

## Silver Linings for Small Businesses in these Cloudy Economic Times

By: Joel Shafferman

In their idyllic song “Look for the Silver Lining”, Jerome Kern and B.G. DeSylva philosophized that “[w]hen e'er a cloud appears in the blue remember somewhere, the sun is shining and so the right thing to do is make it shine for you.” This hopeful lyric can ring true for small business entrepreneurs despite the challenges they face during this time of economic woe. Even now, as PPP funds are being expended and public health experts are saying that we may be in for a perilous fall and winter, savvy small business owners can still work within the confines of our current situation to achieve economic success.

In a recent article published in the September 26, 2020 print edition of the Wall Street Journal entitled “Rising From the Pandemic’s Destruction: A Million New Businesses”, the authors describe how the pandemic is inducing a surge in new businesses similar to the days before the Great Recession. Some of the start-ups described in this article include a bicycle repair shop, reusable mask maker, and college age zoom dating app designer. These new start-ups are thriving because of the demand for the services and products they offer created by the crazy times within which we are currently living. This article shows how these forward-thinking entrepreneurs do not sit around wallowing in despair because of the pandemic, but instead look for new opportunities created by the pandemic.

However, it is not always so simple to shut down a business and reopen it under a new name, even with different owners. Often, critical vendors of the business who are owed money will not want to do business with the new entity, and the new business owners will always be fearful of being subject to successor or alter ego liability claims. In these situations where closing a struggling business and starting a new one is not a viable option, business owners should consider resolving their problems by filing a Chapter 11 case under the recently enacted Small Business Reorganization Act of 2019 (the “SBRA”) which Congress enacted on February 21, 2020 to implement a more streamlined and less costly path to reorganization for small businesses. Congress originally set the total debt limit for eligibility to file a petition under the SBRA at \$2,725,625. In response to the Covid-19 Pandemic, in the CARES Act Congress raised the debt limit for SBRA cases to \$7,500,000 for one year.

A reorganization plan under the SBRA will be confirmed if it provides that the businesses’ disposable income (i.e. income that is not needed for the operation, preservation, or maintenance of the business) be used to make plan payments for a period of 3 to 5 years. Unlike a typical Chapter 11 case, the fees and expenses of the debtor’s attorney and its other professionals do not have to be paid immediately but may be paid over the term of the plan.

The SBRA eliminates many of the other substantive requirements to confirm a plan of reorganization in a typical Chapter 11 bankruptcy case. One critical difference is that the equity holders of small-business debtors can retain their ownership interests

without having to contribute their personal funds into the reorganization effort. Another advantage of the SBRA is that, unlike a traditional Chapter 11 case, the bankruptcy court may approve the restructuring plan even if all of creditors vote to reject the plan. The voting requirement often is the major obstacle to confirming a typical Chapter 11 reorganization plan but is not in a SBRA case.

The provisions of SBRA are also advantageous to small business owners because they reduce the procedural burdens ordinarily associated with Chapter 11 cases. While a typical Chapter 11 reorganization can take between 1 and 2 years to complete, a reorganization case under the SBRA moves on a fast track. In an SBRA case, the bankruptcy court must hold a status conference within 60 days of its commencement, and the debtor must file a plan within 90 days, although a debtor can obtain an extension in appropriate circumstances. Unlike a typical Chapter 11 case, in an SBRA case, creditors cannot file a plan of liquidation. Competing plans in large Chapter 11 cases are often costly and highly litigious.

Although a debtor in a SBRA case remains in possession of his/her/its assets and continues his/her/its operations, the bankruptcy court appoints a trustee for the purchase of facilitating the negotiation and confirmation of a plan. It can be very helpful for a trustee to take an active role in a SBRA case for he/she can serve as a “de facto” mediator and help to foster a resolution of the case, with the result being the confirmation of a consensual plan.

Based upon the decisions that bankruptcy courts have issued so far since the enactment of the SBRA, it appears that the judges are broadly interpreting the statute in a manner that is enabling debtors to reap its benefits. In a recent opinion entitled In re: Ventura 615 B.R. 1 (Bankr. E.D.N.Y. 2020) Judge Robert E. Grossman, who sits in the United States Bankruptcy Court, located in Central Islip, New York, remarked that

[h]ad Congress been given a crystal ball with the power to see what the world is facing today, including the severe disruption to our Nation’s economy and its impact on small businesses, Congress likely could not have drafted a more effective set of mechanisms to help these businesses reorganize and hopefully survive. In re: Ventura, 615 B.R. at 6.

In a decision of first impression, Judge Grossman ruled that the SBRA can, in certain circumstances, be used to modify a home mortgage without the consent of the lender, which is something that cannot be done in other types of bankruptcy reorganization cases. Id. at 24-25

In In re: Ventura a small business owner, Dierdre Ventura (“Ventura”), owned and operated The Harbor Rose, a luxury bed and breakfast located in Cold Spring Harbor, New York (the “B&B”). Id. at 7. Ventura defaulted on her home mortgage loan with Wells Fargo Bank (“Wells Fargo”), after which Gregory Funding (“Gregory”), the purchaser of the Wells Fargo note and mortgage, commenced a foreclosure action against Ventura. Id. at 7-8. In late 2018, Ventura filed a Chapter 11 case, which progressed along a litigious path to the point where both the Debtor and Gregory had filed competing Chapter 11 plans of reorganization. Id. at 10.

The success of Ventura’s plan was contingent on her ability to utilize the

Bankruptcy Code to bifurcate the mortgage into a secured and unsecured claim, and to pay only the secured portion in full. Id. However, because Ventura resided at the B&B, Judge Grossman determined that Ventura's reorganization plan was unconfirmable because the Bankruptcy Code specifically excludes modification of claims secured by liens on a debtor's residence without the consent of the lender. Id. Therefore, Judge Grossman scheduled February 26, 2020 as the date for a hearing on the confirmation of Gregory's competing plan. Id.

Although Gregory obtained the necessary votes to confirm its competing plan, at the February 26, 2020 hearing Judge Grossman advised the parties of the enactment of the SBRA 5 days earlier, and offered Ventura the opportunity to adjourn the hearing for a short time to allow the Debtor to determine whether she wished to amend her petition and proceed under the SBRA. Id. at 11. Ventura opted to adjourn the hearing and converted her Chapter 11 case to a Subchapter V case under the SBRA. Id. Gregory responded to this turn of events by filing a motion objecting to the Debtor's designation as a debtor under Subchapter V case under the SBRA. Id.

Judge Grossman thereafter issued a written decision, which is currently on appeal, holding that a debtor may convert a regular long standing Chapter 11 case into a SBRA case and then may be able to modify their home mortgages if the bankruptcy court determines that the principal purpose of the home mortgage was not to provide the debtor with a place to live, but rather that the loan proceeds were used primarily for the benefit of the debtor's business activities. Id. at 11-34. This decision is significant because it permits a debtor who began his/her/its bankruptcy case under the regular provisions of Chapter 11 to later elect to proceed under the SBRA, and allows a debtor to modify his/her home mortgage over the objection of his/her/its lender, under the circumstances outlined by Judge Grossman. In re Ventura, and others like it where bankruptcy judges read the SBRA broadly give "mom and pop" type stores, restaurants, and hospitality establishments like The Harbor Rose a clear path to survive even in these trying times.

Entrepreneurs like those described in the Wall Street Journal article who can see new business opportunities through the clouds of the current pandemic and takes steps to realize their visions, and debtors who take advantage of the SBRA to restructure the debts of their existing businesses are truly the people that Jerome Kern and B.G. DeSylva envisioned who "always look for the silver lining and try to find the sunny side of life."