Eighth Circuit Judicial Conference 2021

Economic Trends and Hot Topics in Bankruptcy: An Insolvency Professional's Survival Kit

1. **Introduction – Panelists**

    a. Judge Robert J. Kressel, U.S. Bankruptcy Court of District of Minnesota
    b. Chief Judge Shon Hastings, U.S. Bankruptcy Court for the District of North Dakota
    c. Kristina M. Stanger, Shareholder, Nyemaster Goode, P.C., Des Moines, Iowa
    d. J. Thomas Beckett, Shareholder, Parsons Behle & Latimer, Salt Lake City, Utah

2. **Trends and Drivers with Economic Ties –** *see slide deck*

3. **Legislative Hot Topics –** *see slide deck*

    a. 2019 Legislation

        i. SBRA – HR3311

        ii. HAVEN Act – HR 2938

        iii. Chapter 12 – HR 2336

            1. See Overall Farm Bankruptcies Down, But Not in All Regions, AMERICAN FARM BUREAU FEDERATION (Aug.19, 2021), https://www.fb.org/market-intel/overall-farm-bankruptcies-down-but-not-in-all-regions.

            2. Alexandra Power Everhart Sickler, Betting on the Farm: Feasible Chapter 12 Plans, 95 THE AM. BANKR. LAW J., 279-312 (2021).

        iv. National Guard and Reservist Debt Relief Extension Act – HR 3304

    b. 2020 Legislation

        i. CARES Act I – Mar. 27, 2020

            1. Subsection 1113(a) of the CARES Act amends 11 U.S.C. § 1182(1) to change the definition of a debtor under Chapter

11 Subchapter V. The new definition raises the noncontingent liquidated debt limit for a Subchapter V debtor to $7,500,000.00, but otherwise matches the definition of a "small business debtor" as recited in section 101(51D). Sunset clause 1 year from enactment.

2. CARES Act contains several amendments to the Code aimed at consumer bankruptcy relief. Section 101(10A)(B)(ii) of the Code is amended to exclude payments made under federal law relating to the COVID-19 emergency from calculations of "current monthly income. Section 1325 is also amended so that such payments are likewise excluded from calculations of "disposable income" for the purpose of confirming a Chapter 13 plan. Section 1329 of the Code was amended to allow a debtor experiencing hardship as a result of the COVID-19 pandemic to modify a confirmed plan to extend its terms beyond the normal 60-month period.

3. CARES also contained many nonbankruptcy provisions which later prompts BK related amendments.

ii. Consolidated Appropriations Act (CAA) – Dec. 27, 2020

1. Division N, Title III of the CAA is titled the "Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act." Section 320 of this act amends the Code to describe the treatment of PPP loans in bankruptcy. However, these amendments have not gone into effect and it is unclear if they will. Not in effect until the Administrator of the SBA submits a written determination that bankruptcy debtors may be eligible for PPP loans to the Director of the Executive Office for the United States Trustees. At this time, the Administrator has submitted no such determination. If goes into effect, it would allow Debtors in possession or trustee to obtain PPP loan. Only applies to Sub V, ch 12 and Ch 13 cases. (Sunset 2 years from enactment of CAA).

2. Division FF of CAA, is entitled "Bankruptcy Relief" (also sunset 1 year after CAA):

    a. Various consumer relief
    b. Business relief
    c. Eviction moratorium until Jan 31, 2021 – extended 4 more times by the CDC before a Supreme Court per curium opinion ended it on Aug 27, 2021. *Alabama Ass'n of Realtors v. Dep't of Health & Hum. Servs.*

c. **2021 Legislation**

i. **CARES Act II – Mar. 27, 2021**

1. Extends Section 1113 of CARES Act I by an additional year – through March 27, 2022

2. Amends 1329 to all any debtor with confirmed plan before Mar 27, 2021 to extend plan for up to total of 84 months

3. CAA sunset dates remain unchanged

ii. **Introduced/Pending**

1. Student Loans: FRESH START Through Bankruptcy Act (S. 2598) Allowing borrowers to seek to discharge federal student loans in bankruptcy after a waiting period of 10 years. Read twice and referred to the Committee on the Judiciary on Aug. 4, 2021.); Private Student Loan BK Fairness Act (HR 4907)

2. Venue Reform (HR 4193/S. 2827)

3. Protecting Homeowners in BK Act (HR 242)

4. Medical BK Fairness Act (S. 146)

5. No Bonuses Ahead of BK Act (HR 428)

d. **Sackler Act / Nondebtor Release Prohibition Act of 2021**

i. Sackler Act: H.R.2096

ii. Nondebtor Release Prohibit Act of 2021 (NRPA): S.2497 / H.R.477

Aims to:

1. prohibit nonconsensual third-party releases (Adds section 113 to the Bankruptcy Code)

2. limit injunctions preventing filing or continuing suits against non-debtors to 90 days after the petition date

3. permit the dismissal of a case commenced by a debtor that was formed through a divisional merger (*i.e.*, separation of a

company's liabilities and assets) within 10 years of the petition date. (Amends section 1112 of the Bankruptcy Code)

4. Nondebtor Releases

a. Current Landscape

i. Non-Consensual 3rd Party Releases Generally Permitted: Second, Third (but see Washington Mutual), Fourth, Sixth, Seventh, and Eleventh Circuits

ii. Non-Consensual 3rd Party Releases Expressly Prohibited: Fifth, Ninth, and Tenth

iii. Status Uncertain (Officially): First, Eighth, and DC

b. Rationale

i. Rationale of Circuits Approving Non-Consensual 3rd Party Releases: Bankruptcy Code section 524(e) only *generally* provides that bankruptcy discharge does not affect third-parties; however, under the proper circumstances, courts can approve non-consensual 3rd party releases pursuant to Bankruptcy Code section 105(a).

ii. Rationale of Circuits Prohibiting Non-Consensual 3rd Party Releases: The statutory language of Bankruptcy Code section 524(e) expressly prohibits non-consensual 3rd party releases.

a. Note that this does not mean such 3rd party releases are outright banned!
b. Consensual 3rd party releases permitted (i.e. opt-in on ballots). *See, e.g.*, Plan Confirmation Hr'g at 61, *In re RAAM Global Energy Co.*, No. 15-35615 (Bankr. S. D. Tex. Jan. 28, 2016) [Docket No. 399] (Isgur, J.) ("[A]s to the holders of claims, it's limited to parties that have accepted and not opted out, and having reviewed it and in the absence of objections I think it is within the range of authority I have under existing Fifth Circuit law…")

c. Summary of Factors

i. Only for "unusual circumstances"

ii. Factors and weight generally depend on circuit and judge:

a. Substantial contribution to the chapter 11 plan
b. Necessity of the releases for feasibility of the plan
c. Lack of "identity of interest" between the debtors and third-party to justify release
d. Support of plan classes most impacted by release
e. Plan provides for payment to all, or substantially all, of classes affected by release

d. Authorities:

i. *In re Archdiocese of St. Paul and Minneapolis*, 578 B.R. 823 (D. Minn 2017) (Case No. 15-30125)
ii. *In re Purdue Pharma L.P., et al*, 2021 WL 4240974 (S.D.N.Y. Sept. 2021) (Case No. 19-23649)
iii. *Others Pending: In re USA Gymnastics*, S.D. Ind. Case No. 18-09108; *In re Boy Scouts of America*, D. Del. Case No. 20-798.
iv. Article: Maurice "Mac" Verstandig, *Senate Legislation Looks to Upend Nondebtor Releases, Stays,* XL ABI Journal 10, 8, 55-56 (October 2021).

5. Case Law Hot Topics

City of Chicago v. Fulton, 141 S.Ct. 585 (2021):

In Fulton, the Supreme Court held that that "mere retention of estate property after the filing of a bankruptcy petition does not violate §362(a)(3) of the Bankruptcy Code." Id. at 592. In her concurring opinion, Justice Sotomayor highlighted the practical issues for debtors who lose possession of their vehicles and opined that bankruptcy courts are not powerless to facilitate the return of debtors' vehicles to their owners. Id. at 594-95. Below are resources showing how some courts are addressing underrepresented or unrepresented debtors' presumed difficulty in navigating the litigation process that appears necessary to reacquire property seized just before petitioning for bankruptcy relief:

- See S.D. Cal. form "Notice of Motion and Motion for an Order Establishing Adequate Protection, Including Procedures to Return Property." (Attached)

- Hon. W. Homer Drake, et al., Chapter 13 Practice & Procedure § 15:12 (2d ed. 2021).

Bifurcated Fees in Consumer Cases:

- Ridings v. Casamatta (In re Allen), 628 B.R. 641 (B.A.P. 8th Cir. 2021) (involving Chapter 13 debtors' attorney who offered two payment options for his fees: 1) pay $1,500 in full prepetition, or 2) pay $2,000 postpetition through monthly payments; affirming bankruptcy court's determination that the additional $500 was not reasonable because the attorney "provided the same services he would have provided to both [debtors], regardless of whether his fees were paid under the prepetition or postpetition payment option"; and assessing the fees only under the reasonableness standard and "declin[ing] to express an opinion on the validity of bifurcation agreements generally or any problems associated with the 'unbundling' of legal services").

- In re Baldwin et al., 2001 WL 4592265 (Bankr. W.D. Ky. Oct. 5, 2021) (finding that the bifurcated fee agreements entered between Debtors and Attorney Harris and the Fresh Start Funding contracts used in 11 cases violate the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure and the Kentucky Rules of Professional Conduct and advising that "[s]uch contracts are not to be used by any attorney practicing bankruptcy law in the United States Bankruptcy Courts for the Western District of Kentucky).

- Casamatta v. Castle Law Office of Kansas City, P.C. (In re James), 2018 WL 6728395 (Bankr. W.D. Mo. Nov. 29, 2018) (Judge Norton) (involving a motion to withdraw the reference to the bankruptcy court to decide whether the debtors' bankruptcy attorneys violated bankruptcy code provisions, applicable bankruptcy and ethical rules, and should be sanctioned; recommending the district court deny the motion; and not reaching the merits). In the underlying actions, the UST asserted the debtors' attorney and his law firm "employed an improper and undisclosed factoring-type filling arrangement for their consumer debtor clients who were unable to prepay the attorney fees, and that that arrangement made it appear that all, or nearly all, of the fees were incurred for postpetition services when they were not" and that, as a result of this practice, the firm "overcharged debtors and misled the court about the nature of the fees, and in so doing, violated a number of bankruptcy code provisions and ethical rules."

- In re Brown, 2021 WL 2460973 (Bankr. S.D. Fla. June 16, 2021) (in three separate "no money down" or "low money down" cases, UST objected to the business practices of two law firms with respect to the bifurcation of attorney fees in consumer Chapter 7 cases). The court held that:
    - ✓ for an attorney using a bifurcated fee arrangement to meet his or her obligation of competency with respect to prepetition services, the attorney must meet with a potential bankruptcy client and review sufficient information to competently advise the potential client whether to file bankruptcy and, if so, under what chapter;

- ✓ an attorney using a bifurcated fee arrangement must provide certain prepetition and postpetition "core services," as specified by the court;
- ✓ for disclosures to a potential client to be adequate, they must satisfy the requirements set forth by the court ("A fundamental premise of all the fee bifurcation cases is disclosure.");
- ✓ an attorney using a bifurcated fee arrangement must make sure that any such arrangement is properly disclosed to the court and to parties in interest; and
- ✓ a law firm's payment of the filing fee with postpetition repayment by the debtor violates the Bankruptcy Code as well as the Florida Bar rules.

- In re Prophet, 628 B.R. 788, 798, 804 (Bankr. D.S.C. 2021) (determining that, under the court's local rule, an attorney who filed a bankruptcy case on behalf of a debtor was required to represent the debtor in all matters relating to the representation except for adversary proceedings and appeals and bifurcated fee arrangements are therefore impermissible; and requiring the attorney to return to the debtors all fees that he received postpetition in accordance with signed postpetition agreements).

- In re Hazlett, 2019 WL 1567751, at *7-8 (Bankr. D. Utah Apr. 10, 2019) (distinguishing bifurcated fee agreements from limited services agreements and finding bifurcated fee agreements permissible; and emphasizing that attorneys must use special care to ensure full disclosure and informed consent and finding attorney met these requirements).

- In re Carr, 613 B.R. 427 (Bankr. E.D. Ky. 2020) (reviewing a fee statement submitted by Chapter 7 debtor's counsel, which disclosed that attorneys received $300 from debtor prepetition and were to be paid $1,185 postpetition; holding that, if completed properly, an attorney may limit the scope of her bankruptcy services to a prepetition analysis of a debtor's bankruptcy options and filing the debtor's skeletal Chapter 7 petition; concluding that the "dual contract" arrangement by which attorney used pre- and postpetition contracts to bifurcate the services provided to debtor was reasonable).

Subchapter V:

- Article: Hon. Michelle M. Harner, Emily Lamasa and Kimberly Goodwin-Maigetter, *Subchapter V Cases by the Numbers,* XL ABI Journal 10, 12, 59-60 (October 2021).
- Donald L. Swanson, Subchapter V: A New Sale-of-Business Opportunity, MEDIABANKRY, https://mediatbankry.com/2021/07/22/subchapter-v-a-new-sale-of-business-opportunity/.

Subchapter V Eligibility – "Engaged in commercial or business activities:"

- In re Wright, 2020 WL 2193240, at *3 (Bankr. D.S.C. Apr. 27, 2020) (relying, in part, on Colliers, to conclude that "[a]lthough the brief legislative history of the SBRA indicates it was intended to improve the ability of small businesses to reorganize and ultimately remain in business, nothing therein, or in the language of the definition of a small business debtor, limits application to debtors **currently** engaged in business or commercial activities").

- In re Bonert, 619 B.R. 248, 255-56 (Bankr. C.D. Cal. 2020) ("Although the brief legislative history of the SBRA indicates it was intended to improve the ability of small businesses to reorganize and ultimately remain in business, nothing therein, or in the language of the definition of a small business debtor, limits application to debtors *currently* engaged in business or commercial activities . . . . [The debtor] is 'engaged in commercial or business activities' by addressing residual business debt . . . ." (quoting In re Wright, 2020 WL 2193240, at *3; and ruling that debtors' subsequent re-designation as a Subchapter V debtor was reasonable and made in good faith).

- In re Ellingsworth Residential Cmty. Ass'n, Inc., 619 B.R. 519, 521 (Bankr. M.D. Fla. 2020) (finding the plain language of the statute clear and unambiguous; opining that "[a]ny corporation that conducts 'commercial or business activities' is a small business debtor," regardless of profit motive or lack thereof; and ruling that the non-profit community association debtor in this case conducts sufficient 'commercial or business activities' to qualify as a small business debtor").

- In re Blanchard, 2020 WL 4032411, at *1 (Bankr. E.D. La. July 16, 2020) (adopting the reasoning of the Wright court; opining that "although the brief legislative history of the SBRA indicates it was intended to improve the ability of small businesses to reorganize and ultimately remain in business, nothing therein, **or in the language of the definition of a small business debtor**, limits application to debtors currently engaged in business or commercial activities" (quoting In re Wright, 2020 WL 2193240, at *3; finding that the majority of debtors' debts stemmed from both currently operating businesses and non-operating businesses and the sum of these debts did not exceed the SBRA's debt limit; concluding that debtors qualified as small business debtors under SBRA; and rejecting the trustee's argument that allowing debtors to proceed under Subchapter V was inappropriate because they missed applicable deadlines).

- In re Thurmon, 625 B.R. 417, 420-23 (Bankr. W.D. Mo. 2020) (declining to follow previous cases interpreting "engaged in commercial or business activities;"[1] finding that the "plain meaning of 'engaged in' means to be actively and currently involved;" and ruling that debtors "were not as a matter of fact or law 'engaged in commercial or business activities' on the day they filed bankruptcy because they had in fact sold the business with no intent to return to it and were otherwise not active or involved in any commercial or business activities").

- In re Johnson, 2021 WL 825156, at *4-7 (Bankr. N.D. Tex. Mar. 1, 2021) (ruling that a debtor who previously owned and managed certain now-defunct businesses and who, on account of such ownership and involvement, has mostly business-related debts, but who offered no evidence suggesting that the cessation of such commercial and business activities was in any way only temporary in nature was not "engaged in" commercial or business activities for purposes of eligibility under Subchapter V).

- In re Ikalowych, 629 B.R. 261, 276, 280-83, 286-87 (Bankr. D. Colo. 2021) (finding that the plain meaning of "commercial or business activities" is "exceedingly broad," meaning "any private sector actions related to buying, selling, financing, or using goods, property, or services, undertaken for the purpose of earning income (including by establishing, managing, or operating an incorporated or unincorporated entity to do so);" considering the "then-present state of things as of the Petition Date," but also looking at the relevant the circumstances immediately preceding and subsequent to the petition date as well as the debtor's conduct and intent; finding that debtor was still "engaged in" business; and recognizing that the court's legal conclusion regarding the debtor's work for CCIG suggests that "virtually all private sector wage earners may be considered as 'engaged in commercial or business activities'").

- In re Offer Space, LLC, 629 B.R. 299, 306-07 (Bankr. D. Utah 2021) (concluding that to be eligible for Subchapter V, a debtor must be presently "engaged in commercial or business activities" on the date of filing the petition; and using a totality of the circumstances approach, the court found that, as of the petition date, debtor was actively engaged in commercial or business activities even though its business operations were no longer functioning).

- In re Blue, 2021 WL 1964085, at *7-8 (Bankr. M.D.N.C. May 7, 2021) (finding that Debtor's consulting—an activity that "is clearly the delivery of services in exchange for a profit"—qualified as engaging in commercial or business activities; noting that nothing in the Bankruptcy Code "mandates that commercial or business activities must be full-time to qualify, and Debtor's activities in this case are substantial and material;" and rejecting the creditor's assertion that

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[1] See In re Wright, 2020 WL 2193240; In re Bonert, 619 B.R. 248 (following Wright); In re Blanchard, 2020 WL 4032411 (same).

section 1182 requires that debtor's scheduled business debts must be related to her current business activities to qualify for the debt specifications under Subchapter V).

- In re Port Arthur Steam Energy, L.P., 629 B.R. 233, 236-37 (Bankr. S.D. Tex. 2021) (finding that, although the debtor was not conducting its historical business operations (selling steam or electricity) on the petition date, it was engaged in other commercial and business activities that qualify it for relief under subchapter V; and rejecting the argument that debtor's lack of W-2 employees disqualified it as a small debtor under Subchapter V because the small debtor definition does not require debtor to "maintain its core or historical business operations on the petition date.").

- In re Vertical Mac Construction, LLC, 2021 WL 3668037 (M.D.Fla. July 23, 2021) (finding that debtor was "engaged in commercial or business activities" and eligible to proceed under Subchapter V even though it ceased operating its business and sought bankruptcy protection to liquidate and distribute its assets).

