

Small Business Cases Develop Some Teeth

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Two years after the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA),¹ not much law had developed regarding the new small business bankruptcy provisions.² Three years later, debtors are making more use of the small business bankruptcy provisions and courts have had an opportunity to provide guidance on some issues. This article addresses more recent case law interpreting some of the BAPCPA small business bankruptcy provisions.³

A Small Business Case



Gregory R. Schaaf

Whether a debtor or a case qualifies for small business treatment is definitional. A “small business case” is a chapter 11 proceeding involving a “small business debtor.”⁴ A “small business debtor” is a person engaged in

commercial or business activities, other than owning or operating real estate,⁵ with debt no greater than \$2,343,300 (excluding debt to insiders and affiliates).⁶ A creditors’ committee will not exist in a small business case.⁷

The benefit of a small business case is its expedited pace.⁸ However, in order to claim this benefit, it is important that, at a debtor meeting, the debtor should check the following designation on the chapter 11 petition: “Debtor is a small business debtor as defined in 11 U.S.C. § 101(51D).” “The reasons are self-evident. Small business cases impose different obligations and requirements (see, e.g., the Code §§ 1116, 1121(e), 1125(f) and 1129(e)), and it is critical to know at the outset of the case if those Code provisions apply.”⁹

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Sometimes the fast pace of a small business case causes problems, leading a debtor to argue that it is not a small business debtor despite contrary facts. These efforts are not well received, as a debtor is generally judicially estopped from changing its small business status.¹⁰

Early Intervention

The Initial Interview

In keeping with the theme of accelerating the reorganization process and teaching debtors how to operate, BAPCPA also imposes additional obligations on the U.S. Trustee in a small business case.¹¹ The U.S. Trustee is required to conduct an initial interview with the small business debtor “as soon as practicable,” but at least before the

first meeting of creditors.¹² Although this means the first date set for the meeting, rather than the conclusion of the meeting,¹³ this should not cause the debtors or U.S. Trustee much difficulty.

Obligation to File Financial Information

Small business debtors in possession have specific additional duties during the bankruptcy case.¹⁴ For example, 11 U.S.C. § 1116(1)(A) requires debtors to attach their most recent tax return and financial statements to the petition or certify they do not exist. One unusual case dealing with § 1116 involved a creditor’s attempt to use the debtor’s balance sheet as evidence of an informal proof of claim.¹⁵ The U.S. Bankruptcy Court for the District of Puerto Rico denied the attempt because there is no demand for payment in the financial statements submitted in compliance with § 1116 that could substitute for a claim.¹⁶

Another court used the lack of compliance with § 1116 as one reason to deny treatment as a small business case. In *In re Fisher*, the debtors filed a chapter 11 petition, which claimed that their primary debts were consumer debts. The debtors did not check the small business debtor box. In response to the debtors’ failure to comply under an agreed order with the U.S. Trustee that set deadlines for certain actions, the debtors filed an amended petition that indicated they were small business debtors.¹⁷

Notwithstanding the deadlines in the prior agreed-to order, the debtors argued that the Bankruptcy Code deadlines for small business debtors (e.g., 180-day exclusivity period under § 1121(e)) should now apply. The U.S. Bankruptcy Court for the District of Montana recognized, however, that the debtors’ “recently expressed desire to be considered as small business debtors puts Debtors at odds with 11 U.S.C. § 1116.”¹⁸ The debtors did not append their financial statements or the most recent tax return to the petition, nor certify they did not exist, as required by § 1116(1)(A) and (B).¹⁹

Feature

Plan Process Disclosures²⁰

Debtors in large or small business cases must provide “adequate information” to allow a vote on a plan of reorganization.²¹ Section 1125 permits a court to construe the adequacy of disclosure statements on a case-by-case basis.²² Section 1125(f) reduces and adjusts a bankruptcy debtor’s disclosure obligations, recognizing the reduced level of information available and required in small business cases, as well as the need for speed.²³

Section 1125(f)(3) allows conditional approval of a disclosure statement, subject to final approval at a hearing. Although conditional approval is not final approval,²⁴

¹ Pub. L. No. 109-8, 119 Stat. 23.

