By Hon. Hannah L. Blumenstiel

SBRA: Case Law So Far Suggests an Enthusiastic Bench

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The Small Business Reorganization Act of 2019 (SBRA) took effect on Feb. 19, 2020. Although courts have issued just a few decisions concerning this legislation, those rulings indicate that the bankruptcy bench shares Congress's desire for a more efficient, less cumbersome path to reorganization for small business debtors. This article summarizes SBRA decisions issued as of April 26, 2020, points out the most significant issues they address, and identifies specific guidance to which practitioners and judges may look as they navigate this rapidly developing area.

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In re Progressive Solutions Inc.[1]

Progressive Solutions filed its petition in November 2018. As of late January 2020, the court had not confirmed a plan. The debtor then filed two motions, asking the court for permission to elect treatment under the SBRA, establish or modify certain deadlines and confirm a plan. The court convened a hearing the day after the SBRA took effect.

After describing the SBRA's legislative history, the court considered whether its application would disturb any rights vested by prior rulings or events. Finding no possibility of such harm, the court noted that no statute or rule prohibited it from adjusting the deadlines established by the SBRA, such as that by which a debtor must file a plan.[2] These facts, combined with the SBRA's stated purpose — promoting successful reorganizations — led the court to conclude that there was "no legal reason" to prohibit application of the SBRA to cases pending when it took effect.[3] Nevertheless, the court denied both motions.[4]

The court explained that Rule 1009(a) of the Federal Rules of Bankruptcy Procedure permits a debtor to amend its petition "at any time before the case is closed." Given that such amendments do not require prior leave, the court declared the imposition of such a requirement improper, a conclusion supported by the SBRA's procedures for objecting to a debtor's SBRA election.[5] "When and if there is a designation by amendment to the Petition, opposing parties may file objections on a timely basis."[6] Because the debtor had not amended its petition, the court denied its motions as premature.[7]

The discussion in *Progressive Solutions* of the SBRA's legislative history is very helpful. Those searching for such facts should cite this case. *Progressive Solutions* also clearly instructs debtors to amend their petitions if they wish to proceed under the SBRA; they need not request prior permission to do so. Cases decided since *Progressive Solutions* have agreed with this approach.

In re Moore Properties of Person County LLC[8]

The debtor owned three separate parcels of real property, which it leased to third parties. It had no operations other than leasing its real property and related activities. On Feb. 10, 2020, the debtor sought relief under the Bankruptcy Code to put a stop to two foreclosures. The debtor indicated that it was a small business debtor, as defined in § 101(51D). The Bankruptcy Administrator (BA) objected. After the SBRA took effect, the debtor filed an amended petition that included an SBRA election.

The court addressed (1) whether a debtor in a pending case could state an SBRA election, and (2) whether a debtor that did not meet the definition of "small business debtor" prior to the SBRA's enactment may nevertheless proceed under the SBRA's revised definition.[9] In considering whether to apply the SBRA to a pending case, the court turned to authority that addresses application of "new law, or newly amended law, to prior conduct."[10] Noting that the SBRA did not contain any provisions explaining whether it should apply to pending cases, the court looked to canons of statutory construction.

1 2020 WL 975464 (Bankr. C.D. Cal. Feb. 21, 2020).
2 *Id.* at 5.
3 *Id.*
4 *Id.* at 5-6.
5 *Id.* at 6.
6 *Id.*
7 *Id.*
8 2020 WL 995544 (Bankr. M.D.N.C. Feb. 28, 2020).
9 The SBRA changed § 101(51D) as follows:
> [A] "small business debtor" means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning ~~or operating real property or activities incidental thereto~~ *single-asset real estate*) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than ~~$2,566,050~~ *$2,725,625* (excluding debts owed to [one] or more affiliates or insiders), *not less than 50 percent of which arose from the commercial or business activities of the debtor....*

10 2020 WL 995544 at 3 (citing *Landgraf v. USI Film Prods.*, 511 U.S. 244 (1994); *U.S. v. Sec. Indus. Bank*, 459 U.S. 70 (1982)).

The court acknowledged that "a court is to apply the law in effect at the time it renders its decision."[11] Next, it recognized that "retroactivity is not favored in the law."[12] As to the second point, the court explained that "[t]he presumption against retroactivity stems from '[e]lementary considerations of fairness ... [that] individuals should have an opportunity to know what the law is and how to conform their conduct accordingly,' and the principle that 'settled expectations should not be lightly disrupted.'"[13] Courts should prioritize predictability and stability in determining whether to apply new laws.[14]

The court found that application of the SBRA "creates none of the taking or retroactivity concerns" expressed in case law.[15] "Subchapter V incorporates most of existing chapter 11, and ... does not alter the rubric under which debtors may affect pre-petition contractual rights of creditors, much less vested property rights."[16] Although the court took care to note that "[t]o the extent that were a case pending for an extended period of time on the effective date of the SBRA, it is possible that a case could be sufficiently advanced that the substantive alterations in the requirements for plan confirmation arise to a taking of vested property rights." It found that its case presented no such concerns.[17]

The court also had little trouble concluding that, although the debtor did not fall within § 101(51D)'s definition on the "petition date," it did satisfy the definition in effect as of the date of the court's decision.[18] It also found the debtor's amended petition appropriate under Bankruptcy Rule 1009(a).[19] The court overruled the BA's objection.