Subchapter V Debt limits:

- In re Parking Mgmt., Inc., 620 B.R. 544, 552-53, 558-59 (Bankr. D. Md. 2020) (finding that lease rejection claims were contingent obligations until approved by the court and not included in total debt for eligibility purposes; ruling that a PPP loan was a contingent claim because "as of the petition date, the debtor's liability to repay the PPP [was] dependent on it using the funds for ineligible expenses or failing to meet employment retention criteria[,]" which "relies on some future extrinsic event which may never occur;" finding that the PPP loan was unliquidated as of the petition date "because it was not then known, and could not be determined, whether the debtor would use the PPP funds for ineligible expenses or would fail to maintain employee staffing levels in accordance with the PPP;" and concluding that, because the PPP claim was contingent and unliquidated as of that date, it was not included in the debt limit determination and debtor was eligible to proceed under Subchapter V.)

Election to proceed under Subchapter V after Deadlines in 1188(a) (status conference requirement) and 1889(b) (deadline to file plan) passed:

- In re Keffer, 628 B.R. 897 (Bankr. S.D.W. Va. 2021) (allowing debtor to amend petition to elect Subchapter V after certain deadlines in sections 1188 and 1189 had passed and granting debtor's request to extend deadlines).

- In re Seven Stars on the Hudson Corp., 618 B.R. 333, 339, 347 (Bankr. S.D. Fla. 2020) (dismissing the case after debtor filed an amended petition electing to proceed under subchapter V because the deadlines in sections 1188 and 1189

passed and debtor "immediately put itself in default" of these requirements.) The court noted: "Where a debtor elects to proceed under Subchapter V after the statutory deadlines have passed, it cannot be said that the need for an extension of these deadlines is attributable to circumstances for which the debtor should not justly be held accountable."

- In re Trepetin, 617 B.R. 841, 850 (Bankr. D. Md. 2020) (granting debtor's motion to convert, prompting debtor to file an amended petition electing to proceed under Subchapter V; and granting debtor's request to extend deadlines in sections 1188 and 1189 because debtor "should not be held justly accountable for his inability to meet those deadlines.")

- In re Tibbens, 2021 WL 1087260, at *1, *9 (Bankr. M.D.N.C. Mar. 19, 2021) (granting debtor's motion to convert, prompting debtor to file an amended petition electing to proceed under Subchapter V; but denying debtor's request to extend deadlines in sections 1188 and 1189 because he did not meet his burden of showing that he should not be held justly accountable for his inability to meet those deadlines).

- In re Wetter, 620 B.R. 243, 253 (Bankr. W.D. Va. 2020) (determining that Seven Stars sets "too rigid" of a test, and concluding that Trepetin "charts a better path")

- In re Northwest Child Devel. Centers, Inc., 2020 WL 8813586, *3 (Bankr. M.D.N.C. Dec. 8, 2020) (denying motion to extend the deadline for filing a plan under § 1189(b) because debtor failed to carry its burden of showing "the need for an extension of the plan deadline is attributable to circumstances for which the Debtor should not justly be held accountable.").

Applicability of 1111(b) Election in Subchapter V Cases:

- In re Body Transit Inc., 619 B.R. 816, 837 (Bankr. E.D. Pa. 2020) (sustaining debtor's objection to a creditor's 1111(b) election because the secured creditor's collateral was of "inconsequential value" within the meaning of 1111(b)(1)(B)(i) and explaining that "the Debtor's election to reorganize under subchapter V and the purposes and policies underlying the SBRA influence my determination of the level of value that is 'inconsequential'").

- Thomas C. Scherer & Whitney L. Mosby, The Applicability of the § 1111(b) Election in a Small Business Case, XL AM. BANKR. INST. J. 12 (May 2021).

Equitable Dismissal (Mootness):

- *FishDish LLP v. VeroBlue Farms USA Inc. (*In re VeroBlue Farms USA Inc.) 19-3413 (8th Cir. 2021) (reversing the district court's dismissal of an equity holder's appeal of the Chapter 11 confirmation order on grounds of equitable mootness and remanding for reconsideration on the merits. In holding, the 8th Circuit barred dismissal of an appeal without "at least a preliminary review of the merits of [the appellant's] appeal to determine the strength of [appellant's] claims, the amount of time that would likely be required to resolve the merits of those claims on an expedited basis, and the equitable remedies available – including possible dismissal – to avoid undermining the plan and thereby harming *third parties*." The 8th Circuit Court also banished the term "equitable mootness" from "local lexicon," and replaced it with "equitable dismissal.")

OTHERS

Curing Post-Petition Arrears in Chapter 13:

- In re Smith, 2021 WL 2628823, at *4 (Bankr. D.N.J. June 24, 2021) (recognizing "[c]ourts are split on the interpretation of section 1322(b) when considering whether a debtor may modify a Chapter 13 Plan to include post-petition arrears pursuant to section 1329" and concluding that the court may confirm a modified plan that includes payment of post-petition arrears).

- Kinney v. HSBC Bank, USA, N.A. (In re Kinney), 5 F.4th 1136 (10th Cir. 2021) (affirming the dismissal of a case involving a debtor who missed mortgage payments during the final months of her 60-month Chapter 13 plan; and ruling that a debtor may not cure a payment default after her Chapter 13 plan's term ended).

- In re Klaas, 858 F.3d 820 (3d Cir. 2017) (concluding that the bankruptcy court did not abuse its discretion in granting Chapter 13 debtors a grace period to complete plan payments after the term of their plan expired).

401k Contributions in Chapter 13 Cases:

- Penfound v. Ruskin (In re Penfound), 7 F.4th 527, 534 (6th Cir. 2021) (holding that "the bankruptcy code's text does not permit a Chapter 13 debtor to use a history of retirement contributions from years earlier as a basis for shielding voluntary post-petition contributions from unsecured creditors. This is true even if the debtor had no ability to make further contributions in the six months preceding filing; the code makes no exception for such circumstances.").

- In re Aquino, 2021 WL 2144356 (D. Nev. May 25, 2021) (comprehensively reviewing case law and denying confirmation of debtor's Chapter 13 plan because, under the totality of the circumstances, the debtor—who voluntarily contributed $1,509.50 monthly to her retirement plan postpetition, instead of the $612.90 reported at the commencement of the case—did not propose her plan in good faith).

- In re Melander, 506 B.R. 855, 867-68 (Bankr. D. Minn. 2014) (finding the rationale employed by the courts in Seafort, Drapeau, Devilliers and Jensen instructive; and ruling that because the debtor had been making voluntary contributions for the last 14 years, there was "no reason to suggest that her motivation in doing so was anything but in good faith.")

- In re Matsen, 391 B.R. 847, 850 (Bankr. N.D. Iowa 2008) (finding that debtors' voluntary retirement contributions were "permitted by the Bankruptcy Code").

Homestead Exemption Issues:

- Rockwell v. Hull (In re Rockwell), 968 F.3d 12, 20 (1st Cir. 2020) (concluding "that the complete snapshot rule applies to homestead exemptions taken under section 522, where none of the statute's enumerated exceptions applies;" and holding that, even though Maine's homestead law required that debtor reinvest the proceeds from the sale of his homestead in another homestead within six months and he failed to do so, debtor's exemption of homestead proceeds was proper).

Economic Trends and Hot Topics in Bankruptcy:

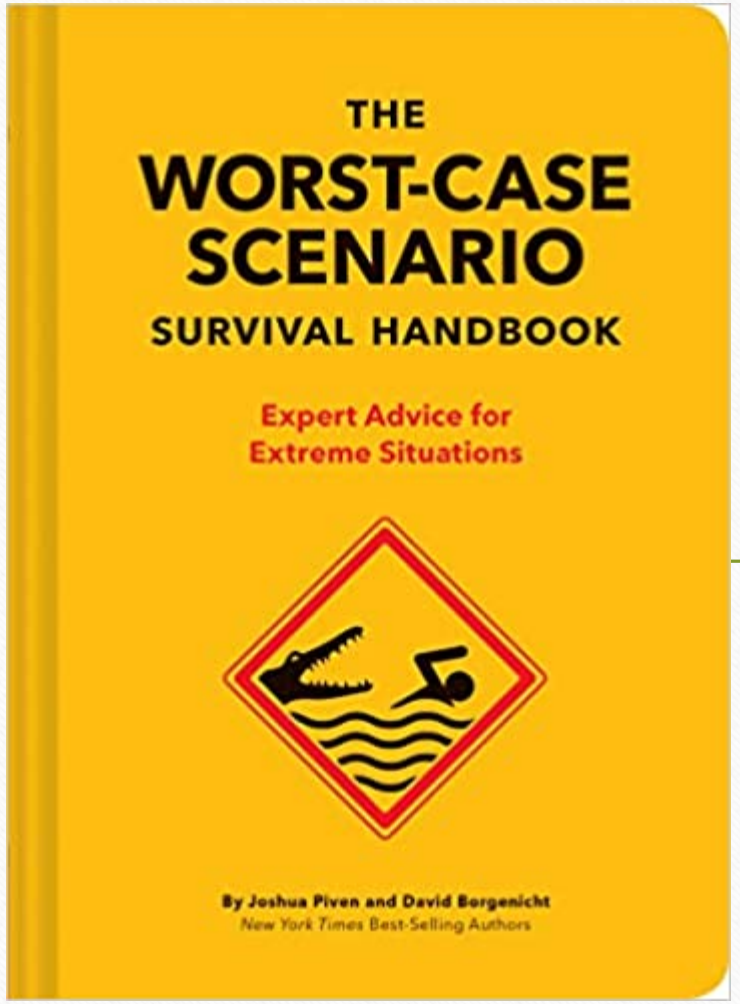
An Insolvency Professional's Survival Kit

Your Survival Guides - Introduction of Panel

- **Judge Robert J. Kressel**, U.S. Bankruptcy Court of District of Minnesota
- **Chief Judge Shon Hastings**, U.S. Bankruptcy Court for the District of North Dakota
- **Kristina M. Stanger**, Shareholder, Nyemaster Goode, PC, Des Moines, Iowa
- **J. Thomas Beckett**, Shareholder, Parsons Behle & Latimer, Salt Lake City, Utah

Today's Map

- Trends and Drivers with Economic Ties
- Legislative Hot Topics
- Nondebtor Releases
- Case Law Hot Topics

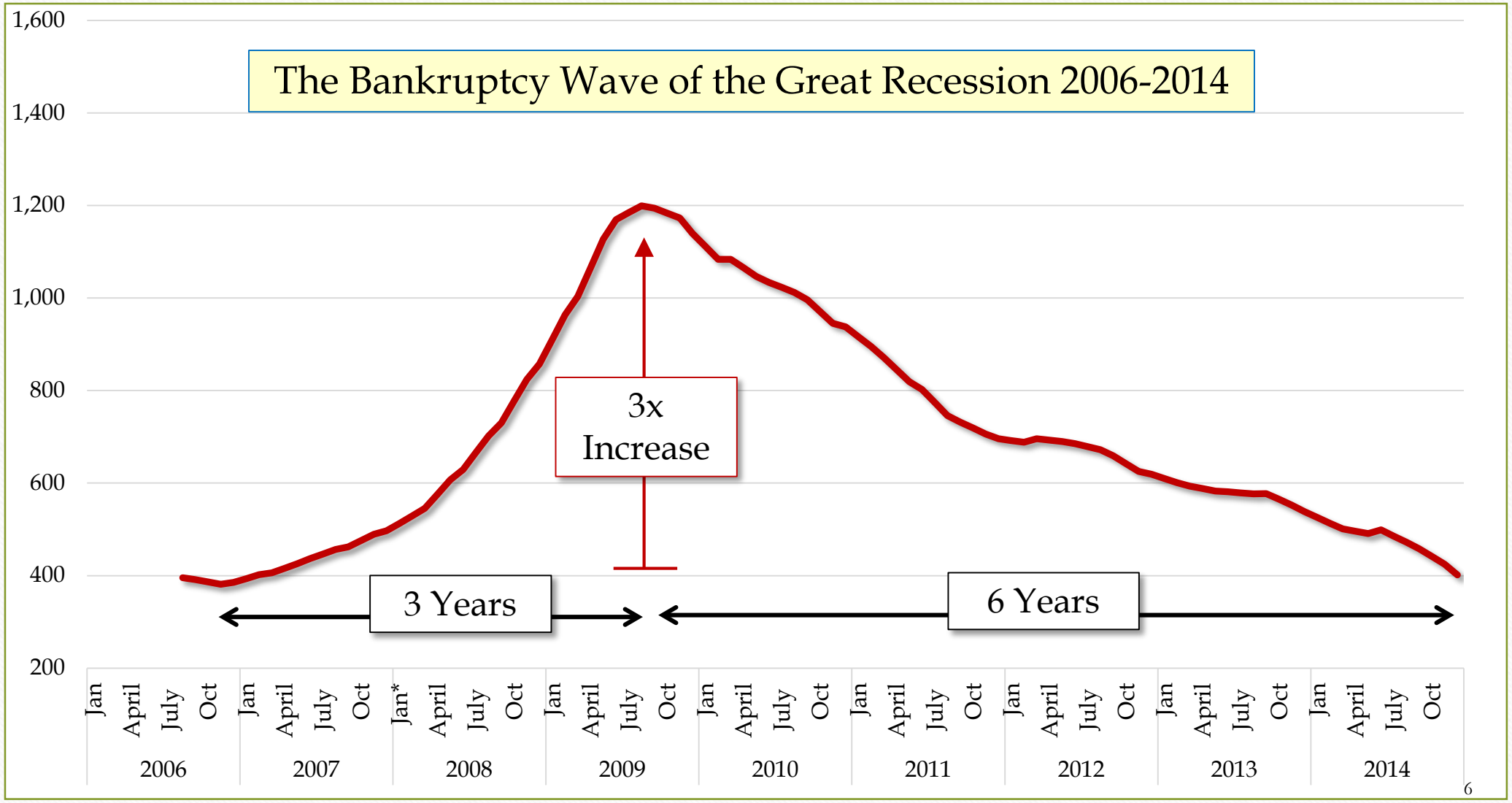


Trends and Drivers with Economic Ties

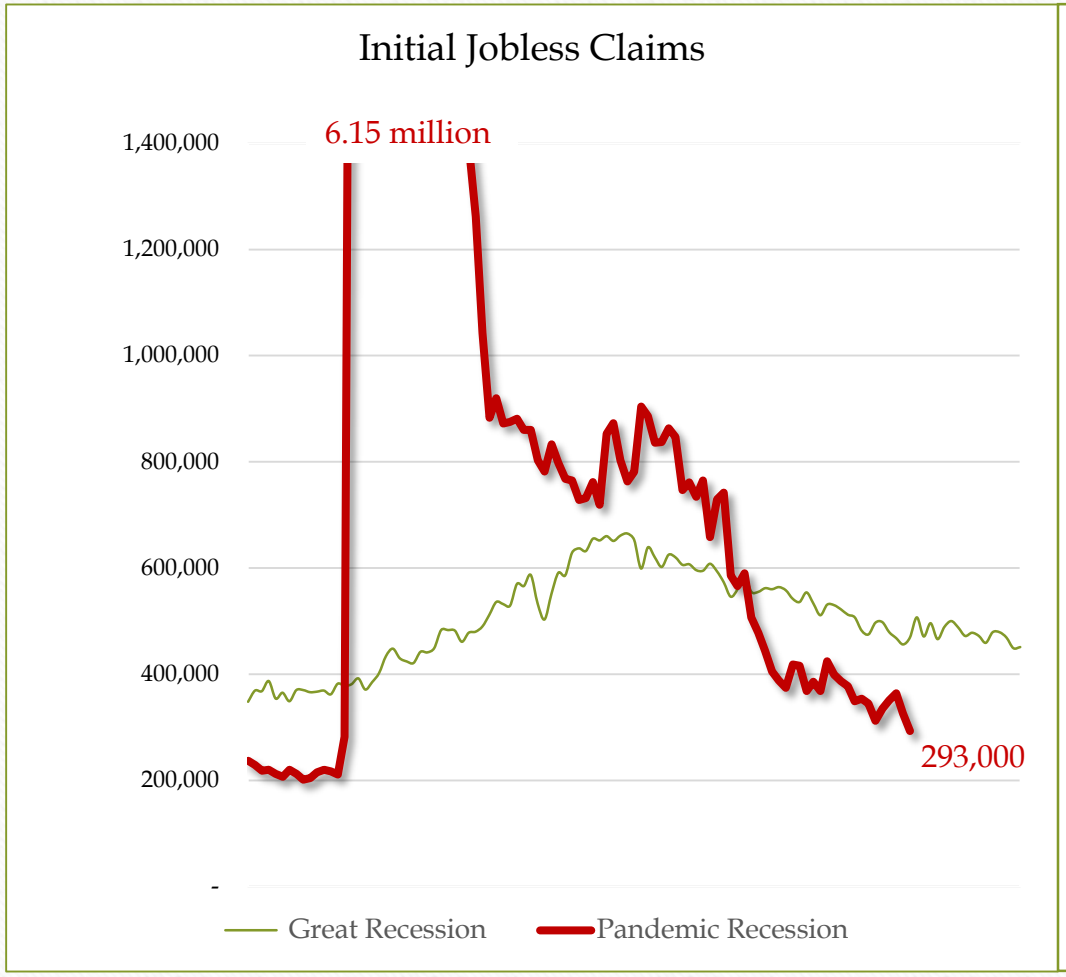
“How did you go bankrupt?” Bill asked.
“Two ways,” Mike said. “Gradually and then suddenly.”

