




**HOT CHAPTER 11 ISSUES
IMPACTING TRADE CREDITORS**

Presented by: Bruce S. Nathan
Andrew Behlmann
Michael Papandrea


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CRITICAL VENDOR ORDERS



- ***There is no Bankruptcy Code Provision That Expressly Authorizes Critical Vendor Status***
- It is Court-Created Based on Doctrine of Necessity
 - Limited by 7th Circuit Court of Appeals decision in *Kmart Corporation*, but doctrine still alive in most jurisdictions
- Critical Vendor Status Contingent on Court Approval Authorizing (not Directing) Debtor's Payment of Pre-Petition Claims of Creditors Deemed Critical or "Essential" to Debtor's Ongoing Business/Successful Reorganization
 - Exception to claims priority rules
 - Only Debtor designates critical vendors
 - Frequently includes § 503(b)(9) "20 day goods" priority claims and claims secured by lien rights

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CRITICAL VENDOR ORDERS



- Standard for Debtor Determining Critical Vendors
 - Debtor has broad discretion
 - Courts have the final say
 - Courts have reached varying holdings on when a vendor is “critical”
 - Some courts prohibit preferred critical vendor status
 - Among those courts allowing critical vendor status, some are stricter than others
 - Vendor less likely to be deemed critical if it is obligated to continue selling to Debtor via pending executory (e.g., supply) contract

RECENT BANKRUPTCY COURT DECISION DENIED CRITICAL VENDOR RELIEF



- *In Re: MacMillan* - Bankruptcy Court, District of Oregon, June 29, 2023
- Denied Critical Vendor Motion
 - Bankruptcy court lacked authority to approve critical vendor payments based on binding authority of 1983 Ninth Circuit U.S. Court Of Appeals holding in *In Re: B&W Enterprises Inc.*
 - Necessity of payment doctrine does not apply to critical vendor relief per B&W decision
 - Section 363(b), which authorizes debtors’ payments outside of ordinary course of business, does not apply to payments violating Bankruptcy Code’s priority rules
 - Bankruptcy court cannot rely on section 105 for authority to grant critical vendor relief where it is not otherwise provided in the Bankruptcy Code
 - Payment of critical vendor claims cannot be approved under standard applied to debtor’s post-petition payment of pre-petition employee wage and benefits priority claims (up to statutory cap) that must be paid in full under a chapter 11 plan; no similar requirement for payment of pre-petition unsecured claims

| CRITICAL VENDOR ORDERS



- ***In Re Windstream Holdings, Inc.* (District Court, Southern District of New York, April 3, 2020) Upholding Critical Vendor Relief**
- The District Court Articulated Three Requirements for Invoking Doctrine of Necessity to pay Pre-Petition Critical Vendor Claims
 - Vendor necessary to a successful reorganization
 - Debtor must exercise sound business judgment
 - Favorable treatment of critical vendors must not prejudice other unsecured creditors



| CRITICAL VENDOR PROGRAMS



- No Assurance of 100% Payment of Critical Vendor's Claim – Subject to Negotiation
- Quid pro quo: Generally, Creditors Receiving Such Payments Must Agree to Extend Post-Petition Credit (Entitled to Administrative Priority Status) and Other Terms, Which Generally Must be Consistent with "Best" Terms Previously Provided
 - Order could permit creditor to negotiate alternative terms
- Critical Vendor Agreement Should be Reviewed by Counsel
 - Negotiate payment and other terms
 - Be careful of fine print that prevents any change in prices and other non-credit related terms
 - Risk of disgorgement of critical vendor payments if creditor stops extending credit
 - Negotiate default provision that gives critical vendor an out based on a current post-petition delinquency of the debtor and other events of default

UNSECURED CLAIMS MOVING UP THE PRIORITY LADDER: § 503(B)(9) “20 DAY” ADMINISTRATIVE PRIORITY CLAIMS



- Administrative Claim for the Value of **Goods the Debtor Received** Within 20 days Before Its Bankruptcy Filing
- Safety Net for Trade Creditors that Supply Goods
 - **Does Not Apply to Services!**
- 20 Day Goods Must be Sold to the Debtor in the Ordinary Course of the Debtor’s Business
- Replaces Reclamation – Defunct / Toothless Trade Creditor Remedy
 - Subject to, and usually rendered valueless, by a secured lender’s floating lien on the debtor’s inventory
 - Limited to goods *in debtor’s possession* on filing date
 - Remedy limited to return of goods – no administrative claim, etc.

