

Restructuring Debt For Small Businesses and Family Farmers Post COVID-19



COVID-19

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Susan M. Cook

40 years of experience in:

- ◆ Bankruptcy, business and agricultural reorganization
- ◆ Represents clients in distressed automotive supply chain
- ◆ Commercial and business law



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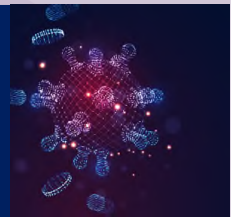
Over 40 years experience in:

- ◆ Bankruptcy reorganization, loan workouts in all types of business and agriculture
- ◆ Automotive, manufacturing, health care industries
- ◆ Representing debtors and secured lenders

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Introduction

This webinar is designed to explore several new additions to federal bankruptcy law which will help small businesses and family farmers to recover from the unprecedented economic challenges which have arisen due to the coronavirus pandemic.



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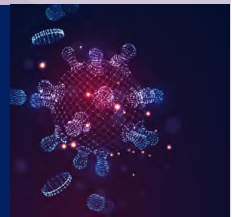
Without question, small businesses and family farmers have suffered extraordinary pressure with the prolonged coronavirus shutdown.

- Many small businesses were required to shut down or continue to operate but service only essential customers and clients.
- In both cases, fixed costs continued to accrue with little or no revenue and, in the case of those required to service essential customers, most expenses continued but revenues were considerably reduced.
- While the SBA PPP loans and COVID Disaster Loans provided significant relief, the loss of revenue for an extended period of time may mean that small businesses cannot recover without restructuring or reducing debt.

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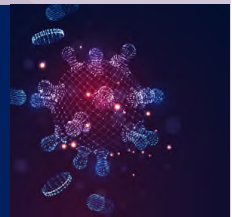
- Farmers, especially dairy farmers, were also hard hit. The dairy farmers expenses of milking and maintaining the herd continued but the shutdown, especially of schools, dried up demand. The price of milk dropped to \$13 a CWT and many farmers had to dump their milk.
- Again, while federal programs aimed at farmers will certainly help, many farmers will not recover without a restructuring or discharging some debt.



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As accountants and financial advisors, you are on the front line with respect to these challenges.

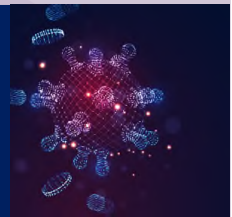
- You will probably be the first professionals to see the financial problems and be asked to help.
- It is important to understand all options that are available to your clients who cannot service their obligations.
- This is best done by a team, consisting of you, the client's trusted financial advisor, an experienced restructuring lawyer and the client.



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- Together, the team can gather the information necessary to assess the best possible options for your client, whether through a court supervised restructuring or an out of court restructuring.
- The most important information will be financial information, both historical and projected results. Again, the financial advisors participation will be key to making certain that the historical information is correct, that projections of future results are reasonable and that the client understands the financial information and the plan.
- The team will work together to advise the client of all options and when a path is chosen, the team will continue to work together to manage the process. Again, in any restructuring, the continued participation of the client's financial advisors is key in continually assessing the client's ability to service debt and the feasibility of any plan.



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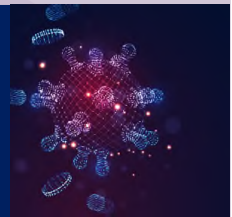
The restructuring options available to small businesses and farmers have been greatly enhanced due to two recent changes in the law.

- In the fall of 2019, a small business chapter, Sub Chapter 5, was added to the Chapter 11 reorganization provisions of the bankruptcy code.
 - Sub Chapter 5 is designed to make Chapter 11 reorganizations for small businesses much simpler and more cost effective.

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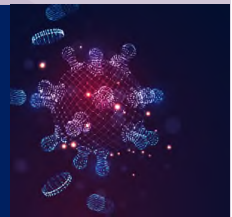
- More importantly, the plan confirmation provisions make it easier for the business owner to retain equity after plan confirmation.
- Unfortunately, the debt limitations to qualify for Sub Chapter 5 were too small, \$2,700,000, so very few businesses were eligible for these enhanced procedures.
- In response to the coronavirus, the Cares Act, raised this debt limitation to \$7,500,000 for a period of one (1) year after enactment of the Cares Act, thus making the enhanced procedures available to many more businesses.