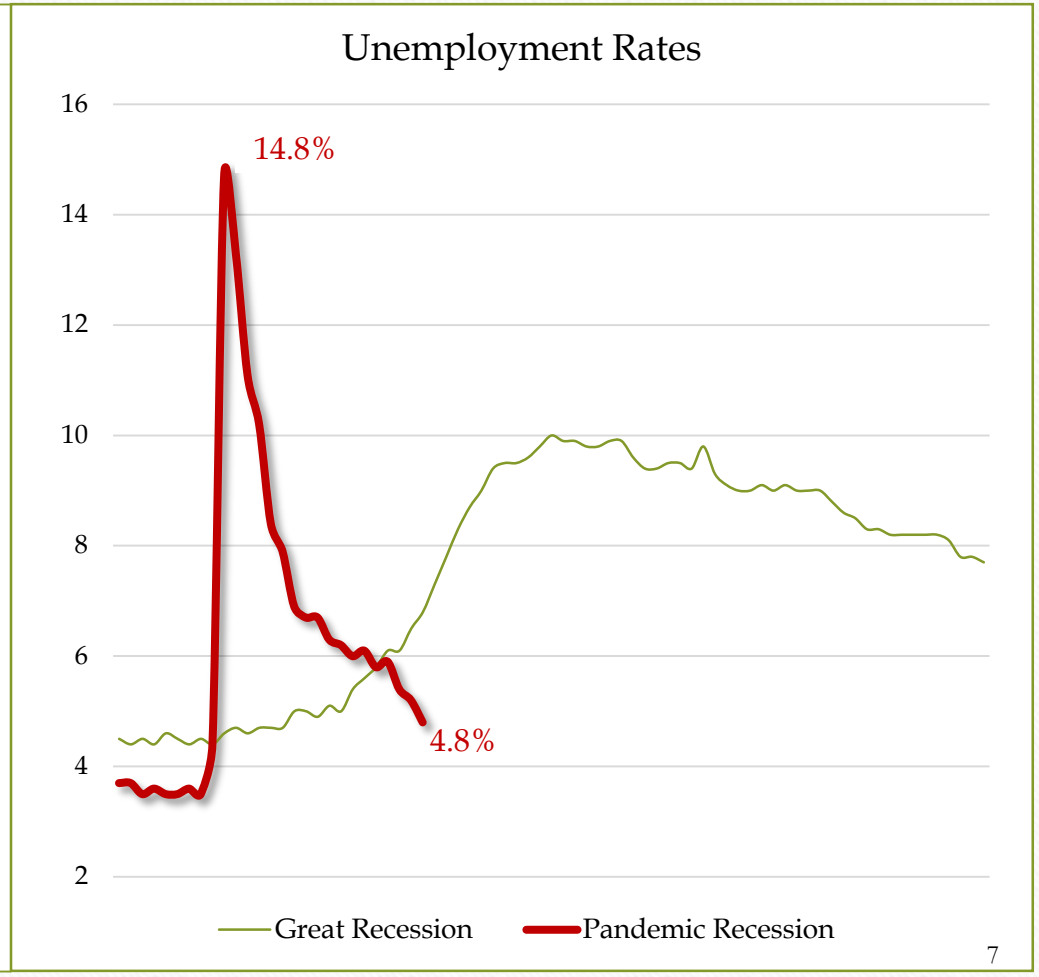
-Ernest Hemingway, “The Sun Also Rises”

The great recession triggered a wave of bankruptcy filings that lasted nine years.

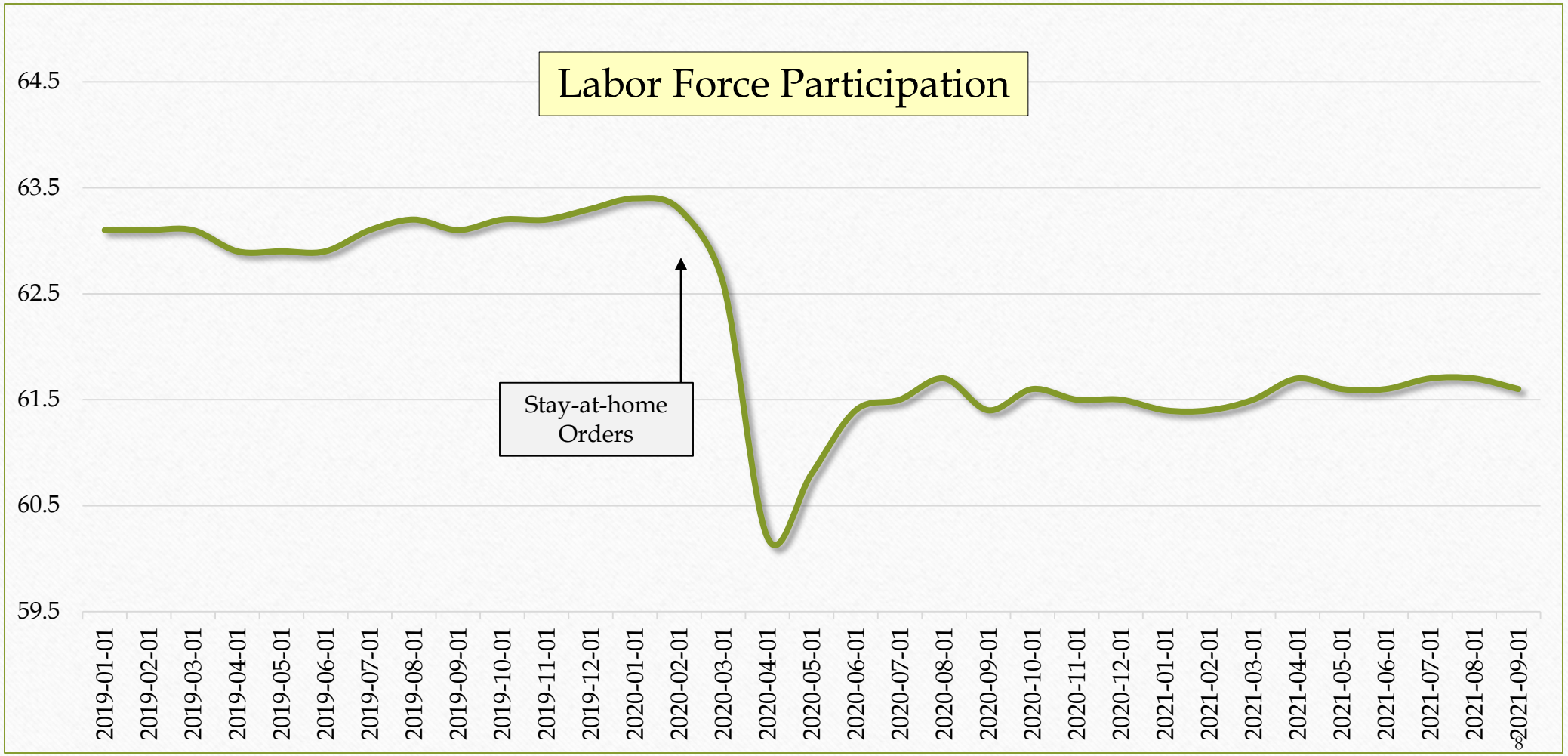


The pandemic recession began more brutally than the great recession and then recovered faster, at first. After a rough COVID winter, initial jobless claims fell in the spring, then slowed their fall in the summer with the Delta variant. Lots of workers have cycled through the workforce at Amazon. And through the ranks of the unemployed.

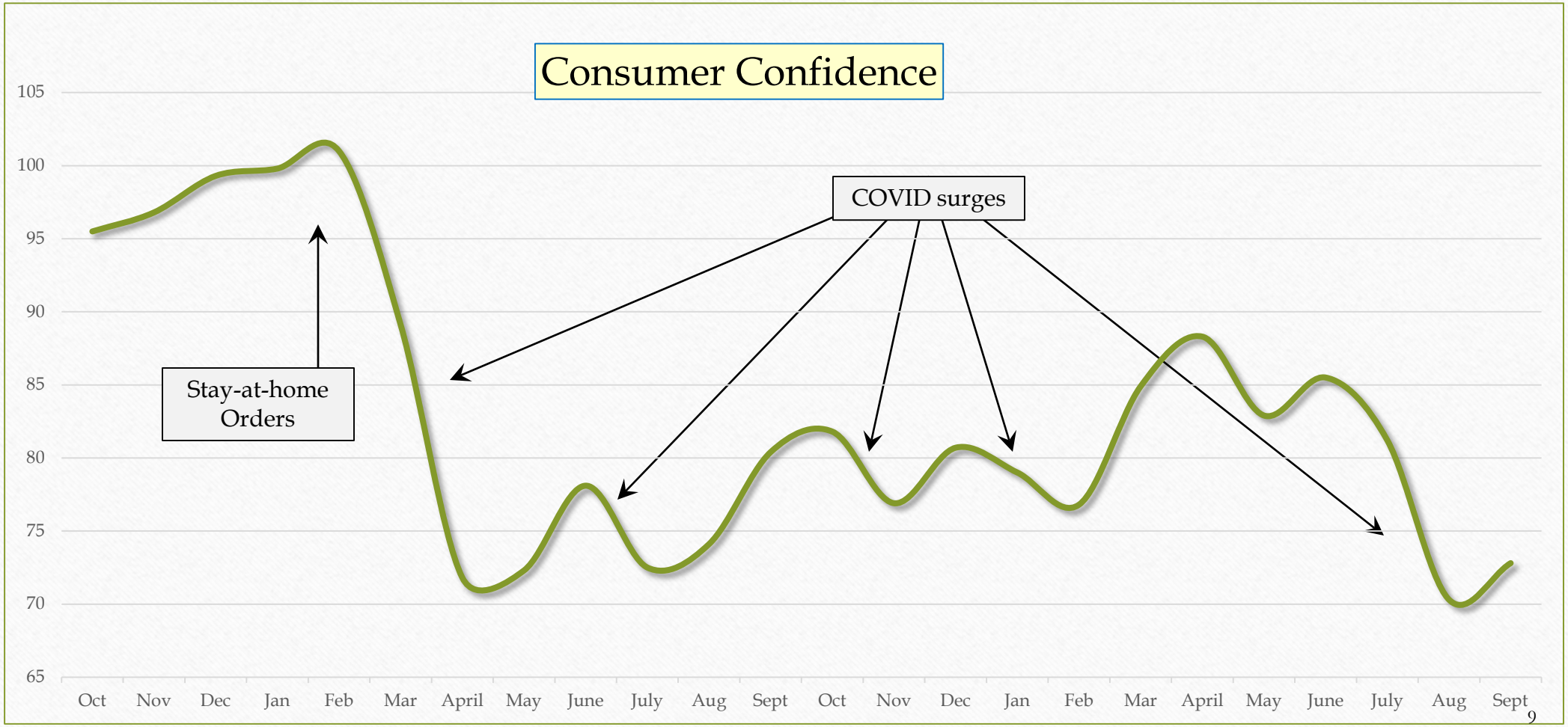




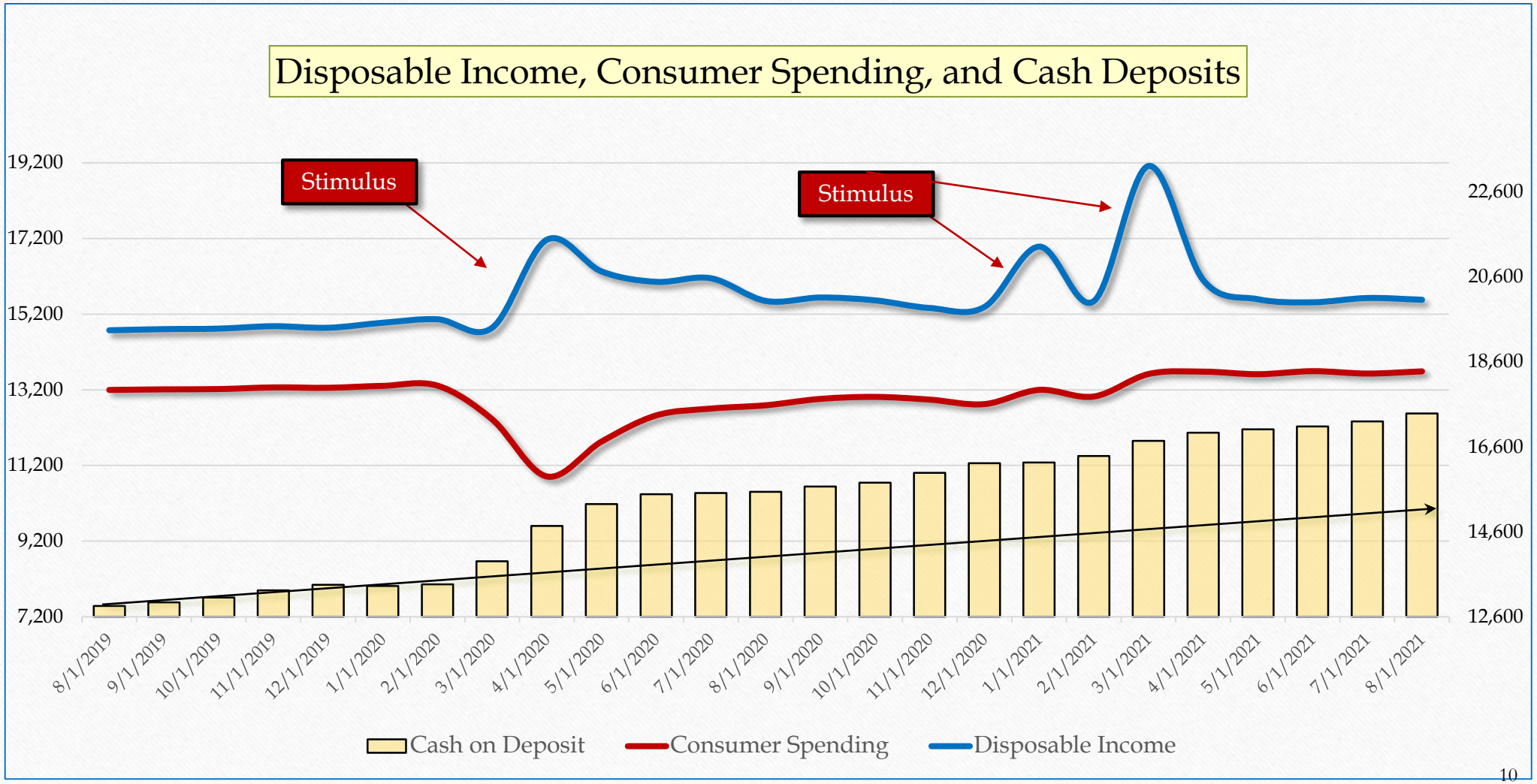
Before the pandemic, labor force participation rates were at their highest levels since 2013. During the pandemic, they fell to the lowest rate since 1972, and they have since recovered less than half the loss. Nearly 2% of workers (3 million) have left the workplace and not returned.



Consumer confidence was also beaten down by COVID surges.



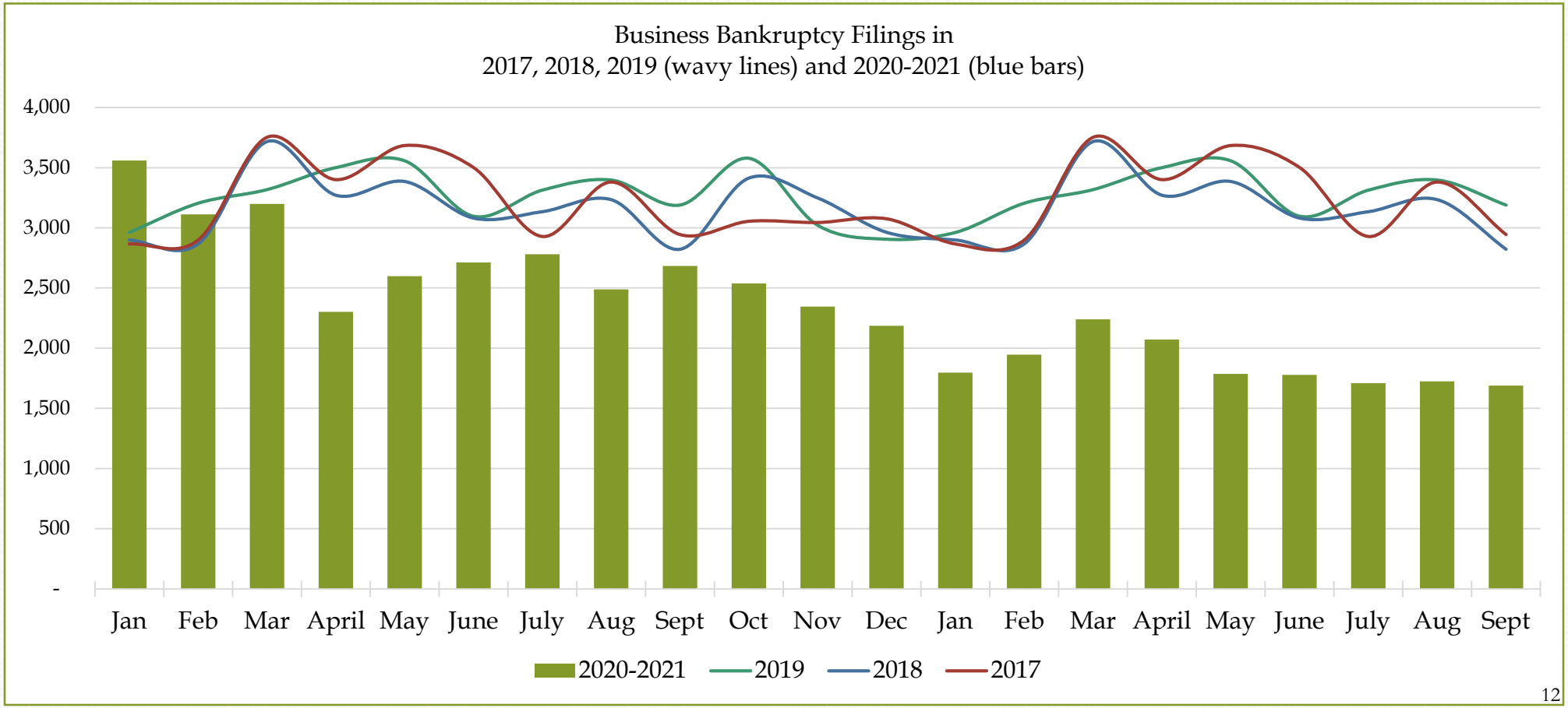
Stimulus increased spending and saving rates. The higher saving rates contributed an additional $3 trillion of cash on deposit at banks. That cash could accelerate the recovery, if consumer confidence were not so low.



