee of unsecured creditors. If the court determines that the committee is not active, it can designate the debtor as a small business debtor and the small business provisions will apply. The effect of this language is uncertain, and probably troublesome. Under the statute as drafted, debtors within the applicable debt limits would not know until well after filing whether the special provisions (and faster timetables) applicable to small business cases apply to them. Bankruptcy Rule 1020(a) requires the debtor to designate itself as a small business, and then by stating that "the status of the case with respect to whether it is a small business case shall be in accordance with the debtor's statement under this subdivision, unless and until the court enters an order finding that the statement is incorrect." Thus, one self designated as a small business debtor, that status sticks until there is a court finding to the contrary.

The debtor might try to avoid this uncertainty by, prepetition, trying to form a committee of creditors (undoubtedly lead by a lawyer known to the debtor's lawyer), and then after filing have that committee confirmed as the official unsecured creditors' committee. If achieved, this would remove small business status. Indeed, Section 1102(b)(1) expressly anticipates such "carryover" representation "if such committee was fairly chosen and is representative of the different kinds of claims to be represented." Thus, depending on whether the members were "fairly chosen," the strategy might work initially– but thereafter such committee will have to be active. If the court

determines that "the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor," then the court will change the case back to a small business case. As a consequence, *all* chapter 11 debtors who are within the applicable debt limits will commence their cases as small business cases. They may lose that status, however, if a committee is formed, but may regain it if that committee isn't doing its job, and the court makes the necessary findings.

B. Enhanced Duties and Disclosure

11 U.S.C. § 1116. Duties of trustee or debtor in possession in small business cases

In a small business case, a trustee or the debtor in possession, in addition to the duties provided in this title and as otherwise required by law, shall—
(1) append to the voluntary petition or, in an involuntary case, file not later than 7 days after the date of the order for relief—
(A) its most recent balance sheet, statement of operations, cash-flow statement, and Federal income tax return; or
(B) a statement made under penalty of perjury that no balance sheet, statement of operations, or cash-flow statement has been prepared and no Federal tax return has been filed;
(2) attend, through its senior management personnel and counsel, meetings scheduled by the court or the United States trustee, including initial debtor interviews, scheduling conferences, and meetings of creditors convened under section 341 unless the court, after notice and a hearing, waives that requirement upon a finding of extraordinary and compelling circumstances;
(3) timely file all schedules and statements of financial affairs, unless the court, after notice and a hearing, grants an extension, which shall not extend such time period to a date later than 30 days after the date of the order for relief, absent extraordinary and compelling circumstances;
(4) file all post petition financial and other reports required by the Federal Rules of Bankruptcy Procedure or by local rule of the district court;
(5) subject to section 363(c)(2), maintain insurance customary and appropriate to the industry;
(6) (A) timely file tax returns and other required government filings; and
(B) subject to section 363(c)(2), timely pay all taxes entitled to administrative expense priority except those being contested by appropriate proceedings being diligently prosecuted; and
(7) allow the United States trustee, or a designated representative of the United States trustee, to inspect the debtor's business premises, books, and records at reasonable times, after reasonable prior written notice, unless notice is waived by the debtor.

The requirements of Section 1116 include both new and old obligations. All chapter 11 debtors must attend meetings and timely file schedules and tax returns and allow the UST to inspect its books, but the 2005 amendments added other obligations for the small business debtor. One theme of the small business amendments is that creditors deserve more and better information, presented in understandable and recognizable formats. Many sections of the small business amendments were framed with this goal in mind. In Although the Bankruptcy Code envisions that creditors should play a major role in the oversight of chapter 11 cases, this often does not occur with respect to small business debtors. The main reason is that creditors in these smaller cases do not have claims large enough to warrant the time and money to participate actively in these cases. Because Congress believed that creditors were not providing necessary oversight in small business cases, it added new requirements for small business debtors. Small business debtors must file balance sheets, income statements, and cash flow statements with the petition, or state under penalty of perjury that none exist. Small business debtors can receive only a 30 day extension of its time to file schedules and statement of financial affairs. In practice, many U.S. Trustees, assistant U.S. Trustees, and staff attorneys had been performing creditors' committee functions for years before the 2005 Amendments, in business cases without committees. The change for the U.S. Trustees with the 2005 Amendments is uniformity of enforcement, and attention to the many new duties small business debtors are required to perform pursuant to Code Section 1116.