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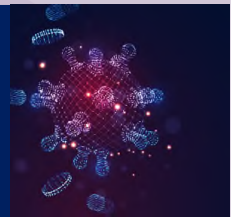
- The second new Congressional enactment increased the debt limitation on Chapter 12 family farmer proceedings from approximately \$4,000,000 to \$10,000,000. Again, this significantly increases those farmers who may take advantage of similar streamlined and cost effective procedures which allow the farmer significant control over the reorganization while retaining equity.
- We will be discussing the benefits of both of these new opportunities today and the important role which you will play in these and all restructuring processes



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History of Small Business Bankruptcy

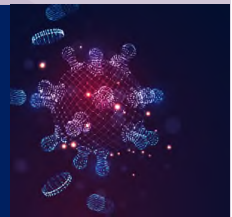
- Evolution and Purpose of Small Business Reorganization Act of 2019. In the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“2005 Act”), Congress amended the Bankruptcy Code and Title 28 of the U.S. Code to provide special rules and procedures for “small business debtors.” The small business provisions of the 2005 Act “institut[ed] a variety of time frames and enforcement mechanisms designed to weed out small business debtors who are not likely to reorganize.”



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History (cont.)

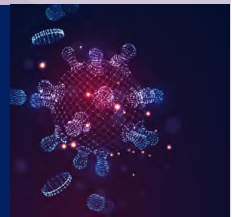
- After 10+ years of practice under the 2005 Act, Congress concluded that “[n]otwithstanding the 2005 Amendments, small business chapter 11 cases continue to encounter difficulty in successfully reorganizing.” H.R. Rep. No. 116-171, at 4 (2019). In response and to “streamline the bankruptcy process by which small businesses [*sic*] debtors reorganize and rehabilitate their financial affairs,” *Id*, Congress enacted the Small Business Reorganization Act of 2019 (the “SBRA”).



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Purpose of SBRA

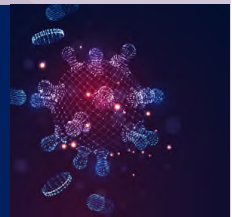
- The SBRA is intended to make chapter 11 simpler and substantially less expensive for small business debtors by, among other things, eliminating or reducing expenses (no committee, no quarterly UST fees, etc.), and simplifying plan solicitation and plan confirmation procedures, among other benefits.



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Appointment of Professionals

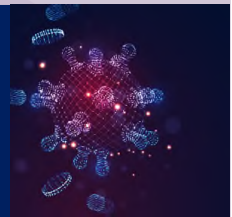
- Any professional may be appointed and will be “disinterested” if they are owed less than \$10,000 at the time of filing. Any pre-petition claim that the professional has will be treated as a general unsecured claim.



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Requirements to Qualify

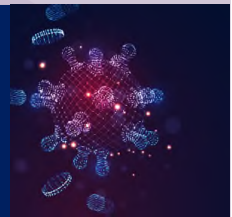
- Subchapter V was originally limited to debtors with aggregate secured and unsecured debt under \$2,725,625.
- In the wake of COVID, the debt limitation was increased to \$7.5 million for one year from the Cares enactment date in late March 2020.



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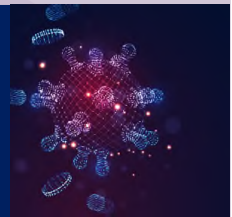
Qualification (cont.)

- The debtor must be engaged in commercial or business activities.
- No less than 50% of debt must arise from the commercial or business activity of the Debtor.
- Debtor may be an individual or corporation or an LLC.



Unique Provisions of SBRA

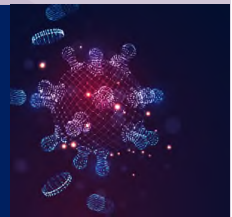
- A trustee is appointed to oversee the Chapter 11 but does not operate the business unless fraud or mismanagement.
- Only the Debtor may file a plan and no creditor or competing plans are allowed. The Plan must be filed within 90 days of the date of filing and this deadline may only be extended if the failure to file is as a result of circumstances not attributed to Debtor.



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Unique Provisions (cont.)

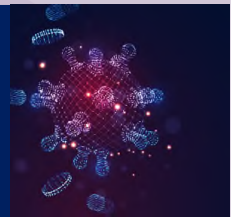
- No Disclosure Statement is required unless ordered by the Court.
- No Creditor's committee appointed.
- No Absolute Priority Rule.
- Administrative Expenses may be paid over life of the Plan.



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Unique Provisions (cont.)