ASSERTION OF “20 DAY” GOODS ADMINISTRATIVE CLAIMS AND TIMING OF PAYMENT



- General Rule – Requests for allowance of § 503(b)(9) claims require notice and a hearing
 - *There is no automatic § 503(b)(9) administrative claim without court approval*
- There is also no Federal Bankruptcy Rule Specifying the Manner in Which to Assert § 503(b)(9) Priority Claims
 - Many courts prescribe manner of assertion
- There is no Deadline to Assert a § 503(b)(9) Claim in the Bankruptcy Code but Check Local Bankruptcy Rules
- Timing of Payment - Most Courts Have Rejected Immediate Payment Where a Debtor Objects
 - Instead, payment is generally made upon confirmation of a plan or earlier if a motion to pay § 503(b)(9) claims has been granted
 - Could be paid pursuant to critical vendor order



ONE OF § 503(B)(9)'S MOST FREQUENTLY LITIGATED ISSUES: MEANING OF RECEIPT OF GOODS



- § 503(b)(9) Does not Define “Receipt”
- Actual Physical Possession (UCC)?
 - UCC § 2-103(1)(c): “Receipt’ of goods means taking **physical possession** of them”
- Is Constructive/Third Party Possession Enough for § 503(b)(9)?



U.S. COURT OF APPEALS, 3RD CIRCUIT: *IN RE WORLD IMPORTS, LTD.*



- “Received” Under § 503(b)(9) Means a Debtor’s/Agent’s Actual Physical Possession of Goods
- Reversed Lower Court Rulings That a Debtor “Received Goods” Upon Delivery to Common Carrier on FOB Port of Shipment, China
- Relied on Dictionary Definitions of “Receive,” the UCC Article 2 Definition of “Receipt,” and Earlier Third Circuit Precedent Addressing Reclamation Rights That Required Actual Physical Possession
- Receipt Does not Occur Until Termination of Seller’s Ability to Stop Delivery of Goods
 - This occurs upon debtor’s/agent’s actual physical possession of goods
 - However, who qualifies as an agent? Common carrier?
- Third Circuit’s Ruling Could be Beneficial to Goods Sellers
 - Delayed occurrence of “receipt” of goods might increase the amount of goods received within § 503(b)(9)’s 20 day window, particularly for goods being imported from outside the United States



APPLICABILITY OF § 503(B)(9) TO DROP SHIPPED GOODS



- **Drop Shipping:** Creditor Ships Goods to a Third Party at Debtor's Instruction
 - Third party is the debtor's agent or customer
- Issue: Debtor Never Received *Actual Physical Possession* of Goods
- *In re Momenta, Inc.* – U.S. District Court of New Hampshire
 - Buyer Does not Obtain Possession of Goods That are Delivered to Buyer's Customer Under Drop Shipment Arrangement
- *SRC Liquidation LLC (f/k/a Standard Register)* – U.S. Bankruptcy Court, District of Delaware
 - Court Denied § 503(b)(9) Priority Status to Seller That Delivered Goods to a Common Carrier for Shipment to Debtor's Customer During the 20 day Period Before the Debtor's Chapter 11 Filing
 - Neither debtor nor debtor's agent took actual physical possession of goods
 - Common carrier deemed not to be debtor's agent
- Contrary View: Official Comment 2 to UCC § 2-705:
 - Receipt by buyer includes receipt by buyer's designated representative, sub-purchaser, when shipment is made direct to sub-purchaser and buyer never receives goods

RECEIPT OF GOODS: DROP SHIPMENT



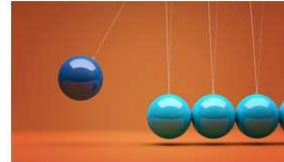
- Can "Receipt" be Defined in Parties' Agreement to Occur Upon Buyer's Customer's Receipt of the Goods?
 - **Suggested Language:** "Receipt of any product by buyer shall immediately occur when buyer, buyer's bailee or other agent or designee receives either actual or constructive possession of such product. Constructive possession shall include, without limitation, receipt by an entity or individual (including, without limitation, buyer's customer) pursuant to a drop ship instruction or other delivery instructions from buyer. Constructive possession specifically does not require actual physical possession by the buyer."
- There are no Reported Court Decisions That Allow, or Discuss the Propriety of, "Contracting Around" the Definition of "Receipt"



ARE GOODS PROVIDED UNDER A SERVICE CONTRACT ELIGIBLE FOR SECTION 503(B)(9) PRIORITY STATUS?