In *In re Franmar, Inc.*, (Bankr. D. Co. 2006), the UST moved to dismiss the small business case when the debtor failed to comply with the additional reporting obligations of a debtor by "appending them to the Petition, " arguing that those documents were an integral part of the voluntary petition itself. The court held that the failure to file the documents does not

mandate automatic dismissal of the case although it can be a reason considered in the context of an 11 U.S.C. 1112 Motion to Dismiss. 11 U.S.C. 1112(b)(4)(F) was added as part of the BAPCPA changes providing that any “unexcused failure to satisfy timely any filing or reporting requirement” could constitute cause.

Collier on Bankruptcy, 15th Ed. Rev., 7-1116 (2007) states that Section 1116 imposes duties on trustees and small business debtors in possession for the purpose of providing "greater administrative oversight and controls" in small business chapter11 cases. These duties, are in addition to those required by the Bankruptcy Code, and they complement the newly added duty of small business debtors to provide periodic reports pursuant to section 308, as well as the United States trustees' new obligations with respect to small business cases pursuant to 28 U.S.C.§ 586(a)(3)(H) and (a)(7). A trustee or small business debtor in possession in a small business case is required to "append" to the voluntary petition the debtor's most recent financial documents, including a balance sheet, statement of operations, cash-flow statement and federal income tax return. The same documents must be provided in an involuntary case within seven days of the order for relief.

C. INITIAL DEBTOR INTERVIEW

In a small business case, the UST is required to conduct an initial interview with the small business debtor before the Section 341 meeting. Senior management and counsel are required to the initial debtor interview, as well as scheduling conferences and meetings of creditors. The court may waive the requirement that senior management and counsel attend the meetings, but only after notice and a hearing and a finding of "extraordinary and compelling circumstances."

Section 116(2), (3), and (7) requires the UST to "review and monitor diligently the debtor's activities, to identify as promptly as possible whether the debtor will be unable to confirm a plan...." Additionally, the U.S. Trustee must determine whether it is appropriate and advisable to visit the business premises of the debtor and shall ascertain the state of the debtor's books and records and verify that the debtor has filed its tax returns.

D. ONGOING REPORTING OBLIGATIONS

11 U.S.C. § 308. Debtor reporting requirements

(b) A small business debtor shall file periodic financial and other reports containing information including—
(1) the debtor's profitability;
(2) reasonable approximations of the debtor's projected cash receipts and cash disbursements over a reasonable period;
(3) comparisons of actual cash receipts and disbursements with projections in prior reports;
(4) (A) whether the debtor is—
(i) in compliance in all material respects with postpetition requirements imposed by this title and the Federal Rules of Bankruptcy Procedure; and
(ii) timely filing tax returns and other required government filings and paying taxes and other administrative expenses when due;
(B) if the debtor is not in compliance with the requirements referred to in subparagraph (A)(i) or filing tax returns and other required government filings and making the payments referred to in subparagraph (A)(ii), what the failures are and how, at what cost, and when the debtor intends to remedy such failures; and (C) such other matters as are in the best interests of the debtor and creditors, and in the public interest in fair and efficient procedures under chapter 11 of this title [11 USCS §§ 1101 et seq.].