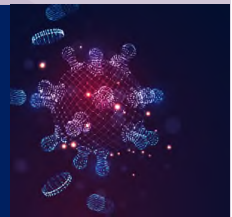
- Security interest or mortgage in debtor's *primary* residence may be modified *if* new value received in connection with grant of security interest was not used to acquire the property but was used primarily in connection with the debtor's business.



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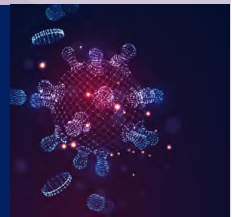
Unique Provisions (cont.)

- No accepting impaired class required before debtor can cramdown plan
- If plan does not discriminate unfairly and is fair and equitable to each class of impaired claims or interests that do not accept the plan, the court shall confirm it.



Discharge of Debtor

- If the plan is confirmed consensually, standard chapter 11 discharge is granted on confirmation of Plan
 - If Plan confirmation is not consensual, discharge is granted only after all plan payments are successfully made, and no discharge is granted for:
 - Debts on which the last payment is due after the first 3 years of the Plan, or such other time not to exceed 5 years fixed by the court; and
 - Debts exempted from discharge on account of fraud, willful and malicious injury, and the other standard reasons for denial of discharge as to a claim.



Plan Payments

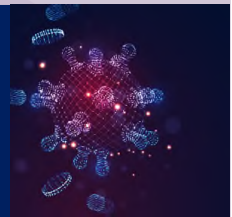
- If the Plan is consensual, payments may be made directly by the Debtor.
- If the Plan is not consensual, payments must be made through the Trustee.



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Property of the Estate After Confirmation

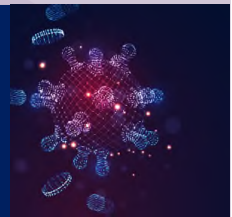
- If a Plan is confirmed consensually, property of the estate is governed by 11 U.S.C. § 541. If, however, the Plan is confirmed non-consensually under 11 U.S.C. § 1191(b), property of the estate includes, in addition to property specified in 11 U.S.C. § 541:
 - “All property of the kind specified in [section 541] that the debtor acquires after the date of commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13 of this title, whichever occurs first; and
 - Earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13 of the title, whichever occurs first.”



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In Conclusion

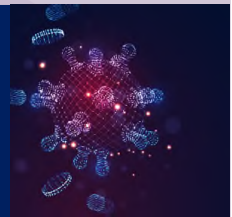
- The purpose of SBRA is to make Chapter 11 more affordable for small businesses by eliminating Creditor Committees and the Absolute Priority Rule. It remains to be seen if the additional expense of the trustee will still make these Chapter 11s too costly.



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History of Chapter 12

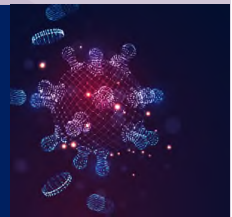
- Chapter 12 of Title 11, United States Code¹ entitled “The Adjustment of Debts of a Family Farmer or Fisherman with Regular Annual Income” (“Chapter 12”) was enacted in 1986 to provide temporary emergency relief to family farmers during a time of low commodity prices, rising input costs and tightening credit.



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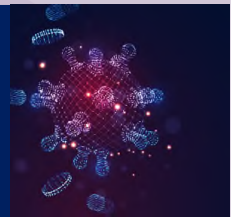
- Chapter 12 was designed to enable financially distressed family farmers and fishermen to reorganize through simplified and streamlined reorganization provisions where, under a three to five year plan, the farmer could; contract operations through the sale or surrender of assets, reduce or discharge obligations, reduce interest rates and re-amortize debt.



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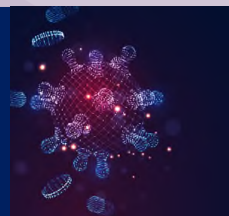
- The Act originally was to have expired in 1993, but was permanently enacted with the Bankruptcy Abuse Prevention Act of 2005, effective July 1, 2005.
- In 2017, Congress enacted the Family Farmer Bankruptcy Clarification Act which made it clear that claims for taxes arising from disposition of property used in the farming operation, whether the sale was before or after the bankruptcy petition, would be prepetition unsecured claims which would be dischargeable through the plan.
- In July of 2019, Congress passed the Family Farmer Relief Act of 2019 which increased the debt limit for family farmers to \$10,000,000.