- Split of Judicial Authority Depending on Applicability of Predominate Purpose Test
 - Is contract predominantly for the sale of goods?
- Majority View
 - Creditor eligible for § 503(b)(9) priority status for the portion of the claim attributed to the goods provided under the contract
 - Must invoice separately identify charges for goods and services?
 - Recent supporting court decision: *In re Sklar Exploration Company*, U.S. Bankruptcy Court, District of Colorado
 - Creditors provided acidizing services to the Debtor that included provision of chemicals (nitrogen and acid)
 - Predominate purpose test inapplicable
 - Court separately analyzed the goods and services components of the creditors' pre-petition claim and held the chemicals provided were goods eligible for priority status



ARE GOODS PROVIDED UNDER A SERVICE CONTRACT ELIGIBLE FOR SECTION 503(B)(9) PRIORITY STATUS?



- Minority View
 - Section 503(b)(9) priority status only applies to contracts that are predominantly for the sale of goods (relying on the predominate purpose test)
 - No Section 503(b)(9) eligibility if the provision of services is the predominant aspect of the transaction
 - Supporting holding: *In re Circuit City Stores, Inc.*, U.S. Bankruptcy Court, Eastern District of Virginia



ADMINISTRATIVE EXPENSE PRIORITY STATUS FOR GOODS SOLD AND DELIVERED PRE-PETITION THAT DEBTOR RECEIVES POST-PETITION?



- Recent Decision in *In re Bluestem Brands*, U.S. Bankruptcy Court, Delaware Granted Administrative Expense Priority Status
- Relied on § 503(b)(1)-Administrative expense priority claim granted for "...the actual, necessary costs and expenses of preserving the estate..."
- Trade Creditors Had Moved For Allowance of Administrative Expense Priority Claims under § 503(b)(1) for Goods Ordered, Sold, and Delivered Pre-Petition that Debtor Received Post Petition
 - Trade creditors benefitted based on Debtor's post-petition receipt and sale of the goods
 - No requirement for post-petition transaction

ADMINISTRATIVE EXPENSE PRIORITY STATUS FOR GOODS SOLD AND DELIVERED PRE-PETITION THAT DEBTOR RECEIVES POST-PETITION? (CONT'D)



- Plan Administrator Objected to Priority Status
 - No benefit to Debtor's estate given no post-petition transaction where claims arose from pre-petition sale and delivery of goods
- Bankruptcy Court Ruled in Creditors' Favor and Allowed Administrative Expense Priority Claim Under § 503(b)(1)
 - Creditors' post-petition receipt of goods and post-petition sale of the goods benefitted Debtor's business and thereby benefitted and preserved estate
 - Post-petition contract or transaction is a not prerequisite for administrative priority status
 - No good reason to grant lower priority status to claim for goods Debtor had physically received post-petition than to a § 503(b)(9) priority claim for goods Debtor had received within 20 days of bankruptcy filing date

A TWO-MINUTE PREFERENCE REFRESHER: WHAT IS A PREFERENCE?



Elements of a Preferential Transfer	Practical Considerations
A transfer of property of the estate to or for the benefit of a creditor, on account of an antecedent debt, made while the debtor was insolvent, on or within 90 days before the filing of the petition (one year for insiders) that enables the creditor to receive more than it would in a hypothetical chapter 7 liquidation where the transfer was not made and the creditor received payment according to the Bankruptcy Code	Typically but not always a payment – check, wire, etc. No debt, no preference – cash in advance/ prepayments are not preferences at all Presumption of insolvency for transfers within 90 days is rebuttable with evidence If you did not fare better than if the allegedly preferential transfer had not been made, the debtor filed chapter 7, and you were paid pursuant to the Bankruptcy Code, no preference (i.e., less than 100% recovery under plan)
“Due diligence” requirement	Who has the burden of proof?

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A TWO-MINUTE PREFERENCE REFRESHER: COMMON DEFENSES



Defense	Description
Contemporaneous Exchange of New Value	Payment was intended to be, and was, a substantially contemporaneous exchange of new value
Subsequent New Value	Creditor provided new value – extensions of credit – to the debtor after receiving the preferential transfer
Ordinary Course of Business	Transfer was payment of a debt incurred in the ordinary course of business or financial affairs of the debtor and creditor, and <ul style="list-style-type: none"> Made in the ordinary course of business or financial affairs of the debtor and the creditor (subjective test), or Made according to ordinary business terms (objective test).