The small business debtor must also satisfy the new reporting requirements of Section 308. These requirements include information about profitability, projections, and comparisons to actual cash receipts. The U.S. Trustee must review and monitor diligently the debtor's activities to identify as promptly as possible whether the debtor will be able to confirm a plan. If at any time the U.S. Trustee finds material grounds for dismissal of conversion, the U.S. Trustee shall promptly make that finding to the court by filing an appropriate motion under Code § 1112. In

order to make it clear that the courts have authority to hold status conferences to move these cases along, Code § 105(d) was amended to grant the courts that power. Like the result in *Franmar*, in practice courts have taken a flexible approach to these requirements.

The following are the required reports:

Profitability Report

Section 308(b)(1), as amended by BACPA, requires a small business debtor to file a report regarding the debtor's profitability, defined loosely in section 308(a) as "the amount of money that the debtor has earned or lost during current and recent fiscal periods."

Cash Receipts and Disbursements Reports

Sections 308(b)(2) and (3) require the debtor to file periodic reports that include "reasonable approximations of the debtor's projected cash receipts and cash disbursements over a reasonable period" and "comparisons of actual cash receipts and disbursements."

Other Required Financial Reports

Pursuant to Section 521(a)(1)(B)(ii), all debtors must file, unless the court orders otherwise, "a schedule of current income and current expenditures." BAPCPA amended section 521 to require all debtors to file, unless otherwise ordered by the court, "a statement of the amount of monthly net income, itemized to show how the amount is calculated" and a "statement disclosing any reasonably anticipated increase in income or expenditures over the 12-month period following the date of the filing of the petition." Although this subsection presumably was intended to apply to consumer debtors in chapter 7 and 13 cases, its application will extend to debtors in possession in chapter 11 as well. BAPCPA also amended title 28 to require the Attorney General to issue rules and uniform forms for "periodic reports by debtors in possession

or trustees in cases under chapter 11 of title 11," including periodic reports showing "cash receipts, cash disbursements and profitability of the debtor for the most recent period and cumulatively since the date of the order for relief."

The problem with Section 308 is that many small business owners are unprepared to generate these financial reports that are now a mandatory part of any bankruptcy case filing. The U.S. Trustee offices have modified the monthly operating reports (MORs) in a way that the new MORs now capture some of the reporting contemplated under Section 308. Many small business debtors will not have systems in place to capture this kind of information and/or will need assistance in assembling it from their current records, a task that an accountant will be able to perform promptly and efficiently. Accounting support at the outset of a case can be invaluable, both in terms of assembling the necessary documentation for the filing, assisting the debtor in the preparation of the necessary reports from and after the filing date, and assisting with the development of financial procedures necessary to comply with Sections 308 and 1116.

E. DISMISSAL OR CONVERSION

The 2005 Amendments expanded the grounds for dismissal and conversion under Section 1112(b) and eliminated much of the discretion that the courts had in determining such cause for a dismissal or conversion if any of the expanded grounds are found. Under the new Section 1112 (b), if a small business debtor fails to timely satisfy any filing or reporting requirement, fails to attend the meeting of creditors or a 2004 examination without good cause, fails to timely provide information or attend meetings reasonably requested by the U.S. Trustee, fails to timely pay post petition taxes or file tax returns due post petition, fails to pay U.S. Trustee's fees, or otherwise fails to file a disclosure statement or confirm a plan within the time fixed by the Code, cause for

dismissal or conversion will be deemed to exist, and the court has no option other than to decide whether it is in the best interest of the estate to dismiss, convert, or appoint a trustee. The first qualifier is in Section 1112(b)(1). The mandatory duty to convert, dismiss or appoint a trustee is excused if there are "unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate." The second qualifier is found in paragraph (2). That paragraph also is an exception to the mandatory conversion, dismissal or appointment of a trustee. It applies if there are [1] unusual circumstances specifically identified by the court that [2] establish that such relief is not in the best interests of creditors and the estate [3] if the debtor or another party in interest objects and [4] establishes that – [5] (A) there is a reasonable likelihood that a plan will be confirmed with the time frames [established in chapter 11], [6] or if such sections do not apply, within a reasonable period of time; and [7] (B) the grounds for granting such relief include an act or omission of the debtor other than under paragraph (4)(A) [regarding substantial or continuing loss, and the absence of a reasonable likelihood of rehabilitation] [8] (i) for which there exists a reasonable justification for the act or omission; and [9] that will be cured within a reasonable period of time fixed by the court. So, conversion, dismissal or appointment of a trustee can be avoided if there is an objection, and a showing that: a confirmable plan is imminent, and that the omission or act that lead to the creation of cause was somehow justifiable, but is not likely to happen again.

