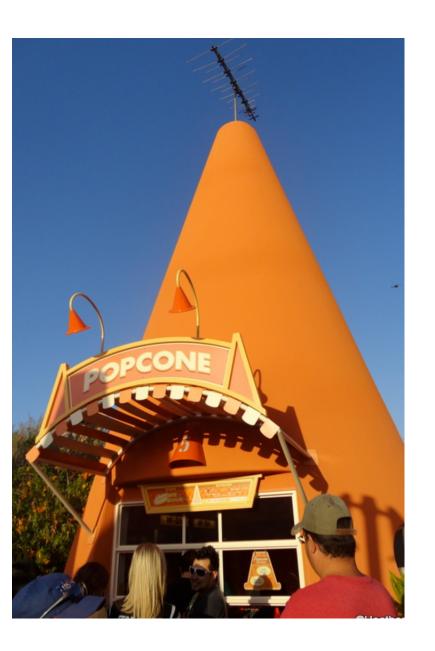
## ~Reorganizations Small and a Bit Bigger~

July 31, 2020

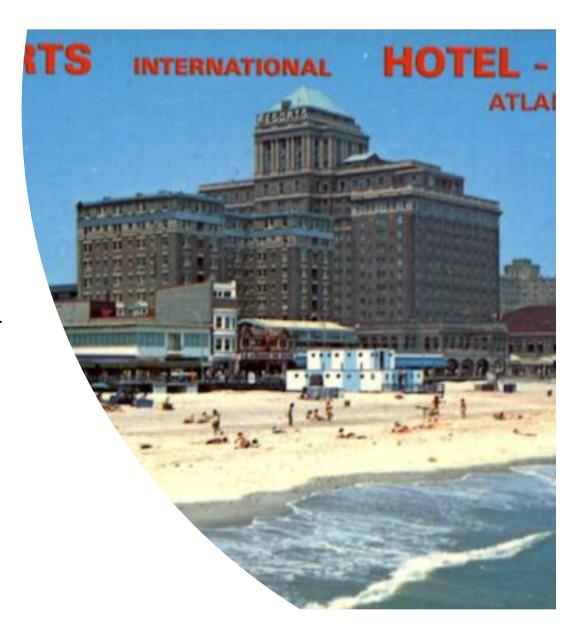


## Mom and Pop's

- 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
    - Creditors don't trust the debtor or the debtor's projections
  - Consensual confirmation is too expensive
    - · 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.

- SBRA
  - Creditor passivity/distrust
    - · No creditors' committee
    - Hybrid trustee
    - Only the debtor can propose a plan.
  - Plan Confirmation
    - 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

## 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