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APPLICABILITY OF NEW VALUE DEFENSE TO PAID § 503(B)(9) INVOICES



- Eleventh Circuit Decision: *Auriga Polymers vs. PMCMZ LLC*
 - Post-petition paid § 503(b)(9) priority claim also counts as new value
 - Post-petition payment of § 503(b)(9) claim was not an “otherwise unavoidable transfer” that precluded inclusion as part of creditor’s new value defense
 - All references to “transfers” in § 547(c)(4) are only pre-petition transfers
 - Since new value defense does not include post-petition extensions of credit, new value defense can include new value paid post-petition
 - Rejected “double payment” argument where creditor is allowed to use the same invoices as part of its post-petition paid § 503(b)(9) priority claim and as part of creditor’s new value defense
 - 11th Circuit holding supports including as part of creditor’s new value defense invoices paid post-petition pursuant to a critical vendor order
- 11th Circuit relied on 3rd Circuit Decision, in *In re Friedman’s, LLC Counted New Value Paid Post-Petition Pursuant to Court’s Wage Order Because New Value is Determined as of the Bankruptcy Filing Date*

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RECENT DECISION IN A&P CHAPTER 11 CASES



- In January 2024, the Southern District of New York bankruptcy court held in a preference action asserted in the A&P chapter 11 cases that the defendant may avail itself of the subsequent new value defense **even if the subsequent new value did not remain unpaid as of the bankruptcy filing!**
- Bankruptcy court also held that the defendant may setoff its allowed 503(b)(9) claim (for the goods sold to and received by the debtor in the 20 days before the bankruptcy filing) against any judgment to recover preferential transfers.
 - Relied on *In re Quantum Foods, LLC* (Bankruptcy, Delaware, 2016)
 - *But see In re Georgia Steel, Inc.* (Bankruptcy, Middle District of Georgia, 1984), where the bankruptcy court rejected setoff of 503(b)(9) claim to reduce preference liability.



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BUT THE A&P HOLDING WAS NOT AS FUN FOR 502(H) CLAIMS . . .



- Section 502(h) - provides that a claim arising from the recovery of property under chapter 5 avoidance provisions shall be allowed or disallowed “the same as if such claim had arisen before the date of the filing of the petition.”
- Bankruptcy court also held that in the event payments made to a creditor for goods sold to and received by the debtor during the 20 days before the bankruptcy filing are recovered as a preference, the claim that the creditor may assert against the bankruptcy estate for the amount recovered is **not** entitled to treatment as a 503(b)(9) claim.

BUT THE A&P HOLDING WAS NOT AS FUN FOR 502(H) CLAIMS . . . (CONT'D.)

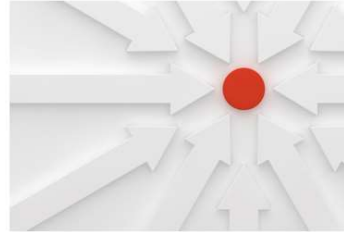


- Is accepting a payment during the potential 20-day period before a bankruptcy filing, which may be recoverable as a preference, worth potentially losing a 503(b)(9) claim?
 - A creditor won’t necessarily know precisely when a customer will file for bankruptcy and therefore may not know in real time whether the parties are in the 20-day period before the filing; and
 - Despite the requirements of the Bankruptcy Code, 503(b)(9) claims are not always paid in full – or at least may not be for a considerable amount of time after the bankruptcy filing.

SUBJECTIVE PRONG OF THE ORDINARY COURSE OF BUSINESS DEFENSE



- Courts Have Been Inconsistent and Unpredictable in Applying the Subjective Component of the Ordinary Course of Business Defense
- Each Side can Pick one or More Methodologies to Support its Position
- This Encourages Expensive, Drawn out, and Unpredictable Litigation
- Range of Payments:
 - All payments?
 - Modified range?
 - Removal of outliers?
 - Payments only when Debtor is healthy?
(*Circuit City* Bankruptcy Court decision from Eastern District, Virginia)
- Comparison of Average Days to Pay/Days Late Prior to and During Preference Period
- Bucket Analysis – Examining Payments by Grouping – Accepted by *Quebecor World*, Bankruptcy Court, Southern District of New York
 - Risk of skewed analysis



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RECENT COURT DECISION UPHOLDING APPLICABILITY OF SUBJECTIVE ORDINARY COURSE OF BUSINESS DEFENSE



- *In re Décor Holdings*-U.S. District Court for Eastern District of New York, 2/23/2022, Affirming U.S. Bankruptcy Court, Eastern District of New York
- Upheld Grant of Summary Judgment Dismissing Preference Complaint Based on Subjective Ordinary Course of Business Defense
- Bankruptcy Court Had Sole Discretion to Determine Test For Considering Applicability of the Defense
- Relied on Average Days to Pay/Average Lateness and Modified Range/Bucketing Test
 - Average lateness comparing average number of days late during baseline/historical and preference periods: subjective ordinary course of business defense applicable based on up to 7 day difference in average lateness during the historical baseline and preference periods
 - Modified range/bucketing analysis: timing of virtually all preference payments consistent with bucket including 82% of payments during historical baseline period – subjective defense satisfied
 - Baseline period-2 years before the onset of the 90-day preference period
- Rejected Plaintiff's Attempt to Create Artificially Narrow Buckets Resulting in Inconsistency between Baseline Period and Preference Payments