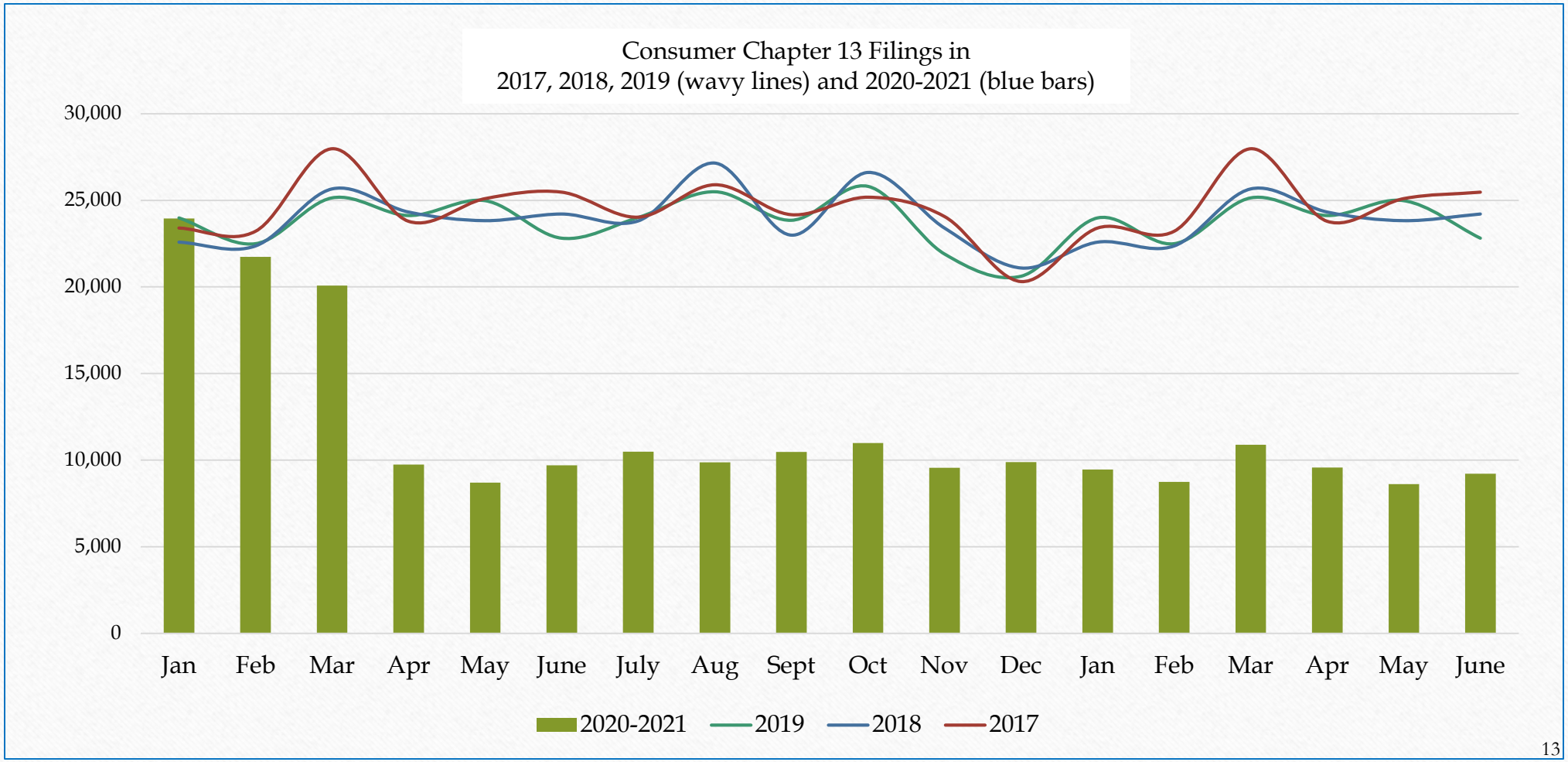
The pandemic whacked our economy. But there was no bankruptcy wave.

Instead, there's been a decline.

During the pandemic, business bankruptcy filings fell substantially and have remained historically low since the first stay-at-home orders. (Business bankruptcies are chapter 7 and 11 filings by commercial entities and chapter 13s that include sole proprietorships.)

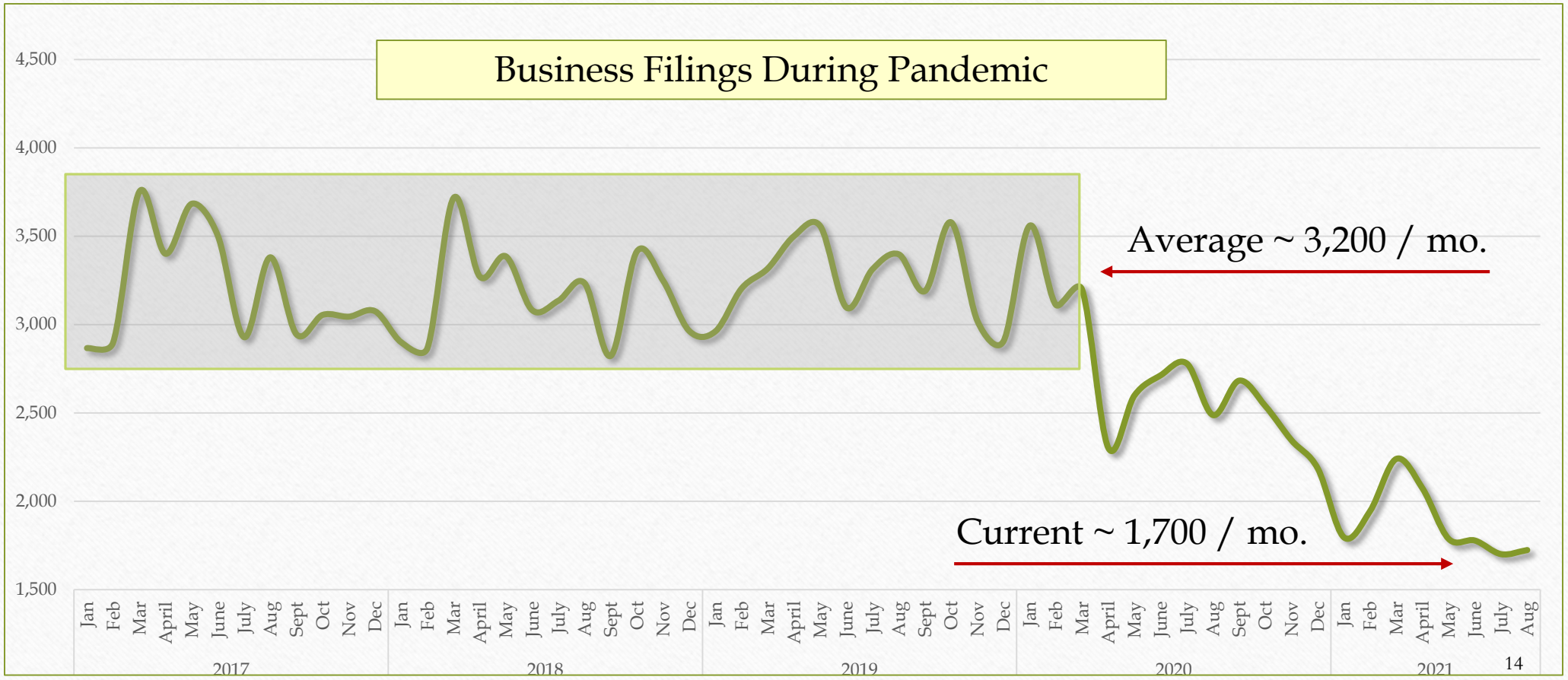


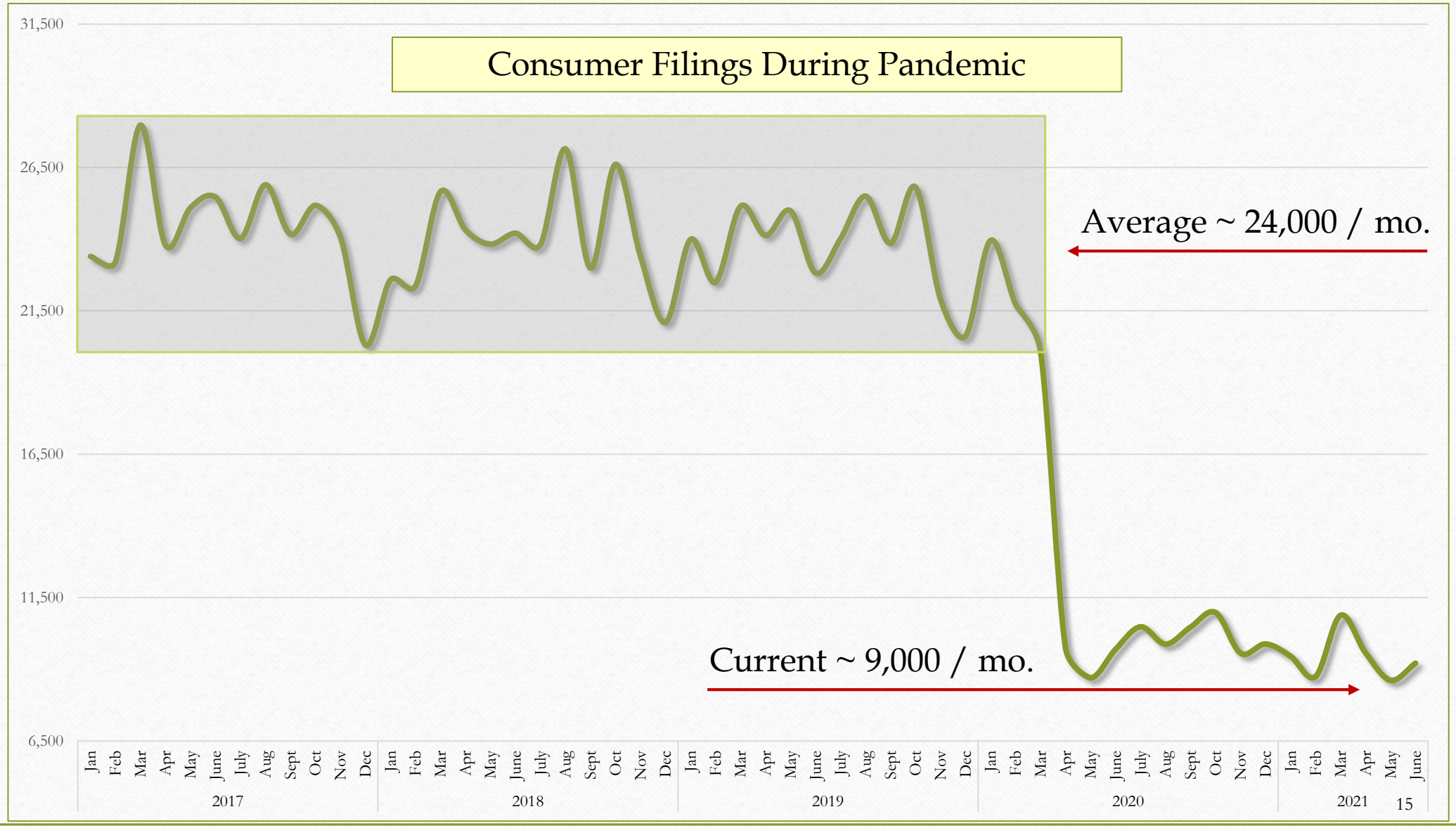
During the pandemic, consumer bankruptcy filings fell precipitously and have remained historically low since the first stay-at-home orders. (Consumer bankruptcies are chapter 7, 11, and 13 filings by individuals.)



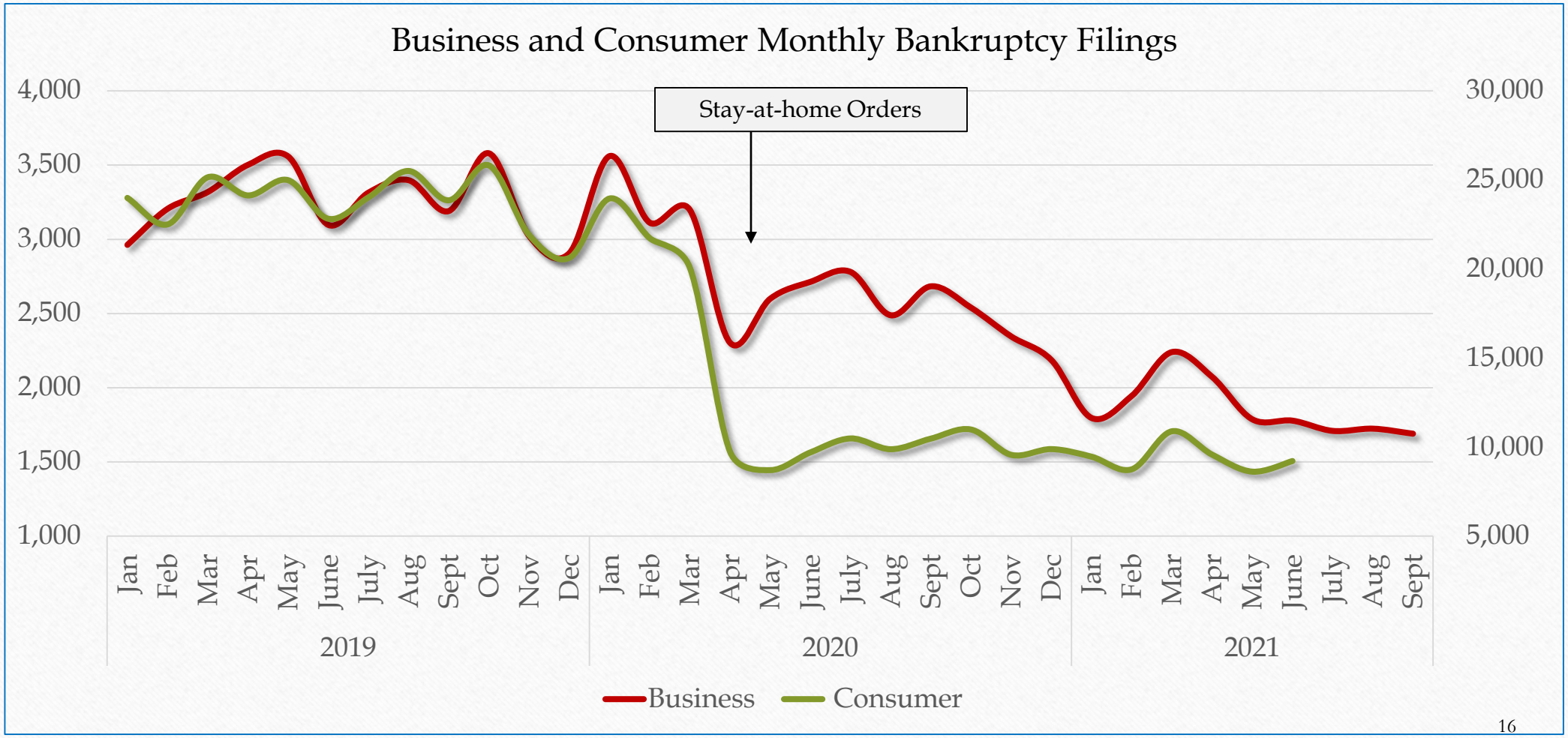
https://www.uscourts.gov/report-name/bankruptcy-filings ; F-2 (One Month)

Pre-pandemic, when our economy was healthy, an average of 3,200 businesses filed bankruptcy every month in the U.S. Economists call this "creative destruction." It is the rate at which marginal businesses naturally fail. Their failure makes room for more efficient businesses to thrive. Since the pandemic began, filings have dropped to 1,700 per month, almost to half the creative destruction rate.

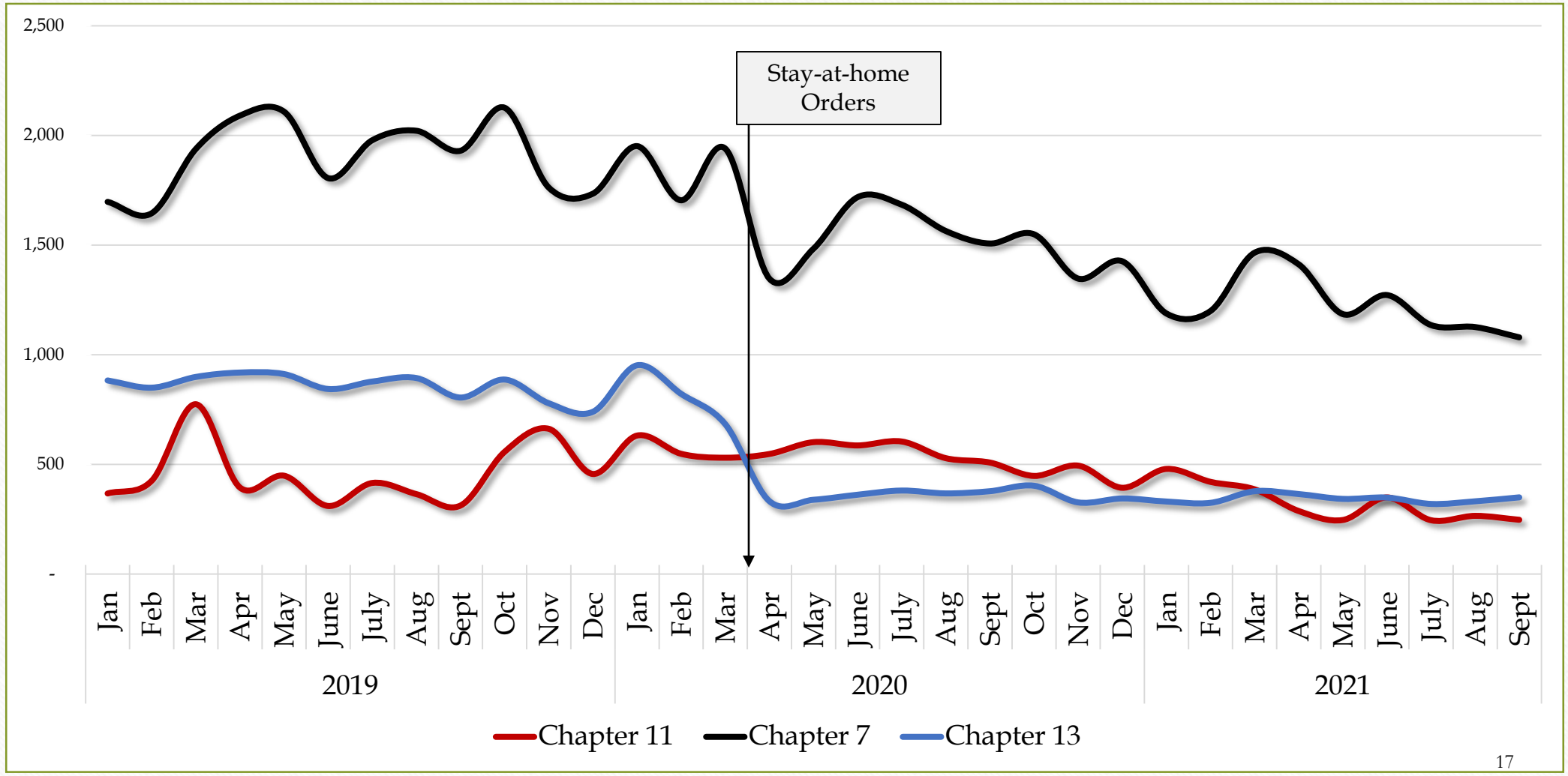



Consumer Filings During Pandemic
31,500
26,500
21,500
16,500
11,500
6,500
Average ~ 24,000 / mo.
Current ~ 9,000 / mo.
Jan Feb Mar Apr May June July Aug Sept Oct Nov Dec
2017
2018
2019
2020
2021

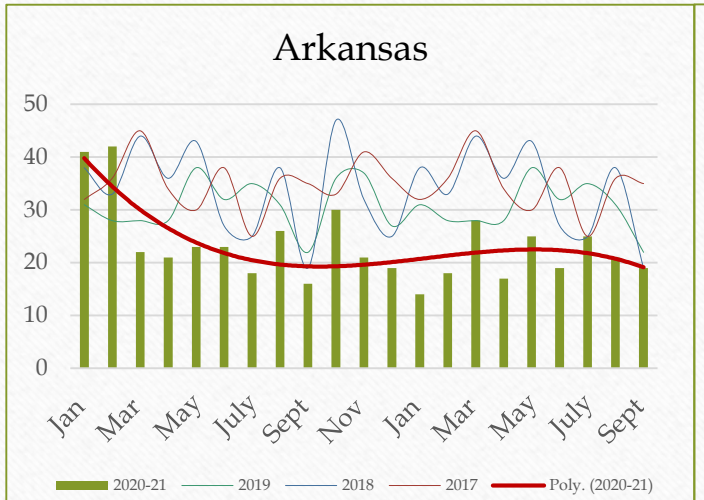
Business and Consumer filing rates are highly correlated; that is, they tend to move in the same direction at the same time. Consumer bankruptcy filing rates declined faster in the pandemic than business filing rates. Business rates declined more gradually.