Compounding this complicated approach to conversion or dismissal is the fact that the 2005 Act amended Section 1112 to require that motions under Section 1112 must be heard within 30 days of their filing, and must be determined with 15 days of the commencement of the

hearing, unless the moving party consents to a continuance or "compelling circumstances prevent the court from meeting the time limits." Thus, decisions regarding the life or death of the chapter 11 case will have to be made on an expedited basis. 11 U.S.C. § 1112(b)(2), (3) The amendment of Section 1112(b) makes it more likely that a small business case will be dismissed or converted (or a trustee will be appointed). Experience dictates an unfortunately high likelihood that a disorganized small business debtor will fail to comply with a court order, or will misunderstand and thus not comply with the new reporting requirements. Experience also indicates a not insubstantial number of repeat or serial filers among small business debtors. The 2005 Act addresses this issue by depriving repeat filers the benefit of the automatic stay. In particular, the stay is denied to:

MSmall business debtors who have a small business case pending at the time of the subsequent filing;

MSmall business debtors who had been a debtor in a small business case that had been dismissed at any time during the two years preceding the filing;

MSmall business debtors who had been a debtor in a small business case in which a plan had been confirmed at any time during the two years preceding filing; or

MAny entity who had acquired substantially all of the assets or business of a small business debtor who had a case pending, or whose case was dismissed, or who had confirmed a plan, within the two years preceding the filing.

11 U.S.C. §362(n) Limitations on automatic stay

§ 362. Automatic stay
(n) (1) Except as provided in paragraph (2), subsection (a) does not apply in a case in which the debtor—
(A) is a debtor in a small business case pending at the time the petition is filed;
(B) was a debtor in a small business case that was dismissed for any reason by an order that became final in the 2-year period ending on the date of the order for relief entered with respect to the petition;
(C) was a debtor in a small business case in which a plan was confirmed in the 2-year period ending on the date of the order for relief entered with respect to the petition; or
(D) is an entity that has acquired substantially all of the assets or business of a small business debtor described in subparagraph (A), (B), or (C), unless such entity establishes by a preponderance of the evidence that such entity acquired substantially all of the assets or business of such small business debtor in good faith and not for the purpose of evading this paragraph.
(2) Paragraph (1) does not apply—
(A) to an involuntary case involving no collusion by the debtor with creditors; or
(B) to the filing of a petition if—
(i) the debtor proves by a preponderance of the evidence that the filing of the petition resulted from circumstances beyond the control of the debtor not foreseeable at the time the case then pending was filed; and
(ii) it is more likely than not that the court will confirm a feasible plan, but not a liquidating plan, within a reasonable period of time.

F. PLAN AND DISCLOSURE STATEMENT

11 U.S.C. §1121(e) Plan exclusivity in small business cases

§ 1121. Who may file a plan
(e) In a small business case—
(1) only the debtor may file a plan until after 180 days after the date of the order for relief, unless that period is—
(A) extended as provided by this subsection, after notice and a hearing; or
(B) the court, for cause, orders otherwise;
(2) the plan and a disclosure statement (if any) shall be filed not later than 300 days after the date of the order for relief; and
(3) the time periods specified in paragraphs (1) and (2), and the time fixed in section 1129(e) [11 USCS § 1129(e)] within which the plan shall be confirmed, may be extended only if—
(A) the debtor, after providing notice to parties in interest (including the United States trustee), demonstrates by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time;

(B) a new deadline is imposed at the time the extension is granted; and
(C) the order extending time is signed before the existing deadline has expired.