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Enhanced Control of the Process by the Farmer

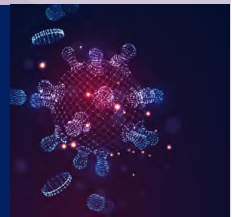
Chapter 12 is a blend of the Chapter 11 and 13 processes but with additional provisions which seek to remedy some of the special needs of reorganizing farmers which are not met by Chapter 11 and 13, including provisions for enhanced control.



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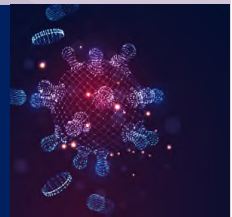
Continued Enhanced Control

- The family farmer has a period of 90 days from the petition in which to file a plan of reorganization; this period can be extended by the court based upon circumstances for which “the debtor should not justly be held accountable”.
- Under Chapter 12, only the farmer may file a plan of reorganization.



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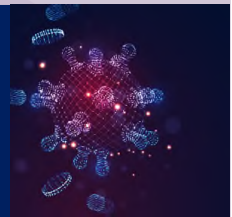
- Unless the case has already been converted from a case under Chapter 7, 13 or 11, the debtor has an absolute right to dismissal or conversion of the case to a Chapter 7 case.
- A Chapter 12 case may only be involuntarily converted to a Chapter 7 case based upon fraud but e may be dismissed on several grounds, at the request of a party in interest.
- Taken as a whole, these provisions allow the farmer to file a Chapter 12 and attempt to reorganize but, absent fraud, the farmer may prevent creditors from forcing the farmer into some other bankruptcy chapter where the farmer will have less control.



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Chapter 12 Is Easier and Less Expensive Than Chapter 11

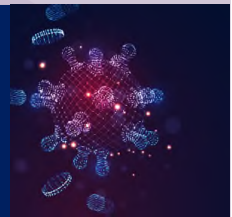
- There are no creditors' committees, with professionals and attendant fees to add a layer of expense.
- A Chapter 12 trustee is appointed by the court. In Michigan, this is a standing trustee who generally serves as the Chapter 13 trustee as well.
- The Chapter 12 trustee oversees the process and advises the court with respect to the progress of the case but is generally not interested in maximizing the return to the unsecured creditors beyond requiring adherence to the requirements of the Bankruptcy Code.



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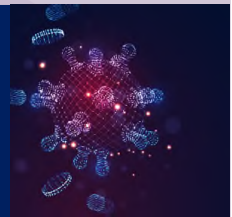
- The trustee receives compensation in the form of a small percentage of the distribution under the Chapter 12 plan.
- Secured creditors are often paid outside the plan for a period longer than the plan term and no trustee fee generally applies to payments outside the plan
- This method of oversight is not intrusive and is both cost effective and less time consuming.
- The farmer continues to control the farming operation and need only follow the rules of the court and the US Trustee, including filing monthly financials, affirmations of tax and insurance payments.



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- Chapter 12 also makes it much easier and cheaper for a farmer to use the secured lender's collateral and sell property free and clear of lien over the objections of a secured lender.



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The Chapter 12 creditors must file claims within the claims bar date or their claims will be discharged by the confirmation order

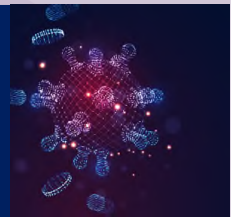
- Except with respect to claims of governmental units, claims must be filed not later than 90 days after the first date set for the meeting of creditors called under Section 341.
- Governmental units have until 180 days after the order for relief to file claims.



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Plan requirements. Chapter 12 also simplifies the confirmation process.

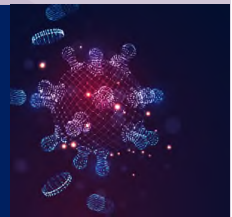
- There is no requirement for a disclosure statement, the creditors do not vote on the plan and hence there are no solicitation requirements nor is there a juggling of classes to obtain the necessary votes in each class of creditors.
- The debtor simply proposes a plan pursuant to the much simplified Chapter 12 plan content requirements and confirmation standards.
- These plans do require historical financial information, projections and a liquidation analysis to show what creditors would get if the farming operation were liquidated. This is an important function for the accountant to perform for the farmer.