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RECENT COURT DECISION UPHOLDING APPLICABILITY OF SUBJECTIVE ORDINARY COURSE OF BUSINESS DEFENSE



- *In re J&M Sales, Inc.*, U.S. Bankruptcy Court, Delaware, 3/1/2022
- Bankruptcy Court Denied Plaintiff's Motion for Summary Judgment that Defendant Did Not Satisfy the Subjective Ordinary Course of Business Defense
- Applied Total Range Analysis Comparing Total Range of Timing of Payments During the Baseline/Historical and Preference Periods
 - Alleged preference payments ranging from 354 to 389 days to pay consistent with historical/baseline range of 100 to 430 days to pay

SUBJECTIVE ORDINARY COURSE OF BUSINESS PREFERENCE DEFENSE – FACTS THAT DEFEAT SUBJECTIVE ORDINARY COURSE OF BUSINESS ON THE NUMBERS



- Consistency in Timing of Payments Before and During Preference Period Alone Might **not be** Sufficient to Prove the Subjective Component of Ordinary Course of Business Defense
- Threats to Subjective Component, Which are all Fact Specific:
 - Change in the type of payment during preference period (regular check to wire, ACH, etc.)
 - Change in method of invoicing (electronic vs. paper)
 - Change in credit terms
 - Imposition of credit limit/enforcement of existing credit limit
 - Threats to stop shipment
 - Imposition of credit holds
 - Change in mode of delivery (regular mail to Federal Express or hand delivery)

IMPACT OF PAYMENT PRESSURE ON SUBJECTIVE ORDINARY COURSE OF BUSINESS DEFENSE



- *Official Committee of Unsecured Creditors of Gregg Appliances vs. D&H Distributing Co. (In re hhgregg)*: 1/13/2022: U.S. Bankruptcy Court, Southern District of Indiana
- Creditor Did Not Prove the Subjective Ordinary Course of Business Defense, Despite Virtually Identical Timing of Payments made During Historical/Baseline and Preference Periods
- Creditor's Efforts to Collect its Claim and Reduce its Exposure Resulted in the Loss of the Defense
 - Escalated collection communications with senior management
 - Threats to withhold shipments unless payments made
 - Tightened payment terms
 - Significant reduction in debtor's credit limit
- Decision Was a Close Call and Likely Influenced by Debtor Ending Up Overpaying Creditor, Resulting in Credit Balance on Bankruptcy Filing Date
 - Creditor loses subjective ordinary course defense if debtor prioritized payment of creditor's claim over other creditors



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IMPACT OF PAYMENT PRESSURE ON SUBJECTIVE ORDINARY COURSE OF BUSINESS DEFENSE



- Another hhgregg Decision Applying Subjective Ordinary Course of Business Defense, Notwithstanding Collection Pressure
 - *Official Committee of Unsecured Creditors of Gregg Appliances vs. Curtis International (In re hhgregg)*: 2/3/2022
- Subjective Ordinary Course of Business Defense Applicable to Virtually all Preference Payments, Notwithstanding Payment Pressure
 - Defendant's collection communications more frequent and insistent during preference period
 - Debtor's and defendant's communications during preference period included their senior executives
 - No threats to alter credit/payment terms, reduce debtor's credit limit, impose credit hold, refer to collection or commence litigation
- Bankruptcy Court Concluded Collection Communications Did Not Rise to Level of "Unusual Collection Activity" that Existed in *D&H Distributing Co.* litigation

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| THIRD-PARTY RELEASES



- Releases of claims of creditors (non-debtor third parties) **against other non-debtor third parties** such as directors, officers, shareholders, private equity sponsors, parents, subsidiaries, other affiliates, advisors, investment bankers, etc.
- Included in many (now perhaps most) Chapter 11 plans
- Typically entitled “Release by Holders of Claims and Interests” or similar names



| THIRD-PARTY RELEASES (CONT'D)



- **Opt-In vs. Opt-Out vs. Nonconsensual Releases**
 - Modern trend is toward “opt-out” releases
 - Failure to take affirmative steps to opt out is **deemed to be consent** – essentially a legal fiction
 - Nonconsensual releases – no opportunity to opt out, appellate courts have said these are reserved for extraordinary circumstances
- A creditor’s failure to opt out of an opt-out release will likely release its claims against a host of released parties identified in the plan.
- Third-party releases are facing increasing scrutiny from the United States Trustee, Congress, and most recently the U.S. Supreme Court.