² See Gregory R. Schaaf, “Small Business Bankruptcies under BAPCPA,” *Am. Bankr. L. J.* 46 (June/July 2007).

³ This article expands the 2007 article (see n.1), looking at cases in the last three years and using the same structure.

⁴ 11 U.S.C. § 101(51C).

⁵ Because real estate is not covered, the definition may not cover a single-asset case.

⁶ 11 U.S.C. § 101(51D).

⁷ *Id.* For cause, “the court may order that a committee of creditors not be appointed” in a small-business case. 11 U.S.C. § 1102(a)(3).

⁸ *In re CCT Commc’n Inc.*, 420 B.R. 160, 170 (Bankr. S.D.N.Y. 2009).

⁹ *In re Roots Rents Inc.*, 420 B.R. 28, 38 (Bankr. D. Idaho 2009).

¹⁰ See, e.g., *CCT Commc’n Inc.*, 420 B.R. 160; *In re Save Our Springs (S.O.S.) Alliance Inc.*, 393 B.R. 452, 458 (Bankr. W.D. Tex. 2008).

¹¹ See 28 U.S.C. § 586(a)(7)-(8).

¹² *Id.* See also 11 U.S.C. § 1116(2) (debtor is obligated to attend meeting).

¹³ See *In re Clark*, 393 B.R. 578 (Bankr. E.D. Tenn. 2008).

¹⁴ See 11 U.S.C. § 1116.

¹⁵ *In re Enterlite Ambulance Corp.*, 2010 WL 1508296, at *1 (Bankr. D. P.R. April 12, 2010).

¹⁶ *Id.* at *2. *In re Fisher*, 2008 WL 1775123, at *1 (Bankr. D. Mont. April 15, 2008).

¹⁷ *Id.* at *6 (although the amendment was not filed within the time limit set under a prior agreed order).

¹⁸ *Id.*

¹⁹ For these and other reasons, the court converted the case to a chapter 7. *Id.* at *14.

²⁰ The prior article (see n.2 *supra*) included a section covering “ongoing reporting obligations.” Research revealed no cases dealing with a small business debtor’s continuing reporting obligations.

²¹ *In re Microwave Prods. of America Inc.*, 100 B.R. 376, 377 (Bankr. W.D. Tenn. 1989).

²² *Id.* See also *In re A&F Elec. Co. Inc.*, 2007 WL 5582063, at *8 (Bankr. M.D. Tenn. Aug. 22, 2007).

²³ 11 U.S.C. § 1125(f).

²⁴ See *In re Sparta Surgical Corp.*, 2008 WL 878948, at *3 (D. Colo. March 28, 2008) (court determined adequate information was not provided at final hearing, denying argument that prior conditional approval was enough).

a debtor may solicit votes for the plan of reorganization pending the final hearing.²⁵ The final hearing is usually combined with the confirmation hearing.²⁶

Confirmation

A debtor's obligation is to confirm the reorganization plan in accordance with 11 U.S.C. §§ 1129(e) and 1121(e).²⁷ If a debtor cannot comply, the case is then subject to conversion. In *In re J.D. Mfg. Inc.*, the U.S. Bankruptcy Court for the Southern District of Texas did not approve the debtor's disclosure statement nor confirm its plan of reorganization.²⁸ The court then recognized that the debtor could not "confirm a chapter 11 plan within the time specified by [§§] 1121(e)(2) and 1129(e), as a year had passed from the date of the filing of the bankruptcy petition without effectuating a plan confirmation."²⁹ Thus, the court converted the case to a chapter 7 case.³⁰

Deadlines

The Code provisions applicable to small business cases contemplate a rapid exit from chapter 11 proceedings. A small business debtor's exclusivity period is 180 days, subject to extension.³¹ A debtor must file a plan of reorganization within 300 days from the filing of the bankruptcy petition.³² Section 1129(e) provides that once a plan of reorganization is filed, the debtor must confirm the small business plan within 45 days.³³ One bankruptcy court described the reason for the deadlines as follows:

Implicit in these requirements is that small business debtors ensure that they have filed plans timely and with adequate disclosures, and that they ensure that the confirmation hearings on those plans can be set, conducted and concluded within the prescribed 45-day period or they are prepared to prove within that period that they are entitled to an extension.³⁴

Section 1121(e)(3) specifies three criteria for granting an extension to the 45-day deadline. The court determined that the criteria are separated by an "and," so "the deadlines of... § 1129(e) 'may be extended only if all three of those statutory conditions are met.'"³⁵ In a similar ruling, the bankruptcy court in *In re Caring Heart Home Health Corp.* denied the debtor's request for a *nunc pro tunc* extension due

to the failure to meet the pre-deadline order requirement of § 1121(e)(3)(C).³⁶

Roots Rents demonstrates the severity of this requirement. The case provides that a court's equitable powers and the Bankruptcy Rules cannot justify straying from the § 1121(e) obligations.³⁷

While, in certain circumstances, Rule 9006(b)(1) allows the Court to grant requests made after the period in question has expired given a showing of excusable neglect, 28 U.S.C. § 2075 provides that the Bankruptcy Rules "shall not abridge, enlarge, or modify any substantive right."... Thus, where the Code requires an act to be completed within a specific time, the Court cannot apply a Rule to circumvent that deadline.³⁸

In *Save Our Springs (S.O.S.) Alliance*, the U.S. Bankruptcy Court for the Western District of Texas determined that the 45-day period commenced on the date that the original plan was filed, not on the amended plan filing date.³⁹ The court distinguished an earlier case that determined that the 300-day deadline would extend back to the date of filing.⁴⁰

Similarly, the court in *In re Castle Horizon Real Estate LLC* determined that an amended plan filed after 300 days that was substantially different from the original plan did not comply with § 1121(e)(2).⁴¹ The *Castle Horizon* court determined that there was clear congressional intent to expedite small business cases, although the court seemed to leave the door open for extensions if a debtor based the request on changed circumstances.⁴²

Conversion or Dismissal of a Small Business Case

Initially, a movant must establish cause for conversion of a small business case.⁴³ The burden then shifts to the debtor to prove the exceptions set forth in 11 U.S.C. § 1112(b)(2).⁴⁴ The exceptions in § 1112(b)(2) may not apply if dismissal is based on loss or diminution to the estate under 11 U.S.C. § 1112(b)(4)(A).⁴⁵ Dismissal under any other clauses of

§ 1112(b)(4) requires consideration of the "unusual circumstances."

Prior to reviewing unusual circumstances, a court must consider whether there is a reasonable likelihood of confirmation within the times set out in 11 U.S.C. §§ 1121(e) and 1129(e).⁴⁶ If a debtor cannot comply with the time periods, a court should dismiss the bankruptcy case.⁴⁷ If time is not an issue, a debtor must show that any act or omission that is cause to convert or dismiss the chapter 11 case has a reasonable justification that the debtor could cure within a reasonable period of time.⁴⁸

If the answer to these questions is "yes," the court must then identify unusual circumstances to avoid conversion or dismissal. "Unusual circumstances" are not defined by the Bankruptcy Code, but the existence of "unusual circumstances" necessarily contemplates conditions that are not common in chapter 11 cases.⁴⁹ Further, proving unusual circumstances does not require proof that is "extraordinary and compelling."⁵⁰ As the *Melendez Concrete* court explained:

When Congress enacted [BAPCPA], it used the phrase "absent unusual circumstances" in 11 U.S.C. § 1112(b)(1), while using the different phrase "absent extraordinary and compelling circumstances" in the newly enacted 11 U.S.C. § 1116. The court need not find that the circumstances are "extraordinary and compelling" to find that they are "unusual."⁵¹

Conclusion

Provisions in the Bankruptcy Code make chapter 11 a viable option for small business debtors. Nevertheless, the benefits come at a price, generally in the form of deadlines. Developing case law is beginning to take some of the uncertainty away from small business cases and gives the law governing these cases some teeth. ■