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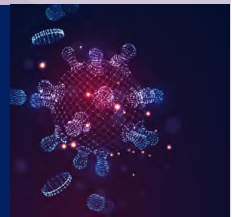
- In a Chapter 12, property of the estate includes the earnings of and property acquired by the debtor after the Chapter 12 petition and prior to the closing of the case.
- The plan projections and liquidation analysis are key elements in any Chapter 12 plan and therefore the farmer's financial advisors should be actively engaged in proposing the plan and the exhibits to the plan.
- The plan is generally for three years unless the court authorizes a longer period, not to exceed five years.
- The debtor must provide for the submission of all or such portion of future earnings or other future income of the debtor as is necessary for the plan.



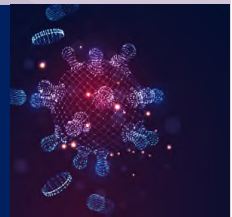
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- The provisions of Chapter 12 do not require that all disposable income be committed to the plan unless; (i) the plan proposes to pay less than the full amount of any domestic support priority claims) over a five year plan; or (ii) the plan is confirmed over the objection of the trustee or an unsecured creditor and the plan is not distributing property equivalent to the debtor's projected disposable income.
- Again, this will involve the input of the farmer's accounting professionals as the debtor may be required to prove its position in an evidentiary hearing.

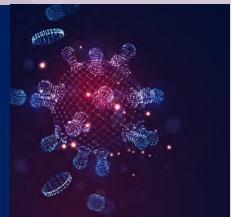


**Governmental Claims Arising
from Sale, Transfer or Exchange
of Farming Assets are
Dischargeable Unsecured Claims.**



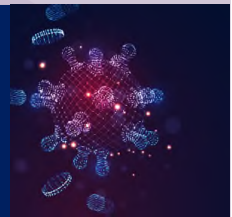
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- Only Chapter 12 provides relief from capital gains, recapture and other similar federal and local taxes arising from the sale of a “farming asset” used in the “debtor’s farming operation.”
- Those claims, for sales both before and after the bankruptcy petition, are treated as general unsecured claims.



Continued

- This is another important area of involvement for the farmer's accountants and financial advisors both before and after the Chapter 12.
- Your client may want to contract its operations but the tax consequences could be significant where the farm has been in the family many years and has a low basis. Working with a bankruptcy practitioner, the Chapter 12 may provide an avenue to contract the business without incurring tax liability which the farmer cannot fully pay.
- The accountant and lawyer must work together prior to bankruptcy to analyze what the plan would look like and whether a Chapter 12 would provide relief.



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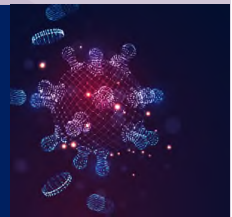
A Chapter 12 plan may modify the terms of both secured and unsecured debts, including obligations secured by the farmer's residence

- The plan may also extend and restructure payment terms beyond the term of the plan, without the consent of the secured creditor.
- A Chapter 12 plan may provide for the sale of property or the surrender of property to a secured creditor, and the rejection, assumption or assignment of executory leases and contracts.

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Confirmation of the Chapter 12 Plan requires separate standards for secured and unsecured creditors

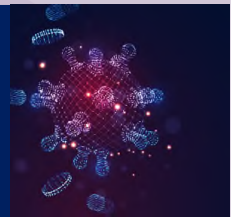
- For secured claims, the creditor must (i) consent to the plan; or (ii) retain its lien and receive distributions equal to its secured claim; or (iii) the debtor must surrender the collateral to the secured creditor. The secured portion of the claim is based upon the value of the collateral securing the claim.
- For unsecured creditors, the debtor must pay at least what they would have received under Chapter 7 of the Code.



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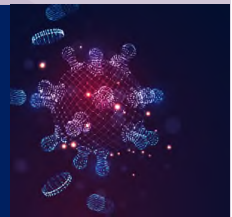
- To establish the unsecured payment amount and establish to the trustee that this criteria is met, a liquidation analysis should be prepared by the financial advisor and included with the plan.
- The court may confirm a plan over the objection of the trustee or a creditor if; (i) the unsecured creditor's claim is fully paid; or (ii) all of the debtors projected disposable income is committed to payments under a three year plan or such other longer period as the court may approve; or (iii) the value of the property to be distributed under the plan is not less than the debtor's projected disposable income during the plan term.
- These are the "cram down" provisions of Chapter 12 with respect to unsecured creditors.