Moore offers a powerful analysis of the legal propriety of applying the SBRA to a pending case, and a road map for those confronted with that question. Later cases have followed *Moore*'s lead, adding to its durability.

In re Body Transit Inc.[20]

The debtor filed its petition on Jan. 2, 2020. As of that date, the debtor owned and operated three fitness centers. In the first six weeks of the case, however, the debtor lost or sold the right to occupy two of its three premises. This led the secured creditor, First Bank, to file a motion requesting appointment of a chapter 11 trustee. First Bank also complained that the debtor had used its cash collateral without consent or court approval.

The debtor then amended its petition to state an SBRA election. It also filed a motion requesting permission to proceed under the SBRA.

First Bank objected, arguing that the debtor's struggling operations, unauthorized use of cash collateral and failure to file monthly operating reports justified appointment of a trustee. According to First Bank, allowing the debtor to remain in possession would cause undue prejudice because SBRA trustees have more limited authority than trustees appointed under § 1104(a). First Bank also argued that new law should not apply retroactively.

In addressing whether a debtor in a pending case could amend its petition to state an SBRA election, the court reviewed *Progressive Solutions* and *Moore*. Based on its agreement with the procedural analysis in *Progressive Solutions*, the court held that the debtor had the "right to amend its ... petition to elect to proceed under [the SBRA] and, once the amendment has been filed, the case should proceed ... until an objection is filed timely and granted by the court."[21]

Having found the case to be in a proper procedural posture, the court considered what standard to apply to First Bank's objection. Following *Moore*, it recognized that "in general, the [SBRA does] not impair the vested property interests of creditors and, therefore, the concerns supporting application of the canon of statutory construction disfavoring the retroactive application of new law are absent."[22] The court also noted that First Bank had not alleged that the SBRA would impair its vested property interests, and that it had not entered orders that had given rise to rights or expectations that the SBRA might offend.[23]

Next, the court looked to authority that addressed amendments under Bankruptcy Rule 1009(a). Finding that the overwhelming majority of such authority focused on whether a debtor's amendments would cause undue prejudice or were made in bad faith, the court held that these same factors should govern its evaluation of First Bank's objection.[24]

The court declined to decide whether, as a matter of law, a § 1104(a) trustee offered more protections than an SBRA trustee.[25] Focusing instead on First Bank's characterization of the debtor's prospects as being hopeless, the court declared that First Bank's concerns were "largely hypothetical."[26] If the debtor proved unable to reorganize, the result would be dismissal or conversion, whether under the SBRA or not.[27] "[I]n the absence of a particularized showing," the court concluded that First Bank had not established prejudice that was sufficient to overcome the debtor's right to amend.[28]

The court also addressed the burden of proof. Acknowledging that the debtor's motion initiated the contested matter, the court observed that the dispute was "more properly characterized as First Bank's Objection to the Debtor's election to proceed under subchapter V.... It is appropriate to place the burden of proof on First Bank, as it is the *de facto* moving party."[29]

Body Transit helps cement *Moore* as the seminal case (so far) on the propriety of applying the SBRA to pending cases. It is also the first decision to reach the question of who bears the burden of proof in a contested matter regarding a debtor's SBRA election.

11 *Id.* (citing *Landgraf*, 511 U.S. at 264).
12 *Id.*
13 2020 WL 995544 at 3 (quoting *Landgraf*, 511 U.S. at 265).
14 *Id.* (citing *Landgraf*, 511 U.S. at 271).
15 *Id.* at 4.
16 *Id.*
17 *Id.*
18 *Id.* at 6-7.
19 *Id.* at 7.
20 2020 WL 1486784 (Bankr. E.D. Pa. March 24, 2020).
21 *Id.* at 6.
22 *Id.*
23 *Id.*
24 *Id.* at 7.
25 *Id.* at 8.
26 *Id.*
27 *Id.*
28 *Id.*
29 *Id.* at 8, n.15.

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In re Bello[30]

The debtor filed a petition for chapter 13 relief on May 3, 2019. On Jan. 15, 2020, the court granted the debtor's motion to convert his case to chapter 11. On March 2, 2020, the debtor amended his petition to state an SBRA election. One week later, the court issued an order requiring the debtor to appear and show cause as to why the court should not strike the amended petition, questioning whether the debtor was eligible to proceed under the SBRA and whether the SBRA could be applied to a pending case.

The debtor and two other parties timely responded to the show-cause order. After considering those responses, the court dissolved the show-cause order and permitted the debtor to proceed. It did so without analysis, stating only that it found *Moore*'s reasoning persuasive, given that the case was "still in the early, pre-confirmation stage."[31]

Bello does not offer substantive guidance. It does endorse *Moore*, which increases the significance of that decision.