⁴⁴ 11 U.S.C. § 1112(b)(2) provides:

(2) The relief provided in paragraph (1) shall not be granted absent unusual circumstances specifically identified by the court that establish that such relief is not in the best interests of creditors and the estate, if the debtor or another party in interest objects and establishes that—

(A) there is a reasonable likelihood that a plan will be confirmed within the timeframes established in [§§] 1121(e) and 1129(e) of this title, or if such sections do not apply, within a reasonable period of time; and (B) the grounds for granting such relief include an act or omission of the debtor other than under paragraph (4)(A)—
(i) for which there exists a reasonable justification for the act or omission; and
(ii) that will be cured within a reasonable period of time fixed by the court.

⁴⁵ 11 U.S.C. § 1112(b)(1).

⁴⁶ See 11 U.S.C. § 1112(b)(2)(A).

⁴⁷ *In re Dovetail Inc.*, 2008 WL 5644889, at *1 (Bankr. N.D. Ill. Dec. 31, 2008).

⁴⁸ 11 U.S.C. § 1112(b)(2)(A).

⁴⁹ See *In re Kent*, 2008 WL 5047799, at *5, n.5 (Bankr. D. Ariz. Sept. 23, 2008); *In re Fisher*, 2008 WL 1775123, at *6 (Bankr. D. Mont. April 15, 2008).

⁵⁰ *In re Melendez Concrete Inc.*, 2009 WL 2997920, at *6 (Bankr. D. N.M. 2009).

⁵¹ *Id.* (footnote omitted). The court found unusual circumstances, including the severe recession and a motivated seller (debtor) because the asset value was three times greater than debt. *Id.* at *7.

²⁵ See, e.g., *A&F Elec. Co. Inc.*, 2007 WL 5582063, at *7.

²⁶ *Id.*

²⁷ 11 U.S.C. §§ 1129(e) and 1121(e).

²⁸ *In re J.D. Mfg. Inc.*, 2008 WL 4533690, at *1 (Bankr. S.D. Tex. Oct. 2, 2008).

²⁹ *Id.*

³⁰ *Id.* (court also found other, seemingly more compelling, cause to convert).

³¹ 11 U.S.C. § 1121(e)(1).

³² 11 U.S.C. § 1121(e)(2).

³³ 11 U.S.C. § 1129(e).

³⁴ *Save Our Springs (S.O.S.) Alliance*, 388 B.R. at 224.

³⁵ *In re Roots Rents Inc.*, 420 B.R. at 36.

³⁶ *In re Caring Heart Home Health Corp.*, 380 B.R. 908 (Bankr. S.D. Fla. 2008).

³⁷ *Roots Rents*, 420 B.R. at 36.

³⁸ *Id.* (footnote omitted).

³⁹ *Save Our Springs (S.O.S.) Alliance*, 388 B.R. at 225.

⁴⁰ *Id.*, distinguishing *In re Florida Coastal Airlines Inc.*, 361 B.R. 286 (Bankr. S.D. Fla. 2007) (original filing date controlled over amended filing date for purposes of determining if plan was filed within 300-day deadline).

⁴¹ *In re Castle Horizon Real Estate LLC*, 2010 WL 3636160, *1-2 (Bankr. E.D.N.C. Sept. 10, 2010) (debtor's plan was not "cleaned up" version, nor did it arise from "same factual occurrence").

⁴² *Id.* at *2.

⁴³ See 11 U.S.C. § 1112(b)(1). After BAPCPA, bankruptcy courts have less discretion on the conversion or dismissal decision. See *In re Products Intern. Co.*, 395 B.R. 101 (Bankr. D. Ariz. 2008) (citing *In re AmeriCERT Inc.*, 360 B.R. 398, 401 (Bankr. D. N.H. 2007), and *In re Gateway Access Solutions Inc.*, 374 B.R. 556 (Bankr. M.D. Pa. 2007)).