

Small Business Bankruptcy and Michigan Receiverships: Restructuring Alternatives in the Time of COVID-19



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Over 40 years experience in:

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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 "instituted 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 million for one year.



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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.



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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.



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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.



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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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Uniform Commercial Real Estate Receivership Act – MCL 554.1011



Continued:

- With the exception of the Construction Lien Act, there has never really been any state specific statutory guidance on receiverships over commercial property. No guidance on appointment, powers and authority.
- Receivership is discretionary, and is an extraordinary or harsh remedy. Only as ancillary relief.
- Until the amendment of MCR 2.622 in 2014, there was never any express authority for a receiver to sell property.

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Uniform Commercial Real Estate Receivership Act – MCL 554.1011



Continued:

- Left with inconsistent application of the law and rules. Some courts would appoint in certain situations and some would not.
- Appointment in limited circumstances where borrower defaulted on its debt or where an entity could no longer do business.
- Even when appointed, questions as to whether receiver could sell property, and if free and clear from liens. Always the question of borrower's statutory redemption rights.

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Uniform Commercial Real Estate Receivership Act – MCL 554.1011



2. Enactment of the Statute

- February 6, 2018, Michigan enacted the uniform commercial real estate receivership statute – MCL 554.1011
- Effective May 7, 2018
- 1 of only 5 states



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Uniform Commercial Real Estate Receivership Act – MCL 554.1011



Continued:

- Still discretionary, and only applies to commercial property, still the Act plainly establishes the circumstances under which a receiver may be appointed.
- Limited to commercial real property and any personal property related to or used in operating the real property. Also includes proceeds, products, offspring, rents or profits from the property

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Uniform Commercial Real Estate Receivership Act – MCL 554.1011



Continued:

- No application to residential property unless it fits into one of the exceptions found at Section 4 subsection 2(a) – (d).
- No application to cases where the receiver is a governmental unit or individual acting on behalf of such unit.
- The Act does not limit the court to appoint a receiver under any other law.

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Uniform Commercial Real Estate Receivership Act – MCL 554.1011



Continued:

- Unlike before, the Act establishes when a receiver may be appointed. Before judgment, after judgment, during a redemption period, and in connection with a mortgage foreclosure or enforcement of a mortgage
- Like before, the court is not bound by any particular nomination for receiver.
- The receiver must still post a bond approved by and in amount specified by the court.

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Uniform Commercial Real Estate Receivership Act – MCL 554.1011



3. Receivers Powers Under the Act

- Section 12 outlines the powers of the receiver. Typical powers which appear in a well drafted receivership order.
- With court approval, a receiver may now accept/reject contracts such as leases. Similar to bankruptcy trustee power.

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Uniform Commercial Real Estate Receivership Act – MCL 554.1011



4. Key Points

- Section 16 addresses transfer power of the receiver. Sales in ordinary course and not in ordinary course.
- With court approval, a receiver may now: (a) sell the property; (b) sell property free and clear of any liens (except senior liens); and (c) sell it free and clear of any statutory redemption rights of the owner.

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Uniform Commercial Real Estate Receivership Act – MCL 554.1011



Continued:

- Extinguished liens transfer to the proceeds with same validity, perfection and priority as before sale.
- Sale may be private or public. Creditor holding a valid lien may credit bid and offset against the purchase price the amount of the secured lien as long as costs are paid and any senior lien extinguished by the transfer is paid.
- Reversal of order for sale does not affect validity of a transfer to a good faith purchaser.

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5. Consequences and Effects of the Act

- Receivership is now a primary rather than ancillary method of realizing on commercial collateral. Does not preclude a foreclosure however.
- The Act overrules decades of "clogging of the Equity of redemption" case law and deference to redemption rights.
- Under common law, courts have long upheld the right of redemption. Only 2-3 unpublished cases which allowed it under the circumstances of that case, but not binding.
- This is the first time outside the construction lien context that we have any specific guidance on whether a receiver can sell free and clear of liens; and this is the first time we have guidance on selling free of redemption rights.

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Uniform Commercial Real Estate Receivership Act – MCL 554.1011



Continued:

- New right for lenders to credit bid at public sale as opposed to typical receivership sale to identified buyers. Allows lender to avoid redemption period and control disposition of the collateral.
- Mortgagees may now seek receivership sales with much more frequency.
- The Act will also give title companies more clarity and security by settling any concerns as to clogging the equity and selling free and clear of liens and redemption rights.

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Uniform Commercial Real Estate Receivership Act – MCL 554.1011



Continued:

- The courts will now have more clarity on this subject. Judges and practitioners now have specific statutory guidance.
- Receivers have enhanced powers.
- Lenders have a more effective tool to realize on commercial collateral.
- Borrowers lose some of their rights.

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