

*~Reorganizations Small and a
Bit Bigger~*

July 31, 2020



Mom and Pop's

- Mom and Pop's Cones (MPC) was, until recently, a highly successful frozen custard stand in Margate, New Jersey.
- MPC is owned and operated by Mort Cohen. His wife Shirley also works at the store from time to time.
- Last year MPC was approached by one of the large Atlantic City casinos to move their shop to the Boardwalk Casino Complex (BCC).
- At the time, MPC had almost no debt. It leased its storefront, and maintained a line of credit at Softserve Bank (SB).
- The move to Atlantic City was a big opportunity.

Negotiations with BCC

- Negotiations with BCC went well for a while.
- They negotiated a term sheet.
- BCC sent copies of a final agreement for signature.
- Cohen signed the documents and returned them.
- Based on assurances from BCC that the documents would be signed, he
 - Arranged financing for the new shop.
 - Entered into long term supply contracts based on anticipated sales.
 - Declined to exercise a renewal option on the Margate lease.
- Then BCC abruptly cancelled the deal.



Consequences

- As a result of the cancellation, MPC faced a difficult choice:
 - Miss the summer season;
 - Find another lease and move in.
- They chose to try to preserve the business.
- On one level this was a success. They found a new place in Margate, had a profitable summer season.
- They also were forced to draw down their line to \$2.3 MM.
- That loan is guaranteed by Mordechai and Shirley.
- Shirley also loaned another \$500,000.
- Unfortunately, because of the COVID outbreak, the summer has been a disaster.
- They are currently making a slim operating profit, but the business cannot service that much debt.



Things get dicey. . .

- Bank has accelerated, is threatening to exercise its remedies and is not taking phone calls.
- Suppliers are getting nervous.
- Shirley isn't talking to Mort.

Is the business worth more alive than dead?

- Survivability
- Source of value
- Profit v. cash flow . . .
 - Assets increase
 - Cash flow decreases
 - Hole filled through debt
 - Bank line or payables
- Who gets to make the decision?
 - Debtor?
 - Creditors?
 - Do the creditors trust the debtor?
 - If not, what can you do?



Is a traditional Chapter 11 an option?

- Chapter 11?
 - Creditor passivity/distrust
 - Can't get the creditors' attention to negotiate a plan
 - Creditors don't trust the debtor or the debtor's projections
 - Consensual confirmation is too expensive
 - Expense of committee
 - Expense of disclosure
 - Expense of voting
 - Can't cram down, because
 - hard to get an impaired accepting class.
 - Lose the business because of the Absolute Priority Rule.
 - Can't modify the mortgage on their house and or any personal guaranties.



Does Subchapter V of the SBRA offer a path to Reorganization?

- Extends the Small Business timeline
- No creditors' committee
- Hybrid trustee
- Only the debtor can propose a plan.
- Combined plan and disclosure statement
- Cramdown
 - No need for impaired accepting class
 - No absolute priority rule
 - Disposable income test for individuals (above median)
 - Administrative expenses paid over the life of the plan.
- Ability to consolidate and address individual and business debt?
 - Ability to modify a residential mortgage

Does SBRA Fix These Problems?

- Chapter 11?

- Creditor passivity/distrust
 - Can't get the creditors' attention to negotiate a plan or participate on creditors' committee
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- SBRA

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Questions:

- Eligibility – CARES Act
- Timeline
- Governance -- Trustee
- Modification of secured claims (residential mortgages)
- Consensual confirmation
- Cramdown

Eligibility

- \$2.7 Million
 - CARES Act increases to \$7.5MM for one year.
- Individual or Corporation?
 - Both
- Groups?
 - Taxi cab medallions
 - Restaurant chains
 - Individual and corporation
- Applies to both individual and corporations.
- Debt limits only count insider debt.
- Can you have both an individual and a corporate case?
 - Administratively consolidated
 - Multiple debt limits??
- Is there an interaction with the means test?
 - If debts are not principally consumer debts?
 - Chapter 7/13/and Sub V

Governance

- Do Mom and Pop remain in control?
 - How do they decide what to do?
 - How do they convince the creditors?
- Role of DIP
 - Control over plan.
 - Trustee
 - Liquidator
 - Disburser
 - Fiduciary
 - Business consultant
 - Operational and Financial Support
 - Advice
 - Mediator
 - Decider?
 - How to maximize value?
 - Liquidate
 - Continue
 - Help/fix management
 - Help/fix business
 - Trust?

Trustee

- Evaluation of the debtor
 - Is there a business worth saving?
 - Does the debtor need help?
 - Is the debtor the problem?
 - Are there assets worth liquidating?
 - What if the answer to both questions is no?



Timeline

- Small Business Bankruptcy
 - 180 extendable to 300 days
 - For “cause.”

- Subchapter V
 - 90 Days to present a plan.
 - Extendable: “reasons for which the debtor should not be held accountable.”
 - From Ch. 12
 - Does this override the 300 days?
 - Indefinite exclusive period.
 - Only the debtor can propose a plan.
 - Conversion
 - First day orders

Consensual Plan

- Problems in Ch. 11

- Costly disclosure requirements
- Multiple hearings
- Voter apathy
 - Only those who vote count . . .
- Committee costly

- Subchapter V

- Combined plan and disclosure statement.
- No separate disclosure hearing.
- No Creditors' Committee
- Trustee
 - Multiple roles.
 - Can it be counted on to help the debtor and negotiate for creditors?

Cramdown

- Secured Creditors

- Must comply with 1129(b)(2)(A)
- What is the security?
 - Value
 - Interest rate
- Mortgage on residential real estate
 - Mortgage can be modified
 - 1322(c) does not apply

- Unsecured Creditors

- Absolute priority rule replaced
- Disposable income test
 - Need not use "means test."

Sweat Equity?

- Was *Ahlers* the right rule for small cases.
- What does absolute priority mean
 - Secured creditors
 - Unsecured creditors

Disposable Income Test

- Individual

- Compare with Chapter 13
 - No “means test”
- Compare with Chapter 12
 - Budget
 - Variable income
- Must consider
 - Expenses of running the business
 - Expenses of living life
 - Mortgage

- Corporation

- Costs of running business
- Salaries to owner

Treatment of Secured Claims

- Assume that Mordechai and Shirley have guaranteed the Line of Credit with a lien on their house.
- Or alternatively that they are doing business as a sole proprietor.
- 1129(b)(2)(A) applies
 - Not limited by 1322(c)
- How should the secured claim be valued?
 - Liquidation value of collateral
 - Value to the business (replacement)?
- What is the collateral?
 - Value of assets
 - Value of business