CONTROVERSY SURROUNDING THIRD PARTY RELEASES: *PURDUE PHARMA* NONCONSENSUAL RELEASES



- Purdue Pharma filed Chapter 11 on September 15, 2019 in the Southern District of New York
- Sackler family – Controlled Purdue and allegedly extracted \$12 billion+ from Purdue over time
 - Sackler family members themselves *did not* file bankruptcy
- Purdue Pharma's plan of reorganization provided the Sacklers with a broad release *by Purdue's creditors* of claims related to Purdue and its business and products, for a cash contribution of \$4.375 billion over time
- Bankruptcy Court confirmed the plan, including the nonconsensual third-party release
- Primary Confirmation Objections / Appeals:
 - 8 States and Other Entities
 - 5 Individual Plaintiffs
 - United States Trustee (USDOJ)



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CONTROVERSY SURROUNDING THIRD PARTY RELEASES: *PURDUE PHARMA* NONCONSENSUAL RELEASES



- District Court **vacated** confirmation order on appeal, finding that Bankruptcy Court lacked statutory and constitutional authority to approve a nonconsensual third-party release.
- Expedited appeal taken to Second Circuit
- Sackler family reached new, \$5.5-6.0 billion settlement in early 2022
- May 30, 2023: Second Circuit **reversed** District Court / **affirmed** Bankruptcy Court
 - Found that Bankruptcy Courts' broad equitable powers permit third-party releases
 - § 105(a) (general equitable powers) + § 1123(b)(6) ("any other appropriate provision") grant a "residual authority consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships"
 - Implemented a seven-factor test for determining whether releases are appropriate, but acknowledged that releases might not be appropriate even where all seven factors are satisfied

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U.S. SUPREME COURT TO HEAR APPEAL FROM SECOND CIRCUIT RULING



- August 10, 2023: United States Supreme Court Accepted U.S. Trustee's Petition for Certiorari for Review of Second Circuit's Decision Upholding Purdue Pharma Nondebtor Plan Releases
 - **Issue addressed:**
Whether the Bankruptcy Code authorizes a court to approve, as part of a plan of reorganization under Chapter 11 of the Bankruptcy Code, a release that extinguishes claims held by nondebtors against nondebtor third parties, without the claimants' consent?
- December 4, 2023: SCOTUS heard oral arguments
- Difficult to predict how SCOTUS will rule



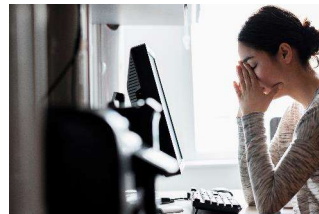
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SUBCHAPTER V: AN INTRODUCTION AND ISSUES LEADING TO ITS ENACTMENT



- Small business chapter 11 cases prior to Subchapter V were not working for small and middle market companies
 - Too time-consuming and expensive
 - Process needed drastic streamlining
 - Absolute priority rule put owner at substantial risk of losing business
- Distressed small businesses had to rely on non-bankruptcy alternatives
 - Assignment for the benefit of creditors
 - Receiverships
 - UCC Article 9 secured party sale
 - Closing the doors and walking away



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SUBCHAPTER V ENACTED AND EXPANDED



- Enacted as Part of Small Business Reorganization Act of 2019 (SBRA)
 - Purpose is to reduce costs and increase efficiency
 - Subchapter V was initially available to businesses with liquidated, non contingent, secured and unsecured debt of \$2,725,625 as of bankruptcy petition date (excluding debt to insiders/affiliates)
 - Limit increased to \$3,024,725 on April 1, 2022
- CARES Act increased Sub V debt limit to \$7,500,000
 - At least 50% from commercial or business activities of the debtor
 - Bankruptcy Threshold Adjustment and Technical Corrections Act preserved \$7.5 million eligibility threshold
 - Increased debt limit is scheduled to sunset on June 21, 2024
 - U.S. Senate considering legislation to extend \$7.5 million debt limit for another 2 years