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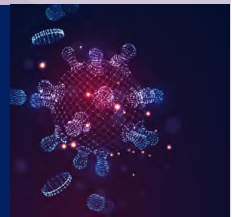
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- There is no “absolute priority rule”, which would preclude the debtor from retaining property under the plan because of an objection of unsecured creditors.
- These confirmation standards provide the simplicity of a Chapter 13 plan but the restructuring power of Chapter 11, without the “absolute priority rule”.
- Finally, there is no Section 1111(b) election under Chapter 12 to foil the efforts of the debtor to reduce the secured debt to the value of the collateral.



Post Confirmation

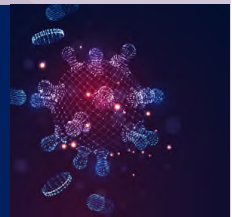
- Between the confirmation and the completion of the plan, the debtor makes payments to the Chapter 12 trustee for disbursement according to the plan and the trustee and court continue to monitor the process.
- The court retains jurisdiction to authorize post confirmation loans to the debtor and asset sales, absent plan provisions that grant the farmer the right to obtain loans or make certain sales.



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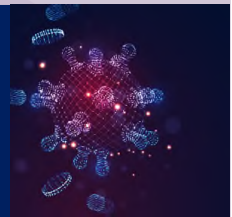
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- Post confirmation, the Chapter 12 plan may be modified at the request of the debtor, the trustee or a party in interest.
- Upon the completion of all payments under the Chapter 12 plan, the debtor, whether an individual or corporation, is discharged from all obligations except those excepted from discharge under Section 523(a) and obligations where payment terms extend beyond the life of the plan.



The New Eligibility Provisions for Chapter 12

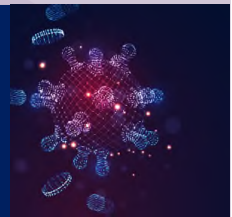
- Only a “family farmer” or a “family fisherman” may be a debtor under Chapter 12.
- There are two categories of “family farmers” with different qualifications.



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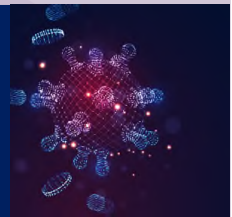
- Category one is as an individual or an individual and a spouse; (i) engaged in a farming operation, whose aggregate debts do not exceed \$10,000,000; (ii) at least 50% of which (80% for a fisherman) must arise from the farming operation, excluding the debt from the family residence; and (iii) who has received not less than 50% of the debtor's income in the preceding year or each of the 2nd and 3rd taxable years preceding the taxable year in which the case was filed. Again, this analysis will require careful analysis by the farmers financial advisor.



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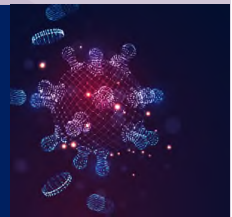
- The second category, is corporations or partnerships; (i) not publicly traded; (ii) in which 50% or more of the stock or equity in the entity is held by one family or one family and the relatives of such family, which relatives conduct the farming operation; (iii) in which more than 80% of the value of its assets are related to the farming operation; and (iv) its aggregate debts do not exceed \$10,000,000, of which 50% of the aggregate non-contingent, liquidated debts, excluding one dwelling at which a shareholder or partner maintains a private residence, arises out of the farming operation.



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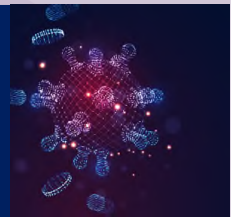
- The field of qualification is further limited by the requirement that the “family farmer” have regular income.
- Regular income means that the debtor have “income sufficiently stable and regular to enable such family farmer to make payments under the plan”.
- Finally, the term “farming operation” includes “farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state.”
- Importantly, a Chapter 12 may only be initiated by a voluntary petition.



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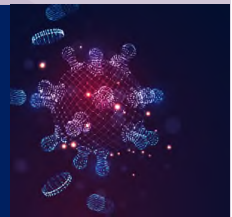
Conclusion

- We cannot emphasize the importance of assembling a team of professionals to assist your small business or farm client at the earliest sign of financial difficulty.
- All professionals need to know options available to their client within a Bankruptcy proceeding in order to negotiate an out of court workout. Knowing the leverage points is a critical factor in these negotiations.



Conclusion

- We rely heavily on the financial advisors for our clients for assistance in both out of court work-outs and bankruptcies but unfortunately, by the time clients reach us, options may be limited. As financial advisors, you are often the first ones to see indications of financial distress. That is the time to reach out to a restructuring attorney so that all options are available and discussed before it becomes a crisis.



Thank You For Attending



COVID-19

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