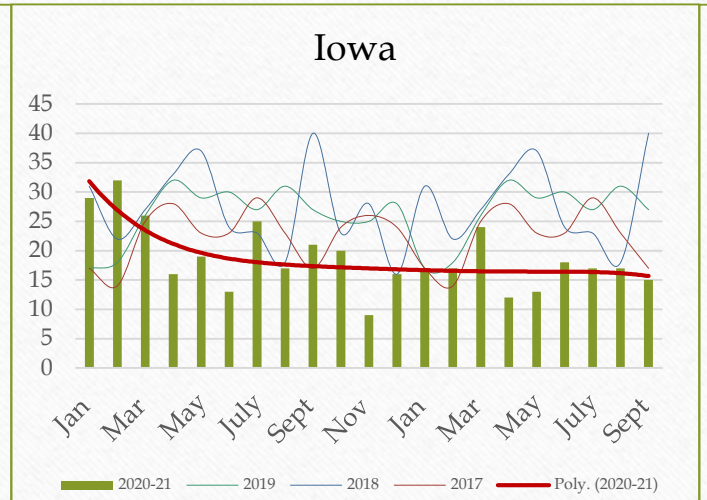


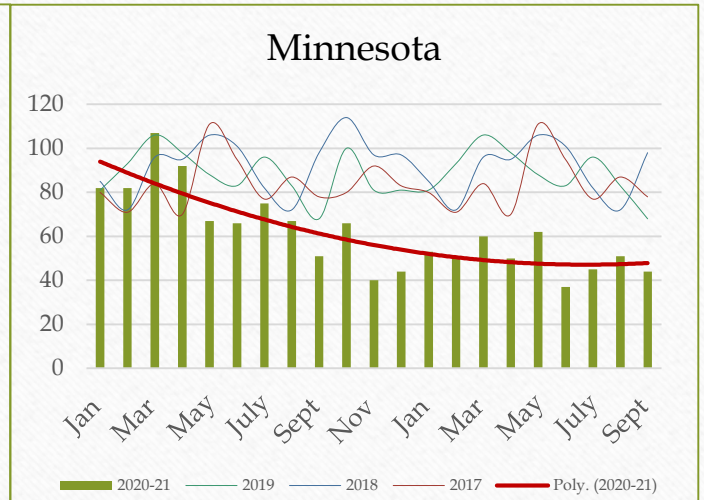
Business chapter 7s and 13s fell more precipitously than chapter 11s with the stay-at-home orders. Nevertheless, business chapter 11s are currently at all-time lows.

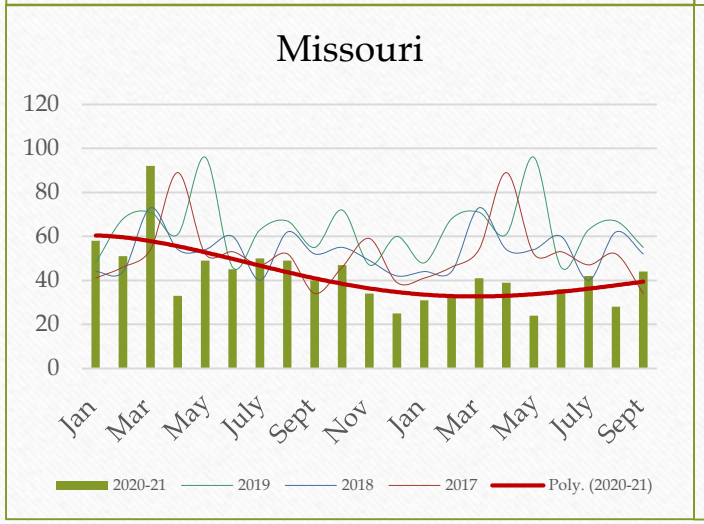


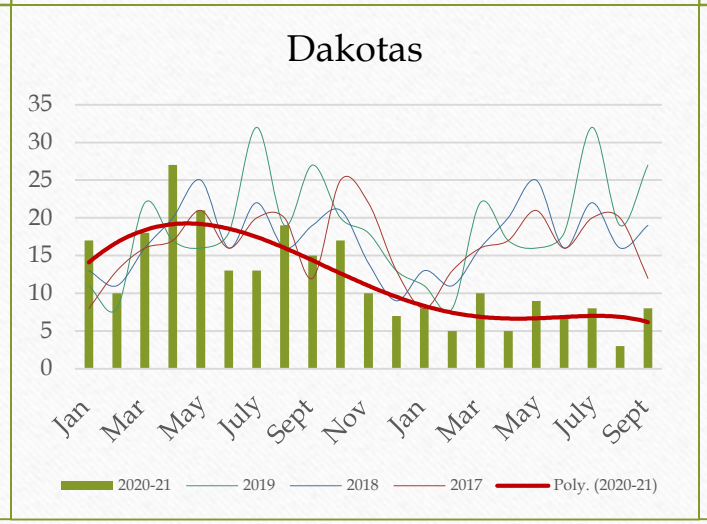
The Eighth Circuit followed the national trend during the pandemic.

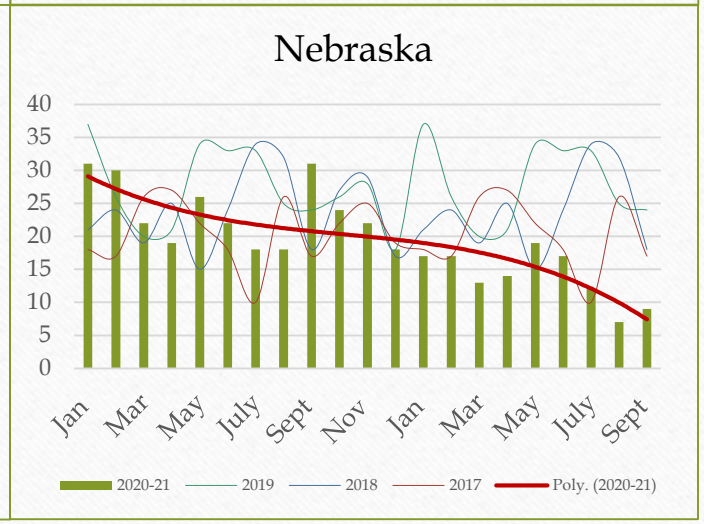




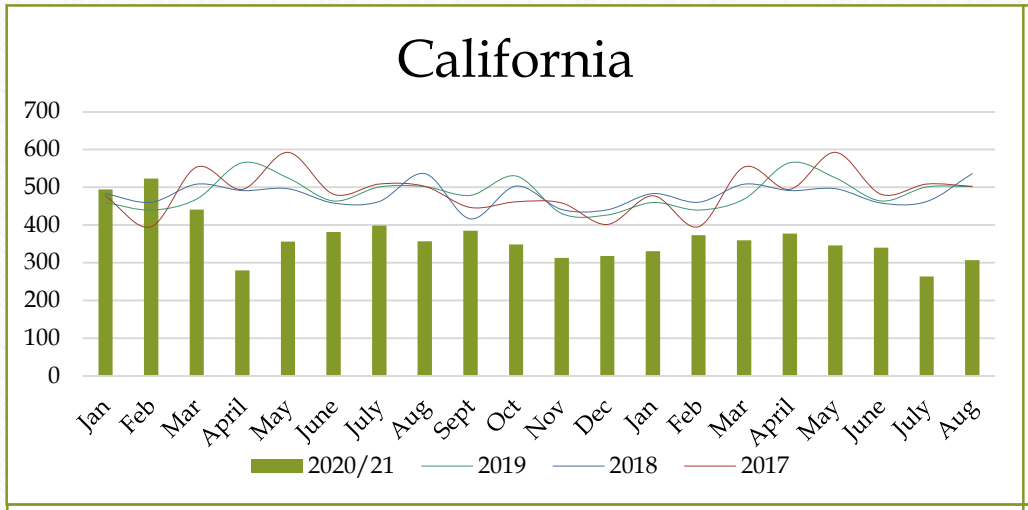


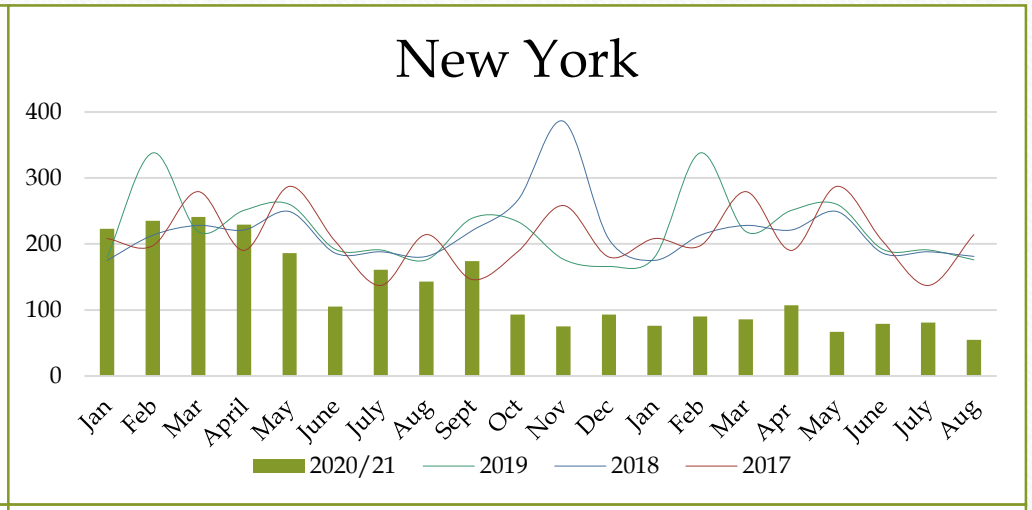


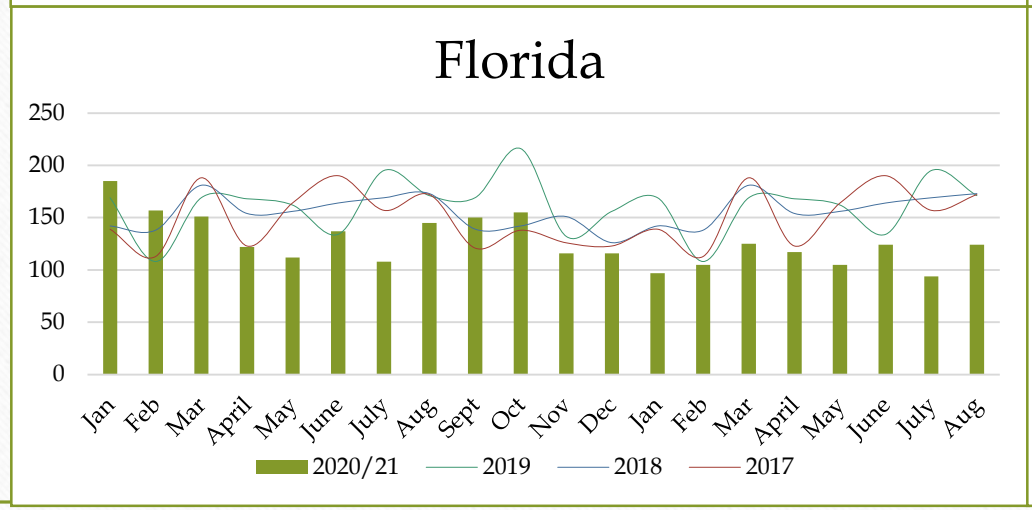


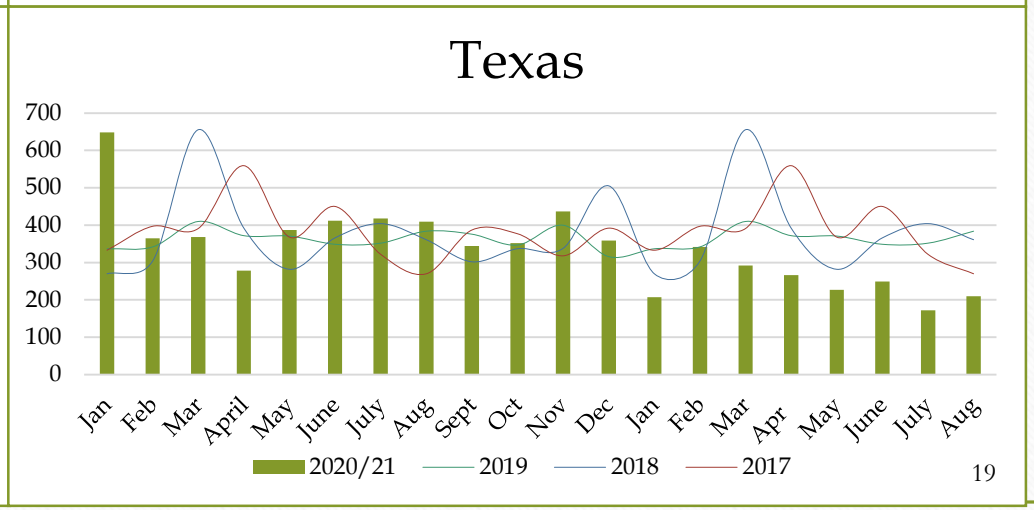


Business bankruptcy filings in three of the four most populous U.S. states also followed the national trend. Texas, one of the most business bankruptcy-active states in 2020, had merely a typical year. Even Texas is off-pace in 2021.

