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**The Impact of BAPCPA and Rule Changes in Chapter 11 Cases**

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**I. Federal Rule Bankruptcy Procedure 6003**

**A. The Rule – The Title Says It All**

*Interim and Final Relief Immediately Following the Commencement of the Case--Applications for Employment; Motions for Use, Sale, or Lease of Property; and Motions for Assumption or Assignment of Executory Contracts*

Except to the extent that relief is necessary to avoid immediate and irreparable harm, the court shall not, within 20 days after the filing of the petition, grant relief regarding the following:

- (a) an application under Rule 2014;
- (b) a motion to use, sell, lease, or otherwise incur an obligation regarding property of the estate, including a motion to pay all or part of a claim that arose before the filing of the petition, but not a motion under Rule 4001; and
- (c) a motion to assume or assign an executory contract or unexpired lease in accordance with § 365.

**B. Effective Date of the Rule – December 1, 2007.**

**C. The following requests for relief, when filed and heard by the Court within twenty days after the filing of the petition, are covered by Rule 6003:**

- i. Retention applications for attorneys, accountants, financial advisors, auctioneers, agents and other professionals.

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<sup>1</sup> These statements are solely those of the author and do not represent a statement of policy or otherwise of any entity, including the U.S. Department of Justice, United States Trustee, and Executive Office for U.S. Trustees.

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- ii. Motions filed under Section 363 and 364 of the Bankruptcy Code, except to the extent already covered by Fed. R. Bankr. P. 4001. As a result of the limiting language at the end of this sentence Rule 6003 compliments, rather than clashes, with Rule 4001 and applies to motions to use, sell or lease property of the estate and obtain credit only to the extent such requests do not implicate the procedural requirements of Rule 4001.
- iii. Motions to assume or assign executory contracts pursuant to 11 U.S.C. § 365.

Motions, applications and other requests for relief of the type set forth above that are filed and set for hearing beyond the twenty day period after debtor files its petition for relief are not subject to the procedural restrictions of Rule 6003.

### D. Reasons for Enactment of the Rule

The Advisory Committee Notes suggest that the rule was adopted to address the “flurry” of first-day motions. The Advisory Committee Notes indicate that the rule “is intended to alleviate some of the time pressures present at the start of a case so that full and close consideration can be given to matters that may have a fundamental impact on the case.”

### E. The Standard Established

The Court shall not grant relief with respect to motions seeking interim or final relief within the first twenty days of the petition with respect to **applications for employment, motions for use, sale, or lease of property, and motions for assumption or assignment of executory contracts except to the extent necessary to avoid immediate and irreparable harm.**

### F. What Is Immediate and Irreparable Harm?

The Advisory Committee Notes indicate that the standard is taken from Rule 4001(b)(2) and (c)(2), so decisions under these subsections offer guidance for the application of Rule 6003. The following decisions discuss issues arising under Rule 4001: *In re The Coldad Group, Inc.*, 324 B.R. 208 (Bankr. W.D. N.Y. 2005); *General Electric Capital Corp. v. Hoerner (In re Grand Valley Sport & Marine, Inc.)*, 143 B.R. 840 (Bankr. W.D. Mich. 1992).

The evidentiary burden placed upon a moving party to establish the need for court ordered relief to avoid immediate and irreparable harm is also extant when courts consider requests for a preliminary injunction. In this context, Circuit Courts of Appeal have held as follows:

To demonstrate irreparable harm, the plaintiffs must show that ... they will suffer “actual and imminent” harm rather than harm that is speculative or unsubstantiated. *Abney v. Amgen, Inc.* 443 F.3d 540, 552 (6th Cir. 2006).

Irreparable harm must be “neither remote nor speculative, but actual and imminent.” *Tucker Anthony Realty Corp. v. Schlesinger*, 888 F.2d 969, 975 (2d Cir. 1989).