SUBCHAPTER V “VS.” TRADITIONAL CHAPTER 11 CASES



- Subchapter V is clearly intended to be a faster, less expensive and more streamlined variant of “traditional” chapter 11
- The key aspects of Subchapter V that further this goal are:
 - Elimination of U.S. Trustee fees
 - Elimination of official committee of unsecured creditors
 - Appointment of Subchapter V trustee
 - True exclusivity: only the debtor can file a plan in Subchapter V, though the debtor must do so within 90 days (subject to extension by satisfying more rigorous standard than in traditional chapter 11)
 - Separate disclosure statement is not required to solicit votes on the plan
 - Plan may be confirmed even if there is no impaired consenting class
 - Abrogation of the “absolute priority rule”
 - Equityholders may retain their interests, even if not all classes of creditors are paid in full, so long as all “disposable income” is paid to creditors over the life of the plan
 - Courts are split as to whether disposable income is subject to adjustment over the life of the plan
 - Risk of deferred payment of administrative expense claims over the life of the plan

CREDITOR ABILITY TO CHALLENGE DISCHARGEABILITY OF CLAIMS



- Emerging issue in Subchapter V cases – Does exception to discharge under section 523(a) of the Bankruptcy Code apply only to individual debtors, or also to corporate debtors?
 - Section 523(a) provides for non-dischargeability of claim owing by individual debtor arising from, *inter alia*:
 - Fraud
 - Willful and malicious injury other section 523(a) grounds
 - Other grounds listed in section 523(a)
- In traditional chapter 11 case – exception to discharge only applies to individual debtor
- Applicability of exceptions to discharge to both corporate and individual Subchapter V debtors
 - Yes
 - Fourth Circuit decision – *In re Cleary Packaging* – held that section 523(a)(2) fraud exception to discharge applies to *both* corporate and individual Subchapter V debtors that have confirmed non-consensual plans
 - Recent Fifth Circuit decision agrees with Fourth Circuit – *In Matter of GFS Industries LLC*
 - No
 - Ninth Circuit Bankruptcy Appellate Panel decision – *In re Off-Spec Solutions, LLC* – exception to discharge applies only to individual Subchapter V debtors

CREDITOR STRATEGIES



- Be assertive!
- Consider objecting early to Subchapter V case if debtor is ineligible
- Utilize chapter 11 creditor remedies, such as critical vendor status, 503(b)(9) priority status, objections to dischargeability of claim
- While there is no creditors' committee, creditors can move for the court to direct appointment of a committee for cause
- ***The Subchapter V Trustee is not a fiduciary for unsecured creditors***
 - Creditors can seek to have Subchapter V trustee investigate possible claims against the Debtor and third parties, such as insiders
 - Court approval required



CREDITOR STRATEGIES (CONT'D.)



- Challenge plan payments
 - Debtor must contribute all projected disposable income to the plan
 - Creditors should be prepared to examine the Debtor's projections, which can be manipulated
 - Creditors could seek to expand plan period to 5 years
 - Creditors could seek recovery of the upside if the Debtor exceeds projections
 - Creditors should consider working with Trustee on plan issues
- Object to any extended repayment of administrative claims under the plan



HOW IS SUBCHAPTER V FARING?



- Subchapter V is popular with debtors
- Filings have significantly increased each year since enactment of the SBRA
- Subchapter V filings in 2023 Increased by 30% compared to 2022
 - 45% of chapter 11 debtors used Subchapter V
- First quarter 2024
 - Subchapter V filings increased 30% compared to first quarter 2023
- Subchapter V filings increased 60% in April 2024 compared to April 2023
- Subchapter V filings increased 53% in May 2024 compared to May 2023
- Substantial increase in filings likely attributed to risk \$7.5 million debt limit will not be extended



HOW IS SUBCHAPTER V FARING?



- Subchapter V has been lauded as being “successful” based largely on the number of cases filed and plans confirmed, but . . .
 - ***Are Debtors truly achieving an effective reorganization?***
 - ***Are Debtors making all of their required plan payments?***
 - ***How is Subchapter V working for unsecured creditors?***

AMERICAN BANKRUPTCY INSTITUTE SUBCHAPTER V TASK FORCE



- Reviewed the implementation and administration of Subchapter V
- Presented its final report and recommendations on Subchapter V
 - Debtor eligibility recommendations
 - Subchapter V debt limit should be permanently set at \$7.5 million with inflation adjustment
 - \$7.5 million debt limit has been in effect for much of period from 3/27/2020 through 12/31/2023
 - About 26.2% of Subchapter V debtors would have been ineligible for Sub V relief if \$7.5 million debt limit was not in effect
 - Plan confirmation rate higher while \$7.5 million debt limit in effect
 - Debt limit should not include future rent payments



AMERICAN BANKRUPTCY INSTITUTE SUBCHAPTER V TASK FORCE (CONT'D.)