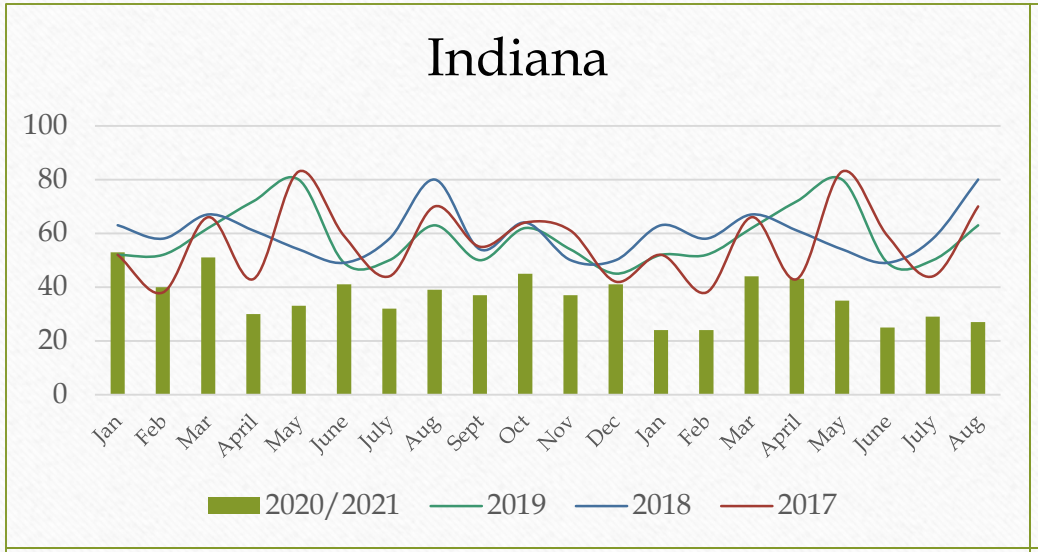


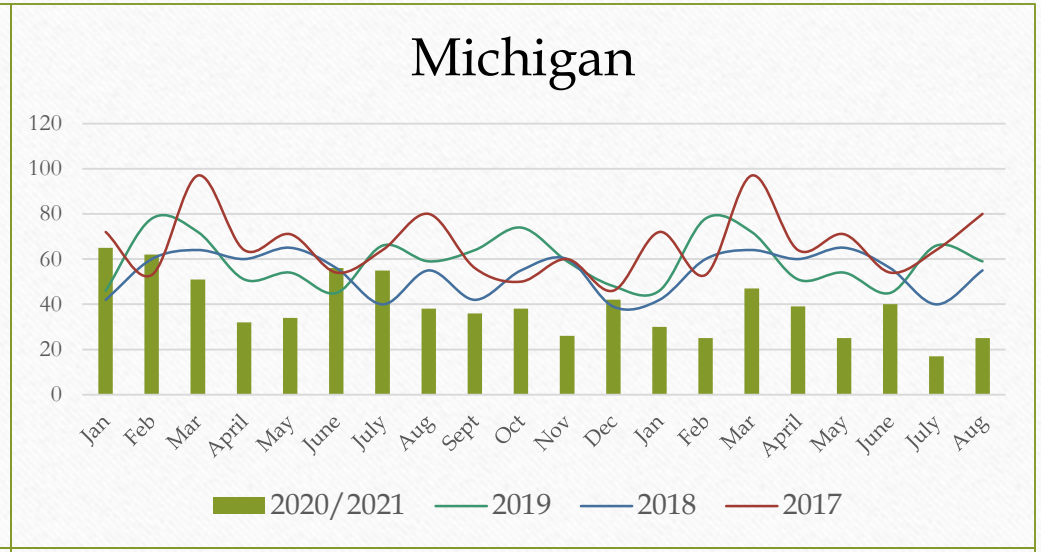


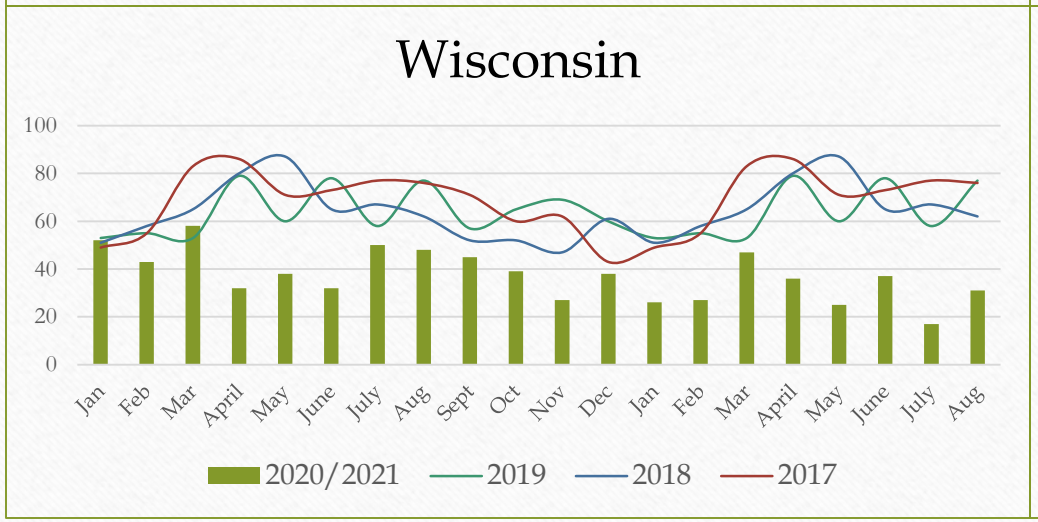


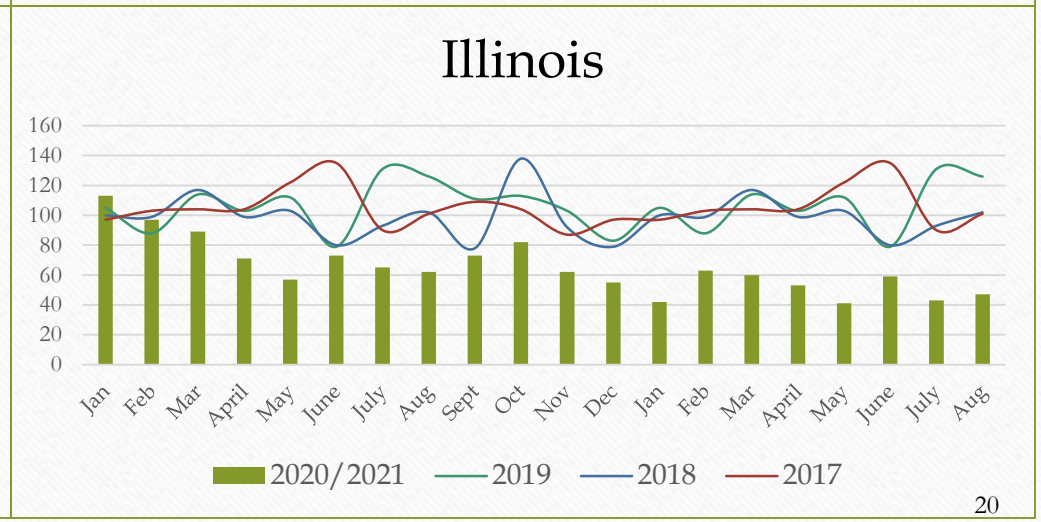


The most populous Central States followed the national trend.

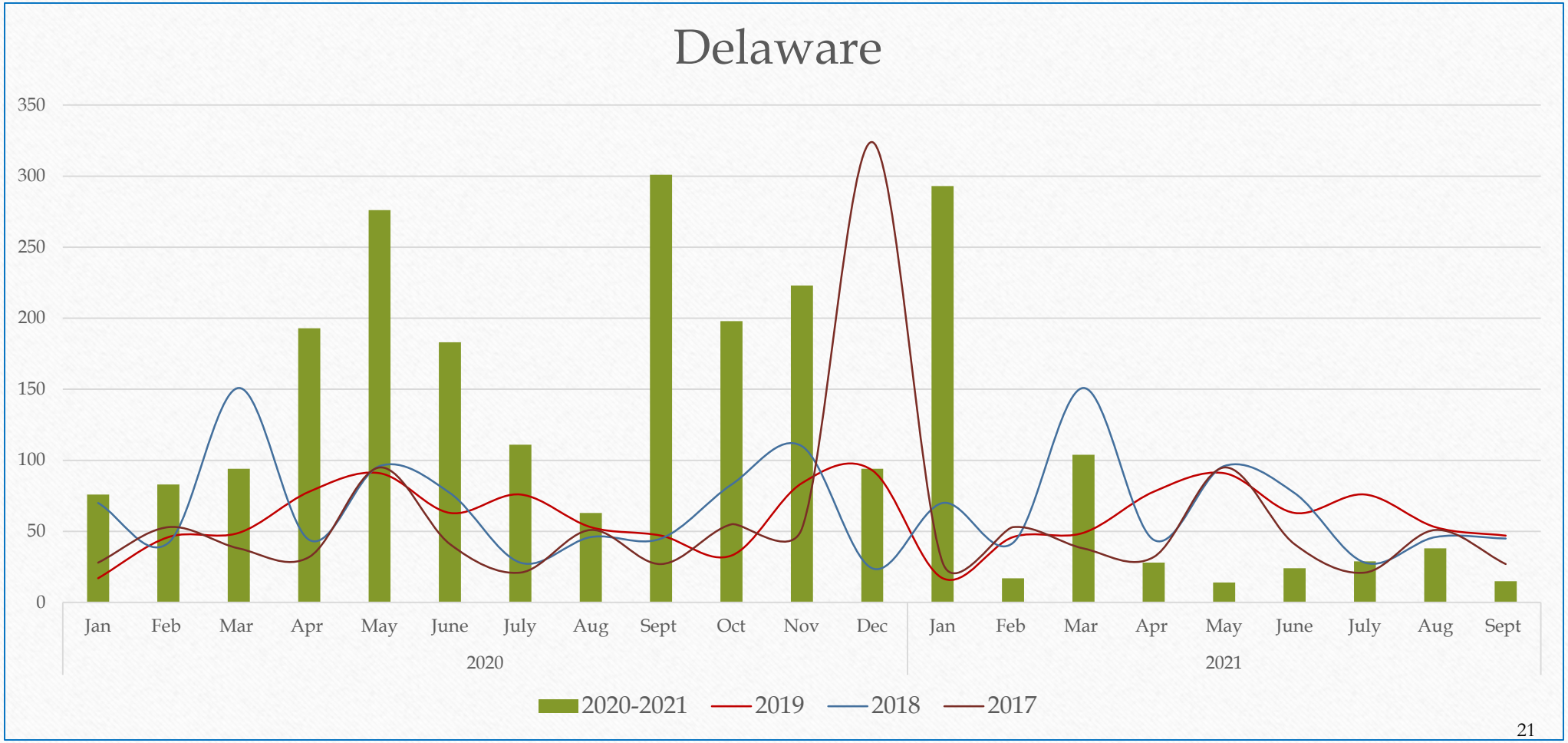




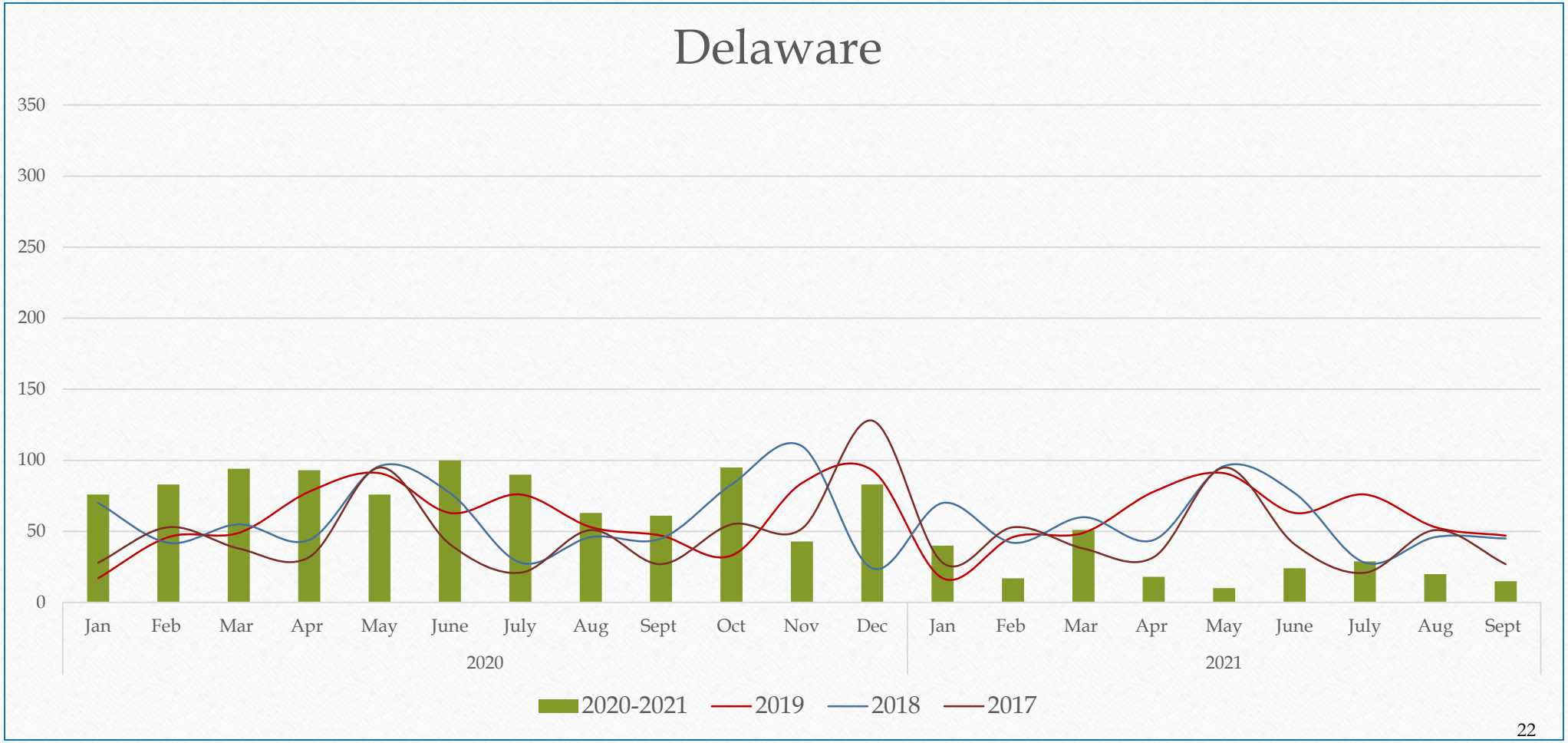


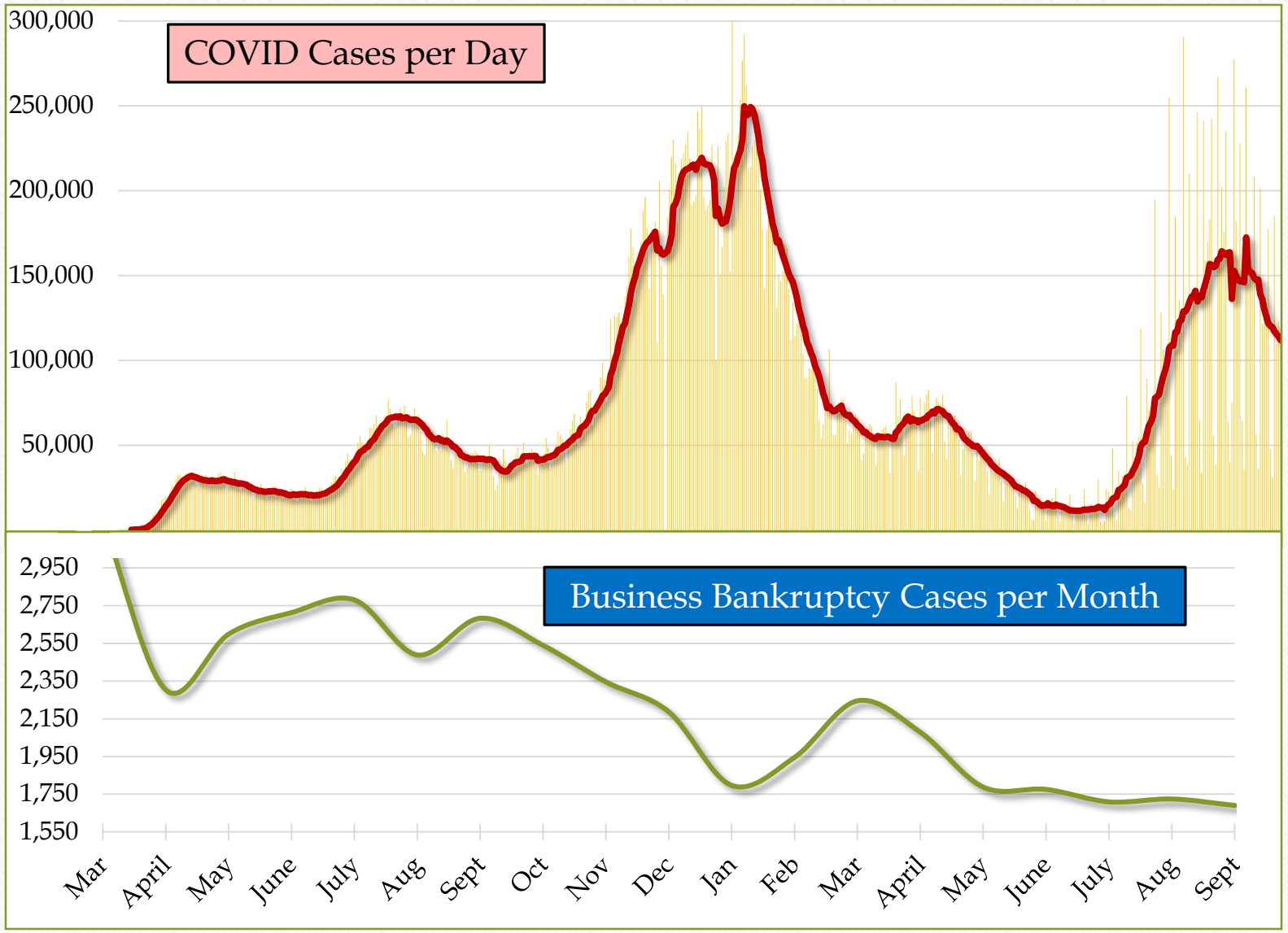


Delaware's raw numbers suggest that business bankruptcy filings were very high in 2020. But whenever Delaware reported unusually high numbers, invariably the cause was a few holding companies that filed with 50+ affiliates in cases that were procedurally consolidated.



When these procedurally consolidated cases are counted as one case each, the revised numbers show Delaware had a normal 2020 and is having a below normal 2021.





Throughout the pandemic (until May 2021) there was a strong inverse correlation between COVID surges and business bankruptcy cases. When COVID cases went up, bankruptcy cases went down, and vice versa.

The correlation was indirect. Bankruptcy filings fell in April because of the chaos initially caused by COVID. They remained low thereafter because of stimulus payments and state and federal moratoriums. They fell after August when COVID surged again, and uncertainty fomented an attitude of "wait and see" and a wave of forbearances.

The symmetry broke in June 2021 when inflation bested COVID as the principal source of uncertainty, and in July through September 2021, when filings fell to half of creative destruction, which evidently is an impenetrable floor.

The Uncertainty Factor

- Kenneth Rogoff, Harvard economist – This is the "uncertainty recession" and COVID is the uncertainty. The economy will not recover until uncertainty (COVID) is vanquished.
  - Creditors' uncertainty: "Should I take my collateral back? Can I sell it?" "Should I only ship goods COD."
  - Debtors' uncertainty: "Will I even survive? If so, do I have a feasible plan for success?"
  - In any event, creditors induce bankruptcy filings more often than debtors do. And creditors have not been aggressive since the pandemic began.
- During the pandemic, uncertainty begat a wave of forbearances. We've kicked a lot of cans down the road.

What are the Uncertainties?

- When will COVID no longer affect the economy?
- Are today's high prices tomorrow's inflation? Where are interest rates going?
- Will the end of moratoriums and forbearances (or a supply chain seize-up) be like a game of musical chairs when the music stops with 25 dancers but only 5 chairs?

- <u>Will there be a wave of bankruptcies?</u>
  - Some say NO. "This is the new normal."
    1. Secured creditors cannot count on successful re-sales or auctions, so they won't foreclose their collateral. (But that's just continuing uncertainty.)
    2. Small and mid-sized debtors will simply hand over the collateral and quietly go out of business. (But what about all the personal guarantees?)
    3. Troubled businesses are being acquired. (But only the promising ones.)

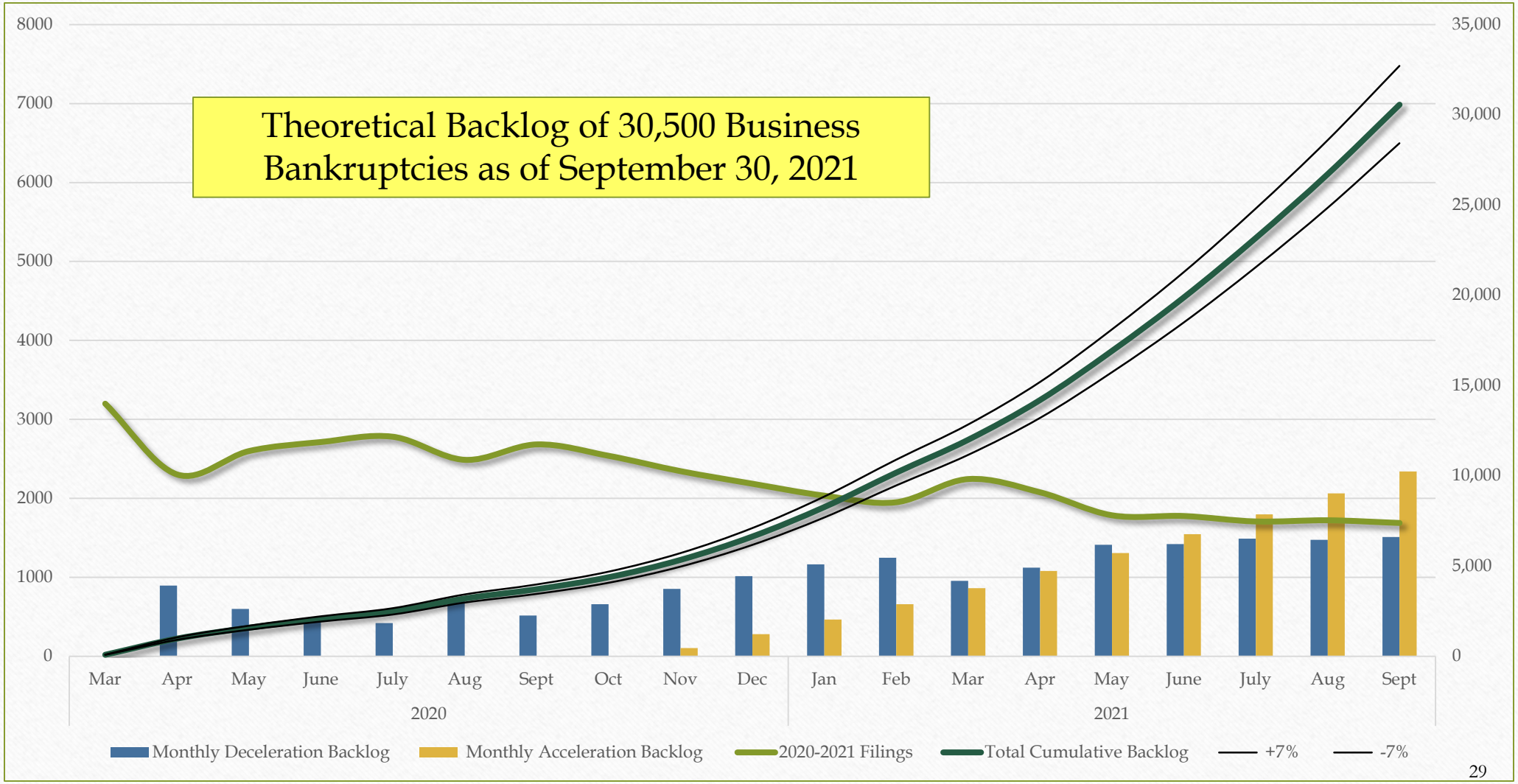
- <u>Will there be a wave of bankruptcies?</u>
  - More likely, the correct answer is YES.
    1. Filings *must* eventually return to the creative destruction rate, which is double the current rate.
    2. Stimulus has ended, moratoriums are ending, forbearances are tapering, and zombies (businesses that needed these props to survive) will file.
    3. Our economy has taken a beating. There must have been some *destructive* destruction in addition to the creative destruction.
    4. Many new filings will negatively affect supply chains. That may cause further filings.