“The ‘clear showing’ of irreparable harm to be suffered by the plaintiff from a denial of the relief must be both ‘actual’ and ‘immediate.’” *Dan River, Inc. v. Icahn*, 701 F.2d 278, 284 (4th Cir.1983)...”; *Direx Israel Ltd. V. Breakthrough Medical Corp.*, 952 F. 2d 802, 812 (4th Cir. 1991).

In order to demonstrate irreparable harm the plaintiff must demonstrate potential harm which cannot be redressed by a legal or an equitable remedy following a trial. The preliminary injunction must be the only way of protecting the plaintiff from harm. *Instant Air Freight Co. v. Air Freight, Inc.*, 882 F.2d 797, 801 (3d Cir. 1989).

#### G. Doctrine of Necessity

Commentators on Rule 6003 have identified its interplay with the “doctrine of necessity” or “necessity of payment” rule which Bankruptcy Courts consider in the context of first-day motions seeking emergency relief under 11 U.S.C. § 105 and § 363 to pay critical prepetition claims or expenses. Stratton and McCollum, *New FRBP 6003: More Questions Than Answers*, 27-APR AM. BANKR. INST. J. 30 (2008). Referencing the “doctrine of necessity: or “necessity of pament” rule, Courts have permitted debtors to pay certain prepetition claims ahead of the claims of other creditors where such payment is essential to the continued operation and survival of the business. *In re Lehigh & N.E. Ry. Co.*, 657 F.2d 570 (3d Cir. 1981); *In re Ionosphere Clubs, Inc.*, 98 B.R. 174 (Bankr. S.D. N.Y. 1989); *In re Michigan Interstate Railway Co., Inc.*, 87 B.R. 921 (Bankr. E.D. Mich. 1988). Question arises whether the standard for satisfying the “doctrine of necessity” or “necessity of payment” rule is the same or different than the requirement under Rule 6003 that relief be necessary to avoid immediate and irreparable harm.

The only case directly considering Rule 6003 in the context of first-day motions is *In re NLC Financial Services, LLC* 382 B.R. 547 (Bankr. S.D. Fla. 2008). In this case, the Bankruptcy Court held that Rule 6003 permits entry of interim orders authorizing the retention of professionals by the debtor-in-possession.

**II. Small Business Chapter 11 Debtors**

A. Definition of a Small Business Debtor

(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) 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).

Stated simply, a small business debtor is:

- Person;
- Engaged in commercial or business activities except for owning or operating real property;
- With not more than \$2,190,000 (amount subject to periodic change) in noncontingent liquidated secured and unsecured debts;
- In a case where no official committee of unsecured creditors has been appointed;

B. Affiliates – 11 U.S.C. § 101(2)

In computing the amount of noncontingent liquidated secured and unsecured debts, you exclude debts between the affiliated entities but aggregate the third-party debts owed by the affiliates.

C. Designation of Small Business Debtors

Federal Rule of Bankruptcy Procedure 1020(a) provides that a chapter 11 debtor must identify itself as a small business debtor and this designation shall control the conduct of the case absent an order finding to the contrary.

Rule 1020(b) indicates that the United States Trustee or a party in interest may file an objection to the debtor's self-identification no later than 30 days after the conclusion of the meeting of creditors held under § 341(a) of the Code, or within 30 days after any amendment to the statement, whichever is later. Objections contesting whether a chapter 11 debtor is or is not a small business debtor are governed by Rule 9014 and handled as contested matters. Fed. R. Bankr. P. 1020(d).

D. Initial Filing Requirements – 11 U.S.C. § 1116

A small business debtor is required to file certain financial documents with the petition or to file a statement under perjury that such documents do not exist. In addition, a small business debtor must, among other things attend an initial debtor interview (IDI) with the United States Trustee, timely file its schedules and statement of financial affairs, file periodic reports on its business operations and allow the United States Trustee to inspect its business premises and records.

A small business debtor must append to its petition --

1. its most recent balance sheet, statement of operations, cash-flow statement, and Federal income tax return; or
2. a statement under penalty of perjury that these documents have not been prepared or filed.