11 U.S.C. §1125(f) Post-petition disclosure and solicitation

§ 1125. Postpetition disclosure and solicitation
(f) Notwithstanding subsection (b), in a small business case—
(1) the court may determine that the plan itself provides adequate information and that a separate disclosure statement is not necessary;
(2) the court may approve a disclosure statement submitted on standard forms approved by the court or adopted under section 2075 of title 28 [28 USCS § 2075]; and
(3) (A) the court may conditionally approve a disclosure statement subject to final approval after notice and a hearing;
(B) acceptances and rejections of a plan may be solicited based on a conditionally approved disclosure statement if the debtor provides adequate information to each holder of a claim or interest that is solicited, but a conditionally approved disclosure statement shall be mailed not later than 25 days before the date of the hearing on confirmation of the plan; and
(C) the hearing on the disclosure statement may be combined with the hearing on confirmation of a plan.

The 2005 Amendments imposed more stringent requirements on small business debtors in filing and confirming a plan of reorganization. Code § 1121(e) was added to impose an exclusivity period of 180 days after the order for relief for the filing of a plan and disclosure statement, but limited the court's ability to extend that period to 300 days. It appears that this 300 day maximum limit is being interpreted to apply only to debtor plans and does not limit the ability to file a plan at a later date. *In re Florida Coastal Airlines*, 386 B.R. 286 (Bankr. S.D.Fla. 2007). In *Florida Coastal*, the debtor's initial Plan was filed 200 days post-petition without extending exclusivity. The debtor's amended plan was filed 309 days post-petition and a competing plan was filed 317 days post petition. The debtor's amended plan related back to before the 300 day period expired, much like an amended pleading pursuant to FRBP 7015, keeping the filing within the 300 day "statute of limitations" –like deadline for filing plans and disclosure statements. The debtor's plan had to have been filed within the 300 day limitation,

however such limitation did not bar non-debtor sponsored plans from being filed following the expiration of the 300 day period. There is no statutory deadline for non-debtors to file competing plans and the filing 317 days post-petition was timely filed by the non-debtor.

Section 1125(b) of the Code indicates that a valid disclosure statement must be provided to each creditor or interest holder before a vote on the plan is taken. That disclosure statement, in turn, must contain "adequate information," defined in section 1125(a) as information of a kind, and in sufficient detail, as far is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, *including a discussion of the potential material Federal Tax consequence of the plan to the debtor, any successor to the debtor and a hypothetical investor typical of the holders of claims or interest in the case*, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan.

There are some benefits to the new procedures. In a small business case, there is a more expeditious confirmation process. The 2005 Act amended Section 1125(f) to allow, in a small business case, for a combined hearing on approval of the disclosure statement and plan, and for a hearing to determine that such documents may be combined. It also permits solicitation based upon conditionally approved disclosure statements, and for combined hearings on plans and disclosure statements. The court can limit the information required by a disclosure statement, or even eliminate the disclosure statement altogether. As stated above, the court may conditionally approve a disclosure statement subject to final approval after a notice in a hearing. Conditional approval will enable the debtor to solicit acceptances and rejections, but the conditionally approved disclosure statement must be mailed at least 25 days before the hearing on the

confirmation of the plan, and the hearing on the disclosure statement will be combined with the hearing on the plan itself.

G. CONCLUSION

As with many of the changes that came in with BAPCPA, the small business case rules are full of traps and pitfalls for the practitioner. Lawyers and accountants will have to work closely together to satisfy the new requirements. The small business debtor provisions are mandatory for those debtors whose debts fit the new definition, and reporting requirements were increased and the time deadlines shortened. Whether this results in more successful chapter 11 cases is something that only time will tell.