- More ABI Subchapter V Task Force recommendations:
 - Role of Subchapter V trustee
 - Case administration recommendations
 - Plan and confirmation recommendation
 - Silent non-voting class deemed to accept plan
 - Debt dischargeability recommendation
 - Non-dischargeability claims only against individual debtor
 - Post confirmation administration matters



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QUESTIONS



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BRUCE S. NATHAN



Partner, Bankruptcy & Restructuring Department

New York
212.204-8686
bnathan@lowenstein.com

Education

University of Pennsylvania Law School (J.D. 1980)

Wharton School of Finance and Business (M.B.A. 1980)

University of Rochester (B.A. 1976),
Phi Beta Kappa

Admissions

New York

With more than 40 years of experience in the bankruptcy and insolvency field, Bruce is a recognized leader nationwide in trade creditor rights and the representation of trade creditors in bankruptcy and other legal matters. He has represented trade and other unsecured creditors, unsecured creditors' committees, secured creditors, and other interested parties in many of the larger Chapter 11 cases that have been filed. Bruce also handles letters of credit, guarantees, security, consignment, bailment, tolling, and other agreements and legal credit issues for the credit departments of institutional clients.

Among his various legal recognitions, Bruce received the Top Hat Award in 2011, a prestigious annual award honoring extraordinary executives and professionals in the credit industry. He was co-chair of the Avoiding Powers Committee that worked with the American Bankruptcy Institute's (ABI) Commission to Study the Reform of Chapter 11, participated in ABI's Great Debates at their 2010 Annual Spring Meeting—arguing against repeal of the special BAPCPA protections for goods providers and commercial lessors—and was a panelist for a session sponsored by ABI. He is a frequent presenter at industry conferences throughout the country, as well as a prolific author regarding bankruptcy and creditors' rights topics in various legal and trade publications.

Bruce is a co-author of "Trade Creditor's Risk-Mitigation Tools and Remedies Manual," published by ABI in 2019. He has also contributed to *ABI Journal* and is a former member of ABI's Board of Directors and former co-chair of ABI's Unsecured Trade Creditors Committee.



ANDREW BEHLMANN



Partner, Bankruptcy & Restructuring Department

New Jersey
973.597.2332
abehlmann@lowenstein.com

Education

Seton Hall University School of Law (J.D. 2009), magna cum laude;
Order of the Coif

University of Missouri-Saint Louis (B.S. 2005), Business
Administration-Finance and Accounting; *Beta Gamma Sigma*

Admissions

New Jersey

Andrew leverages his background in corporate finance and management to approach restructuring problems, both in and out of court, from a practical, results-oriented perspective. With a focus on building consensus among multiple parties that have competing priorities, Andrew is equally at home both in and out of the courtroom, and he has a track record of turning financial distress into positive business outcomes. Clients value his counsel in complex Chapter 11 cases, where he represents debtors, creditors' committees, purchasers, and investors.

Andrew writes and speaks frequently about bankruptcy matters and financial issues. Before becoming a lawyer, he worked in senior financial management at a midsize, privately held company.



MICHAEL T. PAPANDEA



Counsel, Bankruptcy & Restructuring Department

New Jersey
973.422.6410
mpapandrea@lowenstein.com

Education

Rutgers Law School (J.D. 2014),
Rutgers Journal of Law & Public Policy

The College of New Jersey
(B.S. 2010), Criminology

Admissions

New York
New Jersey

Mike provides counsel to debtors, creditors' committees, individual creditors, liquidating trustees, and other interested parties with respect to corporate bankruptcy and creditors' rights matters, including bankruptcy-related litigation.

Reliable and efficient, Mike is appreciated for his innate ability to effectively apply and communicate his understanding of the law and general business principles with respect to complex issues, both while providing advice to clients and while aggressively advocating on their behalf. Mike works tirelessly to understand clients' needs and provide practical solutions that are reasonable, balanced, and favorable to the clients he serves.

Mike enjoys keeping clients and relevant industry professionals in the loop regarding bankruptcy, insolvency, and creditors' rights issues, regularly writing articles for and speaking to professionals in the credit and risk management space. Mike also takes pride in his commitment to the community and provides pro bono representation to individuals and nonprofit organizations regarding bankruptcy and foreclosure-related matters.

Prior to joining the firm, Mike held multiple clerkships in the U.S. Bankruptcy Court; he clerked for the Hon. Jerrold N. Poslusny, Jr. (District of New Jersey), the Hon. Ashely M. Chan (Eastern District of Pennsylvania), and the Hon. Gloria M. Burns (Chief Judge, District of New Jersey). Mike applies the valuable insights learned from working closely and directly with these members of the judiciary to his everyday practice.



THANK YOU

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