After filing for relief under Chapter 11, a small business debtor must --

1. Attend meetings scheduled by the Bankruptcy Court or United States trustee, including the Section 341 meeting and any initial debtor conference;
2. Timely file schedules and statement of financial affairs unless the Court grants an extension of time, which extension cannot be more than 30 days from the date of filing absent extraordinary or compelling circumstances;
3. File all post-petition reports;
4. Maintain insurance;
5. Timely file tax returns and other required government returns or documents; and
6. Allow United States Trustee inspect its business premises, books and records.

### E. The Official Committee of Unsecured Creditors

Section 1102(a)(3) of the Bankruptcy Code provides that “[o]n request of a party in interest in a case in which the debtor is a small business debtor and for cause, the court may order that a committee of creditors not be appointed.”

Prior to enactment of the BAPCPA, under the former small business debtor provisions of the Bankruptcy Code, the Bankruptcy Court for the Eastern District of Pennsylvania considered this provision of the Bankruptcy Code in the case, *In re Haskell-Dawes, Inc.*, 188 B.R. 515 (Bankr. E.D. Pa. 1995). Judge Sigmund examined a motion to dispense with committee appointment filed by a small business debtor who cited the additional financial burdens that would be imposed upon the estate as the primary reason for seeking an order directing that no committee be appointed. In denying the motion, Judge Sigmund noted that if Congress’ intent was to dispense with committees in small business cases due to costs: “...it could have easily tailored the provision to effect this result. Since Congress did not choose this route, we conclude that the ‘cause’ requirement imposed in §1102(a)(3) must require something more than a general assertion that the appointment of a creditor’s committee may cost the Debtor money.” *Haskell-Dawes*, 188 B.R. at 52.

Once the United States Trustee appoints a creditors’ committee, the debtor ceases to be a “small business debtor” under the definition of 11 U.S.C. § 101(51)(D). However, Federal Rule of Bankruptcy Procedure 1020(c) provides if “a committee of unsecured creditors has been appointed under § 1102(a)(1), the case shall proceed as a small business case only if, and from the time when, the court enters an order determining that the committee has not been sufficiently active and representative to provide effective oversight of the debtor and that the debtor satisfies all the other requirements for being a small business.” A request for a determination that the committee has not been sufficiently active and representative to provide effective oversight may be filed by the United States Trustee or a party in interest only within a reasonable time after the committee ceases to be effective. The debtor may seek such a determination at any time.

### F. Time Periods for Filing and Confirming a Plan of Reorganization

The exclusivity period for a small business debtor differs from what is enjoyed by other chapter 11 debtors. A small business debtor has an initial exclusivity period of 180 days, as compared to 120 days for other chapter 11 debtors. 11 U.S.C. § 1121(e)(1). A small business debtor must file its reorganization plan no later than 300 days from the order of relief. 11 U.S.C. § 1121(e)(2).

With respect to confirmation of a plan of reorganization filed by a debtor, Section 1129(e) of the Bankruptcy Code mandates that “the court shall

confirm a plan ... not later than 45 days after the plan is filed unless the time for confirmation is extended in accordance with section 1121(e)(3).”

The ability of a debtor to extend the deadlines for filing a plan and obtaining confirmation is qualified by 11 U.S.C. § 1121(e)(3). Specifically, the debtor must demonstrate by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable time. In addition, the court must impose a new deadline at the time the extension is granted, and the order granting the extension must be signed before the existing deadline expires.

