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BANKRUPTCY

Bankruptcy Update

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Bankruptcy is a big deal right now. The subject of this month's newsletter is two recent statutes that have increased relevance now in light of the ongoing pandemic. Before getting into those details, from a big picture standpoint, a surety professional should keep the following in mind if, and when, a bankruptcy notice comes through the door:

1. ***Get your professional involved early***. It is not an exaggeration to say that the entire trajectory of a bankruptcy can be impacted within the first 24 hours. In cases where we have seen the greatest protections for our clients, it usually was because we were engaging with counsel for the debtor within hours of the filing. Certainly, there is always an ability to get involved after the fact, but there is no doubt that an early conversation is important.

2. ***Understand the process***. A majority of surety claim professionals are adept at navigating Chapter 11 corporate bankruptcies. This newsletter will help explain some of the nuances created by two recent laws to aid in the ongoing education process.

3. ***Evaluate proof of claim/recovery***. Part of this involves understanding any collateral base that exists, so it is important to engage with underwriting (which likely would already happen to begin with). This also goes back to looking at any of the protections that are able to be coordinated within the first 24 hours of filing. As noted below, laws are being enacted to try and make bankruptcy faster for debtors, meaning that creditors have no time to waste.

Two New Statutes

The CARES Act has received significant attention over the last several weeks – and deservedly so – for the possibility of helping small businesses across the country that are suffering from the negative impacts of the coronavirus. What has flown more under the radar are two bankruptcy related acts that were passed in August 2019, but just went into effect within the last month or so: the Small Business Reorganization Act ("SBRA") and the Honoring American Veterans in Extreme Need ("HAVEN") Act.

SBRA has several important features. The most prominent is creation of a new subchapter in a Chapter 11 proceeding that was designed to help small businesses successfully reorganize. A business is eligible to take advantage of the new subchapter if they have less than around $2.7 million in total debt and generate at least 50% of income from commercial or business revenue (the old options are also available). The biggest procedural change is that there is a new small business trustee appointed (as opposed to a traditional US trustee) and the debtor is the only party that can file a plan, which usually would occur within 90 days of the case being filed. All of this goes to the notion of trying to make bankruptcy simpler and more affordable for businesses that need the relief of a pause button and a fresh start.

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To "Go Green", our firm uses recyclable paper or ceramic cups and no longer uses Styrofoam cups. In addition, we have adopted a less-paper office environment.

We hope that these changes make big differences in the future.

Well done is better than well said.

- Benjamin Franklin

There are, however, some trade-offs from a creditor perspective. For instance, there is no impaired accepting class needed in order for a cramdown of the plan to occur. This was a large protection for creditors under the old scheme given the sometimes inequitable results that can occur if you are part of the cramdown class (although this does not affect secured claims). Additionally, the owner of the business no longer must pay creditors in full in order to retain their equity interests. Yet, the other side of that trade-off is that the new subchapter requires the debtor to dedicate "all or such portion of the future earnings or other future income" for 3 to 5 years as needed to execute the plan. The law is still unsettled on exactly how much income must be dedicated, but the idea is that creditors will ultimately see a meaningful recovery once the business is back up and running and emerges from the bankruptcy.

One final SBRA note – preference laws have been tweaked, which generally speaking also is in favor of the creditor. Now, there is language in the statute that requires due diligence to make sure that the filing party has examined any "known or reasonably knowable affirmative defenses" of a target defendant. As with some of the other provisions of the statute, there is not yet authority on what this looks like in practice. That said, the hope is that preference actions will not be filed under a "ready, fire, aim" scheme, but rather will only be asserted if there is a good faith basis (similar to bringing a fraud claim in federal court).

Finally, HAVEN is worth mentioning. The goal is to provide additional protections for servicemen and women given the sacrifices they have made for the country. The biggest take away is that HAVEN has modified the means test for veterans in connection with qualifying for a chapter 7 proceeding. All things being equal, chapter 7 is typically more affordable than chapter 13 and is usually a quicker process (as proofs of claim are typically not permitted and a discharge of qualified debts happens within 4 to 6 months). What has been changed is that now a veteran does not need to take into account any compensation received in connection with a disability, combat related injury, or death of a member of any of the uniformed services. Essentially, any of this compensation/income is ignored. As a result, there should be a greater ability of veterans to qualify for relief under Chapter 7 once this compensation is not part of the analysis.

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