"We're recovering, but to a different economy."

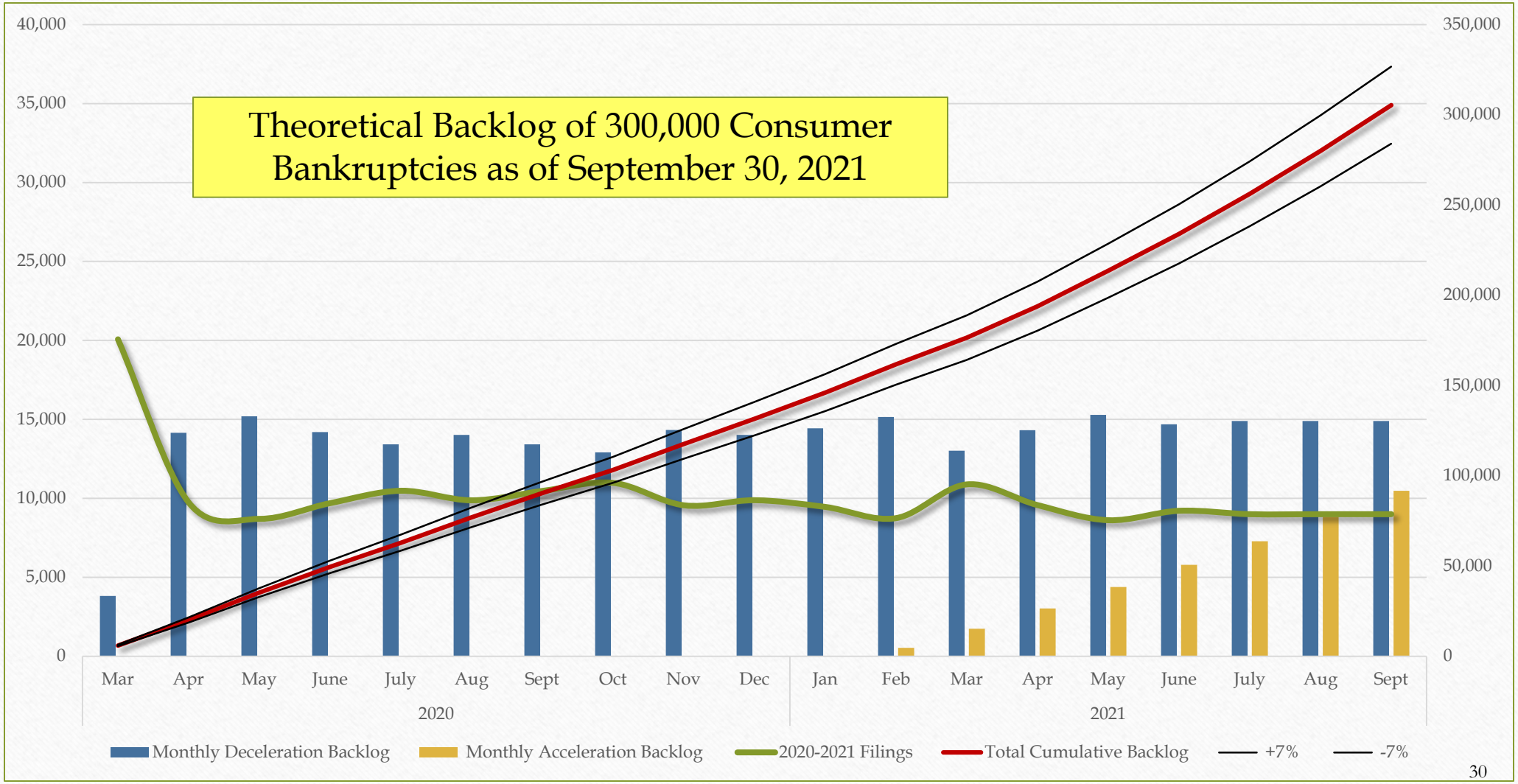
- Fed Chair Jerome Powell, November 10, 2020

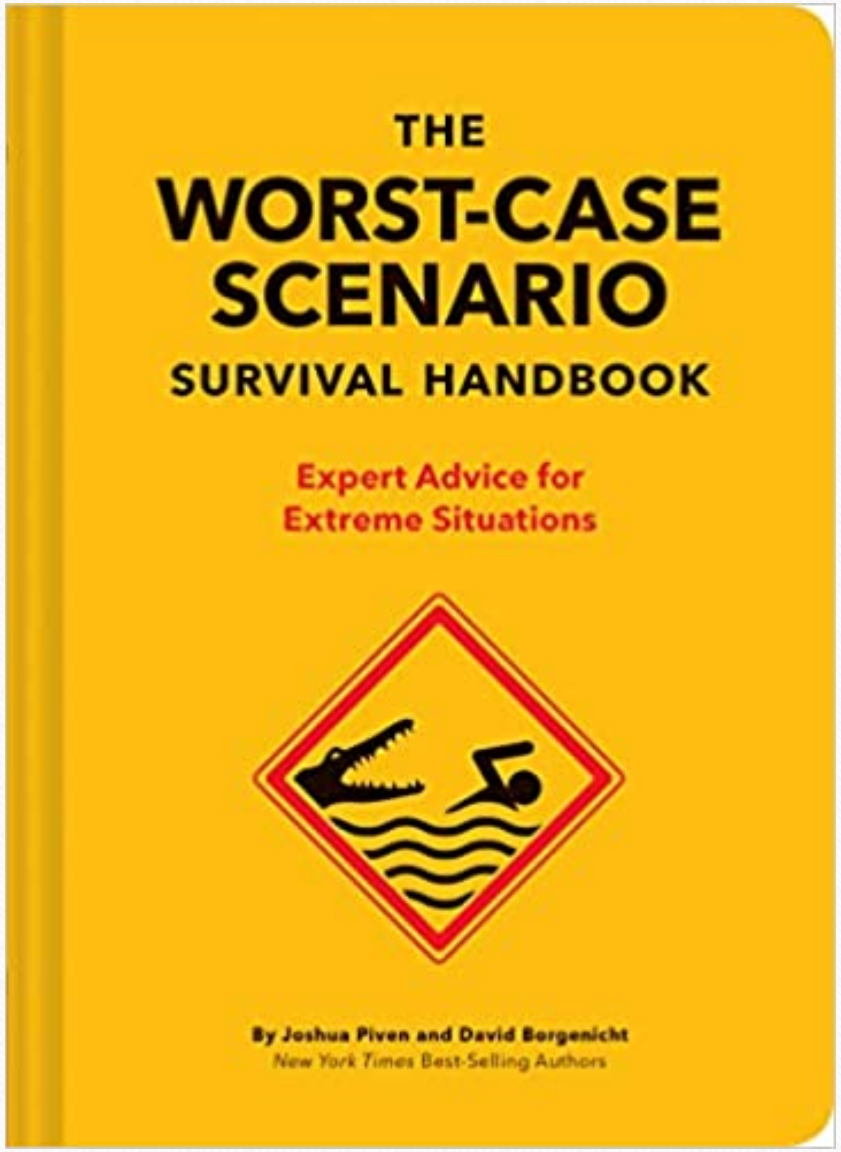
- Our economy has been restructured, *de facto* but not *de jure*. The interested parties and their restructuring lawyers haven't yet hammered out the details.

Business bankruptcy filing rates decelerated during the pandemic when we expected them to accelerate (as they did in the great recession).



Consumer bankruptcy filing rates also decelerated during the pandemic when we expected them to accelerate (as they did in the great recession).





Advice # 147:

The sea recedes abnormally when a tsunami is building.

React and prepare ASAP.

- Economic data: Federal Reserve Economic Data | FRED | St. Louis Fed (stlouisfed.org) and Household Debt and Credit Report - FEDERAL RESERVE BANK of NEW YORK (newyorkfed.org).

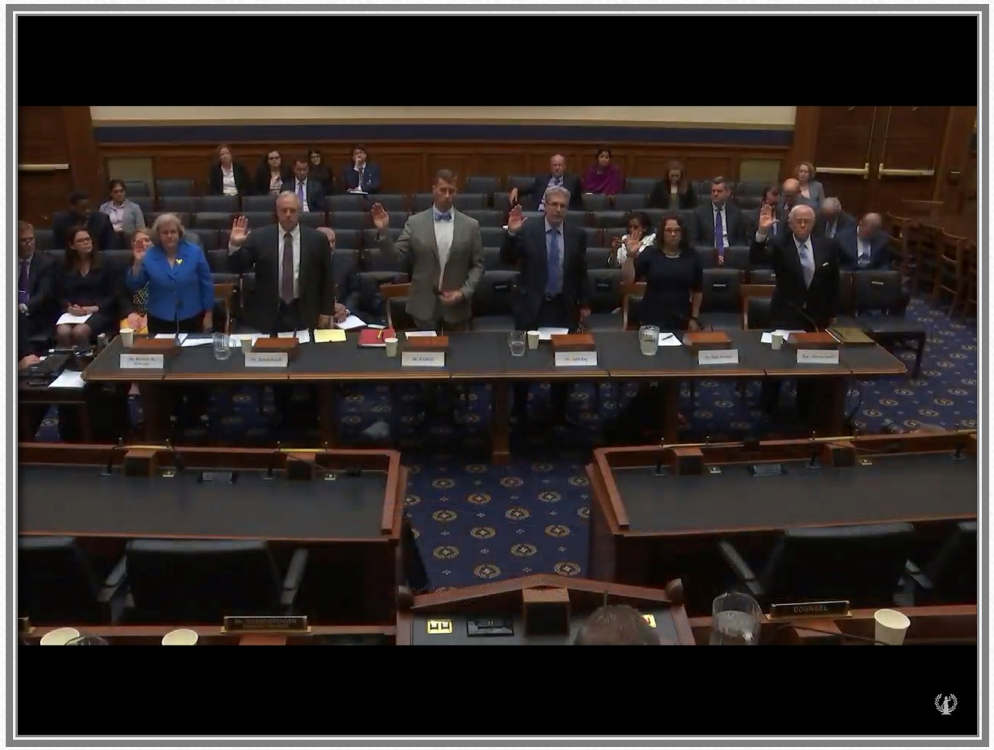
- Bankruptcy filing data: AACER Bankruptcy Information Services Platform: Download Stats | Epiq and https://www.uscourts.gov/report-name/bankruptcy-filings, F-2 (One Month).

- COVID data: COVID-19 Data Explorer - Our World in Data.

Legislative Hot Topics

2019 Bankruptcy Legislation

- Small Business Reorganization Act – HR 3311
- HAVEN Act – HR 2938
- Family Farmer Relief Act – HR 2336
- National Guard and Reservist Debt Relief Extension Act – HR 3304



2020 Bankruptcy Legislation

- CARES Act I – Mar. 27, 2020
  - Amends Sub V Definition of Debtor to $750,000
  - Many Consumer focused
  - PPP
  - Sunset 1 year; later extended
- CAA – Dec. 27, 2020
  - Division N: Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act – Tx of PPP loans in BK (2yr)
  - Division FF: Bankruptcy Relief (1 yr sunset)

2021 Bankruptcy Legislation

- CARES Act II – Mar. 27, 2021
  - Extends Section 1113 of CARES Act I by an additional year – through **March 27, 2022**
  - Amends 1329 to all any debtor with confirmed plan before Mar 27, 2021 to extend plan for up to total of 84 months.
  - CAA sunset dates remain unchanged

Introduced / Pending

- Student Loans: FRESH START Through Bankruptcy Act (S. 2598); Private Student Loan BK Fairness Act (HR 4907)
- Venue Reform (HR 4193/S. 2827)
- Protecting Homeowners in BK Act (HR 242)
- Medical BK Fairness Act (S. 146)
- No Bonuses Ahead of BK Act (HR 428)

Sackler Act / Nondebtor Release Prohibition Act and Cases

Nondebtor Releases

- Sackler Act (HR 2096) – March 2021
- Nondebtor Release Prohibition Act 2021 (NRPA) (HR 4777/S.2497) – July 2021
- Cases
  - *In re Archdiocese of St. Paul and Minneapolis*, 578 B.R. 823 (D. Minn 2017) (Case No. 15-30125)
  - *In re Purdue Pharma L.P., et al*, 2021 WL 4240974 (S.D.N.Y. Sept. 2021) (Case No. 19-23649)
  - *Others Pending: In re USA Gymnastics*, S.D. Ind. Case No. 18-09108; *In re Boy Scouts of America*, D. Del. Case No. 20-798.
- Article: ABI Journal, *Senate Legislation Looks to Upend Nondebtor Releases, Stays* (October 8, 2021).

Proposed Legislation:

Sackler Act (HR 2096)

Nondebtor Release Prohibition Act of 2021 (HR 477/ S. 2497)

- Aims of the NRPA:
  - prohibit nonconsensual third-party releases
    - Would add section 113 to the Bankruptcy Code to do so
  - limit injunctions preventing filing or continuing suits against non-debtors to 90 days after the petition date
  - permit the dismissal of a case commenced by a debtor that was formed through a divisional merger (*i.e.*, separation of a company's liabilities and assets) within 10 years of the petition date.
    - Would amend section 1112 of the Bankruptcy Code to do so.

Current 3rd Party Release Landscape

- Non-Consensual 3rd Party Releases Generally Permitted: Second, Third (but see *Washington Mutual*), Fourth, Sixth, Seventh, and Eleventh Circuits

- Non-Consensual 3rd Party Releases Expressly Prohibited: Fifth, Ninth, and Tenth

- Status Uncertain (Officially): First, Eighth, and DC

Current 3rd Party Release Landscape (cont)

- Rationale of Circuits Approving Non-Consensual 3rd Party Releases: Bankruptcy Code section 524(e) only *generally* provides that bankruptcy discharge does not affect third-parties; however, under the proper circumstances, courts can approve non-consensual 3rd party releases pursuant to Bankruptcy Code section 105(a).
- Rationale of Circuits Prohibiting Non-Consensual 3rd Party Releases: The statutory language of Bankruptcy Code section 524(e) expressly prohibits non-consensual 3rd party releases.
  - Note that this does not mean such 3rd party releases are outright banned!
  - Consensual 3rd party releases permitted (i.e. opt-in on ballots). *See, e.g.*, Plan Confirmation Hr'g at 61, *In re RAAM Global Energy Co.*, No. 15-35615 (Bankr. S. D. Tex. Jan. 28, 2016) [Docket No. 399] (Isgur, J.) ("[A]s to the holders of claims, it's limited to parties that have accepted and not opted out, and having reviewed it and in the absence of objections I think it is within the range of authority I have under existing Fifth Circuit law…")

Factors for Non-Consensual 3rd Party Release

- Only for "unusual circumstances"
- Factors and weight generally depend on circuit and judge:
  - Substantial contribution to the chapter 11 plan
  - Necessity of the releases for feasibility of the plan
  - Lack of "identity of interest" between the debtors and third-party to justify release
  - Support of plan classes most impacted by release
  - Plan provides for payment to all, or substantially all, of classes affected by release

In re The Archdiocese of Saint Pail and Minneapolis

Case No. 15-30125

United States Bankruptcy Court for the District of Minnesota

In re Purdue Pharma L.P.

Case No. 19-23649 (RDD)
United States Bankruptcy Court for the Southern District of New York, White Plains Division

- Judge Drain approved plan providing for nonconsensual third-party releases to, among others, Sackler family and Purdue D&O's.
  - *See* Docket No. 3786 for bench ruling; Docket No. 3787 for Confirmation Order
- Sackler family gives $4.3 billion contribution to plan.
- Approved by 95% of creditors.
- Sacklers (and others) benefit from channeling injunction for past and future claims.
  - i.e. victims recoveries limited to solely proceeding against various trusts.

Case Law Hot Topics

City of Chicago v. Fulton, 141 S.Ct. 585 (2021)

- The Supreme Court held that "mere retention of estate property after the filing of a bankruptcy petition does not violate §362(a)(3) of the Bankruptcy Code." Id. at 592.
- Practical outcome: Pro se debtors lose temporary access to vehicles
  - Solutions?
    - 1. Form motions.
      - See S.D. Cal. form "Notice of Motion and Motion for an Order Establishing Adequate Protection, Including Procedures to Return Property."
    - 2. Motion for Turnover
      - Hon. W. Homer Drake, et al., Chapter 13 Practice & Procedure § 15:12 (2d ed. 2021).

Attorney Fee Bifurcation or Unbundling in Chapter 7 Cases

Debtors' decisions to petition under Chapter 7 or 13 are often shaped by the sum of the attorney's fees and when they must pay them, raising access to justice issues for those debtors with no nonexempt property who are eligible for Chapter 7 relief. See Pamela Foohey, Robert M. Lawless, Katherine Porter & Deborah Thorne, *"No Money Down" Bankruptcy*, 90 S. CAL. L. REV. 1055, 1057 (2017).