In the case, *In re AMAP Sales & Collision, Inc.*, -- B.R. --, 2009 WL 778773 (Bankr. E.D. N.Y. March 25, 2009), the Bankruptcy Court granted a small business debtor’s motion to extend time to obtain confirmation of its filed plan of reorganization. Contrastingly, in the case *In re Save Our Springs (S.O.S.) Alliance, Inc.* 388 B.R. 202 (Bankr. W.D. Tex. 2008), the Bankruptcy Court denied confirmation of the plan along with the small business debtor’s request for extension of time to obtain confirmation. Each decision discusses the time frame for confirmation established under 11 U.S.C. § 1129(e) and the evidentiary foundations for obtaining an extension of time under 11 U.S.C. § 1121(e)(3)(A). Specifically, these opinions address what evidence the debtor must put forth to convince the Court that it is more likely than not that the plan will be confirmed within a reasonable period of time. These opinions reject the notion that the Bankruptcy Court must conduct a mini-confirmation hearing in order to issue a ruling on whether an extension should be granted. But the Bankruptcy Courts stress that a debtor must come forward with more than unsubstantiated aspiration.

#### G. The Disclosure Statement – Conditionally Approved or Dispensed With

If a court determines that the plan of reorganization, by itself, provides adequate information, the Court can rule that a separate disclosure statement is not necessary. Alternatively, the Court may conditionally approve a disclosure statement drafted by the debtor or submitted by the debtor on a standard form adopted by the Court. 11 U.S.C. § 1125(f).

Federal Rule of Bankruptcy Procedure 3017.1 sets for the procedural requirements for conditional approval of a disclosure statement in a small business case.

In the case, *Colorado Mountain Express, Inc. v. Aspen Limousine Service, Inc.* (*In re Aspen Limousine Service, Inc.*), 193 B.R. 325 (D. Col. 2006), the District Court affirmed the Bankruptcy Court’s confirmation of a small business debtor’s plan of reorganization over an attempt by a creditor to obtain conditional approval for a competing disclosure statement. The District Court found that the Bankruptcy Court “properly balanced competing

interests of enabling diligent debtor to gain fresh start while, at the same time, encouraging competitive bidding for equity of reorganized debtor.”

### H. Conversion or Dismissal

While obtaining the benefit of a quicker, more expedient, route to confirmation, small business debtors must ensure they adhere to the initial filing requirements, navigate the established time frames and provide the requisite periodic reporting to the United States Trustee.

Section 1112(b) embodies several elements that may trigger conversion or dismissal of a small business case. Under Section 1112(b)(4), cause exists for conversion or dismissal based on --

- unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter;
- failure to attend the meeting of creditors convened under section 341(a) or an examination ordered under rule 2004 of the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor;
- failure timely to provide information or attend meetings reasonably requested by the United States trustee (or the bankruptcy administrator, if any);
- failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief; or
- failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court.

### I. Automatic Stay

With the amendments to the Bankruptcy Code effected through BAPCPA, Congress truncated the ability of small business debtors who are repeat filers to avail themselves of the protection of the automatic stay. Section 362(n) specifies that the automatic stay does not apply where the present debtor: (1) is a debtor in a small business case pending at the time the subsequent case is filed; (2) was a debtor in a small business case dismissed for any reason pursuant to an order that became final in the two-year period ending on the date of the order for relief entered in the pending case; (3) was a debtor in small business case in which a plan was confirmed in the two-year period ending on the date of the order for relief entered in the pending case; or (4) is an entity that has acquired substantially all of the assets or business of a small business debtor described in the preceding paragraphs, unless such entity

establishes by a preponderance of the evidence that it acquired the assets or business in good faith and not for the purpose of evading this provision.

Similar to the exceptions to the automatic stay set forth for repeat filers under 11 U.S.C. § 362(c), the restriction on the automatic imposed under 11 U.S.C. § 362(n) does not apply to an involuntary case involving a small business debtor, so long as the debtor is not involved in any collusion with the petitioning creditors, or if the debtor proves by a preponderance of the evidence that (a) the filing of the present petition resulted from circumstances beyond the debtor's control and was not foreseeable at the filing of the prior case; or (b) it is more likely than not that the court will confirm a feasible plan of reorganization (not a liquidating plan) within a reasonable period of time. *See*, HR Rep. No. 31, 109th Cong., 1st Sess 441 (2005)).