Chapter 7 General Practice – Collect attorney fees before filing the petition because "any prepetition obligation that is not paid prior to a chapter 7 filing is subject to discharge under § 524 of the Bankruptcy Code." In re Allen, 628 B.R. 641, 644 (B.A.P. 8th Cir. 2021).

What happens if a debtor cannot afford to pay attorney fees up front?

Attorney Fee Bifurcation or Unbundling in Chapter 7 Cases (Cont)

Attorney Fee Payment Options for Chapter 7 Debtors:

1. Debtor pays attorney fees in full fee immediately
2. Attorney postpones filing petition until attorney fees are paid
3. Attorney accepts down payment and hopes debtor will voluntarily pay the balance at some unknown time in the future
4. Attorney "unbundles" services and provides only limited assistance to debtor
5. Attorney bifurcates fees – 1 prepetition fee and agreement and 1 postpetition fee and agreement

Attorney Fee Bifurcation or Unbundling in Chapter 7 Cases (Cont)

Unbundling:

- With unbundling, the attorney is contractually limiting services to a discrete task, such as filing the bankruptcy petition. The primary concern with unbundling is that the attorney provides a limited service and then leaves the client to his or her own devices to complete the legal process. This is problematic, even though it is becoming more widely recognized that having at least some legal representation in a consumer Chapter 7 case is better than none.

  In re Hazlett, No. 16-30360, 2019 WL 1567751 at *7 (Bankr. D. Utah Apr. 10, 2019).

- Rule 1.2 (c) provides: "A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent."

Attorney Fee Bifurcation or Unbundling in Chapter 7 Cases (Cont)

Unbundling:

- In re Bowman, 2020 WL 504760, at *2 (Bankr. S.D. Ind. Jan. 30, 2020) ("The exclusion of certain services in representing a client is not, in and of itself, improper. Indiana Rule of Professional Conduct 1.2(c) provides that counsel "may limit the scope and objective of the representation if the limitation is reasonable under the circumstances and the client gives informed consent." It is not uncommon, at least in this District, for debtors' counsel to exclude adversary proceedings from the scope of their services. Assuming that the Firm's clients are made aware of what that exclusion means and consent to the same, the Court has **no issue with unbundling adversary proceedings**.").
- In re Banks, 2018 WL 735351 *22 n.6 (Bankr. W.D. La. Feb. 2, 2018) ("This **Court permits 'unbundling' for legal services in Chapter 7 cases for adversary proceedings**; however, it requires debtor's counsel must represent the debtor, without exception, for all legal services from case filing to discharge, or the date a discharge order would have been entered if a complaint under 11 U.S.C. § 727 is filed in the main bankruptcy case.").

Attorney Fee Bifurcation or Unbundling in Chapter 7 Cases (Cont)

Bifurcated Fees:

- ABA Model Rule 1.1: "A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."
- ABA Model Rule 1.2(a) and (c): "… a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued" and "A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent."
- ABA Model Rule 1.3: "A lawyer shall act with reasonable diligence and promptness in representing a client."
- ABA Model Rule 1.4(b): "A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation."
- ABA Model Rule 1.5(a) and (b): "A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses" and "The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation . . . ."
- Disclosure & Timing: 11 U.S.C. § 523; 11 U.S.C. § 526(a)(4); 11 U.S.C. § 528(a); 11 U.S.C. § 329; Fed. R. Bankr. P. 2016(b)

Attorney Fee Bifurcation or Unbundling in Chapter 7 Cases (Cont)

Bifurcated Fees:

- In re Brown, 2021 WL 2460973 (Bankr. S.D. Fla. June 16, 2021) (in three separate "no money down" or "low money down" cases, UST objected to the business practices of two law firms with respect to the bifurcation of attorney fees in consumer Chapter 7 cases). The Court held that:
  - for an attorney using a bifurcated fee arrangement to meet his or her obligation of competency with respect to prepetition services, the attorney must meet with a potential bankruptcy client and review sufficient information to competently advise the potential client whether to file bankruptcy and, if so, under what chapter;
  - an attorney using a bifurcated fee arrangement must provide certain prepetition and postpetition "core services," as specified by the court;
  - for disclosures to a potential client to be adequate, they must satisfy the requirements set forth by the court ("A fundamental premise of all the fee bifurcation cases is disclosure.");
  - an attorney using a bifurcated fee arrangement must make sure that any such arrangement is properly disclosed to the court and to parties in interest; and
  - a law firm's payment of the filing fee with postpetition repayment by the debtor violates the Bankruptcy Code as well as the Florida Bar rules.

Attorney Fee Bifurcation or Unbundling in Chapter 7 Cases (Cont)

Bifurcated Fees – Permissible:

- In re Hazlett, 2019 WL 1567751, at *7-8 (Bankr. D. Utah Apr. 10, 2019) (distinguishing bifurcated fee agreements from limited services agreements and finding bifurcated fee agreements permissible; and emphasizing that attorneys must use special care to ensure full disclosure and informed consent and finding attorney **met these requirements**).
- In re Carr, 613 B.R. 427 (Bankr. E.D. Ky. 2020) (reviewing a fee statement submitted by Chapter 7 debtor's counsel, which disclosed that attorneys received $300 from debtor prepetition and were to be paid $1,185 postpetition; holding that, if completed properly, an attorney may limit the scope of her bankruptcy services to a prepetition analysis of a debtor's bankruptcy options and filing the debtor's skeletal Chapter 7 petition; concluding that the **"dual contract" arrangement by which attorney used pre- and postpetition contracts to bifurcate the services provided to debtor was reasonable**).

Attorney Fee Bifurcation or Unbundling in Chapter 7 Cases (Cont)

Bifurcated Fees – Impermissible:

- In re Baldwin et al., 2001 WL 4592265 (Bankr. W.D. Ky. Oct. 5, 2021) (finding that the bifurcated fee agreements entered between Debtors and Attorney Harris and the Fresh Start Funding contracts used in 11 cases **violate the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure and the Kentucky Rules of Professional Conduct** and advising that "[s]uch contracts are **not to be used by any attorney practicing bankruptcy law in the United States Bankruptcy Courts for the Western District of Kentucky**).

- In re Prophet, 628 B.R. 788, 798, 804 (Bankr. D.S.C. 2021) (determining that, under the court's local rule, an attorney who filed a bankruptcy case on behalf of a debtor was **required to represent the debtor in all matters relating to the representation except for adversary proceedings** and appeals and **bifurcated fee arrangements are therefore impermissible**; and requiring the attorney to return to the debtors all fees that he received postpetition in accordance with signed postpetition agreements).

Attorney Fee Bifurcation or Unbundling in Chapter 7 Cases (Cont)

Bifurcated Fees – Impermissible Because Fees Were Unreasonable:

- Ridings v. Casamatta (In re Allen), 628 B.R. 641 (B.A.P. 8th Cir. 2021) (involving Chapter 13 debtors' attorney who offered two payment options for his fees: 1) pay $1,500 in full prepetition, or 2) pay $2,000 postpetition through monthly payments; affirming bankruptcy court's determination that the additional $500 was **not reasonable** because the attorney "provided the same services he would have provided to both [debtors], regardless of whether his fees were paid under the prepetition or postpetition payment option"; and assessing the fees only under the reasonableness standard and "declin[ing] to express an opinion on the validity of bifurcation agreements generally or any problems associated with the 'unbundling' of legal services").

Attorney Fee Bifurcation or Unbundling in Chapter 7 Cases (Cont)

Bifurcated Fees – Impermissible Due to Disclosure Issues:

- Casamatta v. Castle Law Office of Kansas City, P.C. (In re James), 2018 WL 6728395 (Bankr. W.D. Mo. Nov. 29, 2018) (Judge Norton) (involving a motion to withdraw the reference to the bankruptcy court to decide whether the debtors' bankruptcy attorneys violated bankruptcy code provisions, applicable bankruptcy and ethical rules, and should be sanctioned; recommending the district court deny the motion; and not reaching the merits). In the underlying actions, the UST asserted the debtors' attorney and his law firm "employed an improper and undisclosed factoring-type filling arrangement for their consumer debtor clients who were unable to prepay the attorney fees, and that that arrangement made it appear that all, or nearly all, of the fees were incurred for postpetition services when they were not" and that, as a result of this practice, the firm "overcharged debtors and misled the court about the nature of the fees, and in so doing, violated a number of bankruptcy code provisions and ethical rules."

Subchapter V

- Initial data suggests Subchapter V is affordable and effective
- Eligibility
- Debt Limits
- Proceedings under Subchapter V after deadlines in 1188(a) and 1889(a) have passed

Subchapter V is affordable and effective

- Initial data suggests Subchapter V is working as intended

  See Hon. Michelle M. Harner, Emily Lamasa, Kimberly Goodwin-Maigetter, Subchapter V Cases by the Numbers, Am. Bankr. Inst. J., Oct. 2021, at 12, 59-60.

1. Roughly 60 % of cases not dismissed were confirmed
2. Roughly 60% of the cases confirmed with consensual plans
3. Conformation was generally achieved within 6 months
4. Median trustee fees are approximately $5,000 per case

Subchapter V: Eligibility – "Engaged in commercial or business activities:"

Broader Interpretation:

- In re Wright, 2020 WL 2193240, at *3 (Bankr. D.S.C. Apr. 27, 2020) (relying, in part, on Colliers, to conclude that "[a]lthough the brief legislative history of the SBRA indicates it was intended to improve the ability of small businesses to reorganize and ultimately remain in business, nothing therein, or in the language of the definition of a small business debtor, limits application to debtors **currently** engaged in business or commercial activities;" and finding that debtor, who **ceased operating his businesses and sold most of his business assets before petitioning** for bankruptcy relief, met the definition of "a small business debtor").
- In re Bonert, 619 B.R. 248, 255-56 (Bankr. C.D. Cal. 2020) (adopting the reasoning of In re Wright and finding that debtor qualified as "small business debtors" even though **debtors were not operating a business as of the petition date** and ruling that debtors' subsequent re-designation as a Subchapter V debtor was reasonable and made in good faith).

Subchapter V: Eligibility (Cont)

Broader Interpretation:

- In re Ellingsworth Residential Cmty. Ass'n, Inc., 619 B.R. 519, 521 (Bankr. M.D. Fla. 2020) (finding the plain language of the statute clear and unambiguous; opining that "[a]ny corporation that conducts 'commercial or business activities' is a small business debtor," regardless of profit motive or lack thereof; and ruling that the **non-profit community association** debtor in this case conducts sufficient 'commercial or business activities' to qualify as a small business debtor").
- In re Blanchard, 2020 WL 4032411, at *1 (Bankr. E.D. La. July 16, 2020) (adopting the reasoning of the Wright court; finding that the majority of debtors' debts stemmed from both currently operating businesses and non-operating businesses and the sum of these debts did not exceed the SBRA's debt limit; concluding that debtors qualified as small business debtors under SBRA; and rejecting the trustee's argument that allowing debtors to proceed under Subchapter V was inappropriate because they missed applicable deadlines).

Subchapter V: Eligibility (Cont)

Broader Interpretation:

- In re Ikalowych, 629 B.R. 261, 276, 280-83, 286-87 (Bankr. D. Colo. 2021) (finding that the plain meaning of "commercial or business activities" is "exceedingly broad," meaning "**any private sector actions related to buying, selling, financing, or using goods, property, or services, undertaken for the purpose of earning income** (including by establishing, managing, or operating an incorporated or unincorporated entity to do so);" considering the "then-present state of things as of the Petition Date," but also looking at the relevant the circumstances immediately preceding and subsequent to the petition date as well as the debtor's conduct and intent; finding that debtor was still "engaged in" business; and recognizing that the court's legal conclusion regarding the debtor's work for CCIG suggests that "virtually all private sector wage earners may be considered as 'engaged in commercial or business activities'").
- In re Offer Space, LLC, 629 B.R. 299, 306-07 (Bankr. D. Utah 2021) (concluding that to be eligible for Subchapter V, a debtor must be presently "engaged in commercial or business activities" on the date of filing the petition; and using a **totality of the circumstances** approach, the court found that, as of the petition date, debtor was actively engaged in commercial or business activities **even though its business operations were no longer functioning**).
- In re Blue, 2021 WL 1964085, at *7-8 (Bankr. M.D.N.C. May 7, 2021) (finding that Debtor's **consulting**—an activity that "is clearly the delivery of services in exchange for a profit"—qualified as engaging in commercial or business activities; noting that nothing in the Bankruptcy Code "mandates that commercial or business activities must be full-time to qualify, and Debtor's activities in this case are substantial and material;" and **rejecting the creditor's assertion that section 1182 requires that debtor's scheduled business debts must be related to her current business activities to qualify for the debt specifications under Subchapter V**).

Subchapter V: Eligibility (Cont)

Broader Interpretation:

- In re Port Arthur Steam Energy, L.P., 629 B.R. 233, 236-37 (Bankr. S.D. Tex. 2021) (finding that, although the debtor was **not conducting its historical business operations** (selling steam or electricity) on the petition date, it was engaged in other commercial and business activities that qualify it for relief under subchapter V; and rejecting the argument that debtor's lack of W-2 employees disqualified it as a small debtor under Subchapter V because the small debtor definition does not require debtor to "maintain its core or historical business operations on the petition date.").

- In re Vertical Mac Construction, LLC, 2021 WL 3668037 (M.D.Fla. July 23, 2021) (finding that debtor was "engaged in commercial or business activities" and eligible to proceed under Subchapter V even though it **ceased operating its business and sought bankruptcy protection to liquidate and distribute its assets**).

Subchapter V: Eligibility (Cont)

Narrower Interpretation:

- In re Thurmon, 625 B.R. 417, 420-23 (Bankr. W.D. Mo. 2020) (declining to follow previous cases interpreting "engaged in commercial or business activities;"[1] finding that the "plain meaning of 'engaged in' means to be actively and currently involved;" and ruling that **debtors "were not as a matter of fact or law 'engaged in commercial or business activities' on the day they filed bankruptcy because they had in fact sold the business** with no intent to return to it and were otherwise not active or involved in any commercial or business activities").
- In re Johnson, 2021 WL 825156, at *4-7 (Bankr. N.D. Tex. Mar. 1, 2021) (ruling that a debtor who previously owned and managed certain now-defunct businesses and who, on account of such ownership and involvement, has mostly business-related debts, but who offered **no evidence suggesting that the cessation of such commercial and business activities was in any way only temporary in nature was not "engaged in"** commercial or business activities for purposes of eligibility under Subchapter V).

[1] See In re Wright, 2020 WL 2193240; In re Bonert, 619 B.R. 248 (following Wright); In re Blanchard, 2020 WL 4032411 (same).

Subchapter V: Debt Limits

- In re Parking Mgmt., Inc., 620 B.R. 544, 552-53, 558-59 (Bankr. D. Md. 2020) (finding that lease rejection claims were contingent obligations until approved by the court and not included in total debt for eligibility purposes; ruling that a **PPP loan was a contingent claim** because "as of the petition date, the debtor's liability to repay the PPP [was] dependent on it using the funds for ineligible expenses or failing to meet employment retention criteria[,]" which "relies on some future extrinsic event which may never occur;" finding that the PPP loan was **unliquidated** as of the petition date "because it was not then known, and could not be determined, whether the debtor would use the PPP funds for ineligible expenses or would fail to maintain employee staffing levels in accordance with the PPP;" and concluding that, because the PPP claim was contingent and unliquidated as of that date, it **was not included in the debt limit determination** and debtor was eligible to proceed under Subchapter V.)

Subchapter V: Proceedings after deadlines in 1188(a) (status conference requirement) and 1889(b) (deadline to file plan) passed:

Extension of Deadlines Granted:

- In re Keffer, 628 B.R. 897 (Bankr. S.D.W. Va. 2021) (allowing debtor to amend petition to elect Subchapter V after certain deadlines in sections 1188 and 1189 had passed and granting debtor's request to extend deadlines).
- In re Trepetin, 617 B.R. 841, 850 (Bankr. D. Md. 2020) (granting debtor's motion to convert, prompting debtor to file an amended petition electing to proceed under Subchapter V; and granting debtor's request to extend deadlines in sections 1188 and 1189 because debtor "should not be held justly accountable for his inability to meet those deadlines.")
- In re Wetter, 620 B.R. 243, 253 (Bankr. W.D. Va. 2020) (determining that Seven Stars sets "too rigid" of a test, and concluding that Trepetin "charts a better path")

Subchapter V: Proceedings after deadlines (Cont)

Extension of Deadlines Denied:

- In re Seven Stars on the Hudson Corp., 618 B.R. 333, 339, 347 (Bankr. S.D. Fla. 2020) (dismissing the case after debtor filed an amended petition electing to proceed under subchapter V because the deadlines in sections 1188 and 1189 passed and debtor "immediately put itself in default" of these requirements.) The court noted: "Where a debtor elects to proceed under Subchapter V after the statutory deadlines have passed, it cannot be said that the need for an extension of these deadlines is attributable to circumstances for which the debtor should not justly be held accountable."
- In re Tibbens, 2021 WL 1087260, at *1, *9 (Bankr. M.D.N.C. Mar. 19, 2021) (granting debtor's motion to convert, prompting debtor to file an amended petition electing to proceed under Subchapter V; but denying debtor's request to extend deadlines in sections 1188 and 1189 because he did not meet his burden of showing that he should not be held justly accountable for his inability to meet those deadlines).
- In re Northwest Child Devel. Centers, Inc., 2020 WL 8813586, *3 (Bankr. M.D.N.C. Dec. 8, 2020) (denying motion to extend the deadline for filing a plan under § 1189(b) because debtor failed to carry its burden of showing "the need for an extension of the plan deadline is attributable to circumstances for which the Debtor should not justly be held accountable.").

Equitable Dismissal (Mootness)

- *FishDish LLP v. VeroBlue Farms USA Inc. (*In re VeroBlue Farms USA Inc.) 19-3413 (8th Cir. 2021) (reversing the district court's dismissal of an equity holder's appeal of the Chapter 11 confirmation order on grounds of equitable mootness and remanding for reconsideration on the merits. In holding, the 8th Circuit barred dismissal of an appeal without "at least a preliminary review of the merits of [the appellant's] appeal to determine the strength of [appellant's] claims, the amount of time that would likely be required to resolve the merits of those claims on an expedited basis, and the equitable remedies available – including possible dismissal – to avoid undermining the plan and thereby harming *third parties*." The 8th Circuit Court also banished the term "equitable mootness" from "local lexicon," and replaced it with "equitable dismissal.")

QUESTIONS?

Economic Trends and Hot Topics in Bankruptcy:

An Insolvency Professionals' Survival Kit