In re Ventura[32]

The debtor filed her petition to prevent the foreclosure sale of her real property by secured creditor Gregory Funding. Her real property was a historic house that she operated as a bed and breakfast inn.

After negotiations failed, the court set a deadline for the filing of competing plans. Gregory Funding's plan provided for the sale of the property and payment in full to all creditors. The debtor's plan depended entirely on a significant modification of Gregory Funding's loan.

At a hearing in early January 2020, the court determined that because the debtor resided at the property, § 1123(b)(5) prohibited her from modifying Gregory Funding's loan, which rendered her plan unconfirmable. The court approved Gregory Funding's disclosure statement and scheduled a confirmation hearing.

At the Feb. 26, 2020, confirmation hearing, the court offered to adjourn and give the debtor time to determine whether to proceed under the SBRA. The debtor amended her petition.

Gregory Funding objected, arguing that (1) allowing the debtor to proceed under the SBRA would prejudice its vested rights, as its plan was ready to confirm; (2) the debtor did not meet the definition of "small business debtor"; (3) the debtor should be judicially estopped from characterizing her debt as business debt, given her prior representations that it consisted primarily of consumer obligations; and (4) even under the SBRA, the debtor could not modify the Gregory Funding loan because she used it to purchase the property as her residence. The U.S. Trustee also objected, arguing that procedural issues rendered the debtor's SBRA election inappropriate. The court denied Gregory Funding's motion and overruled the U.S. Trustee's objection.[33]

The U.S. Trustee focused on the tight deadlines imposed by the SBRA, noting that the court could modify these deadlines only upon a finding that doing so was "attributable to circumstances for which the debtor should not justly be held accountable."[34] Citing *Progressive Solutions*, the court concluded that these procedural issues did not preclude application of the SBRA.[35]

The court then addressed whether the SBRA would prejudice any rights vested in Gregory Funding by virtue of the order permitting Gregory Funding to file its own plan or its finding that the debtor's plan was "patently unconfirmable." The court began by noting Gregory Funding's concession that "there is no statutory prohibition to applying the SBRA to cases that were pending prior to the effective date of this legislation."[36]

Next, relying on *Moore* and *Body Transit*, the court reframed the question. It stated that "[w]hile Gregory speaks in terms of damage to its vested rights resulting from the progress made in the Debtor's bankruptcy case, Gregory is focused on the wrong question. The correct question to ask is whether [the SBRA] will impair Gregory's rights as they existed prior to [its] effective date."[37] Viewing the arguments through that lens, the court found that the SBRA's revised definition of "small business debtor" in no way affected any vested rights.[38] The court also addressed the "more difficult question" of whether § 1190(3)[39] should apply to Gregory Funding's property rights, which were vested prior to the SBRA's effective date.

The court pointed out that the debtor had received a discharge of any personal liability to Gregory Funding through a prior chapter 7. It then found that nothing in the SBRA — and particularly § 1190(3) — disturbed Gregory Funding's *in rem* rights, as it retained the right to look to the value of the property to satisfy the loan.[40]

The case's procedural posture also did not render application of the SBRA inappropriate. As the court explained, "[u]ntil a plan is confirmed, no property rights can be said to have vested in either the Debtor or Gregory."[41] More to the point, Gregory Funding "will retain many of the rights it had at the inception of the case [and] any delay caused by this ruling is not sufficiently prejudicial to Gregory, given the current economic conditions."[42] The court held the SBRA applicable "in its totality."[43]

30 2020 WL 1503460 (Bankr. E.D. Mich. March 27, 2020).
31 *Id.* at 1.
32 2020 WL 1867898 (Bankr. E.D.N.Y. April 10, 2020).
33 *Id.* at 17.
34 11 U.S.C. § 1188(a) (modification of 60-day deadline for convening status conference); § 1189(b) (modification of deadline for filing plan).
35 *Id.* at 9.
36 *Id.*
37 *Id.* at 10.
38 *Id.*
39 Section 1190 governs the contents of plans proposed pursuant to the SBRA. Subsection (3) states: "notwithstanding section 1123(b)(5) ... [a plan] may modify the rights of the holder of a claim secured only by a security interest in real property that is the principal residence of the debtor if the new value received in connection with the granting of the security interest was — (A) not used primarily to acquire the real property; and (B) used primarily in connection with the small business of the debtor."
40 2020 WL 1867898 at 10.
41 *Id.* at 11.
42 *Id.*
43 *Id.*

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As to whether the debtor could satisfy the SBRA's definition of a "small business debtor," the court explained that the debtor had purchased the property intending to operate it as an inn, and had always managed it that way. Municipal regulations required the debtor to reside at the property. According to the court, these facts justified characterization of the Gregory Funding loan as business debt, which left the debtor eligible for relief under the SBRA.[44]

The court also rejected Gregory Funding's judicial estoppel argument. After laying out the "general test,"[45] the court noted it was not clear whether the debtor had made inconsistent representations concerning the nature of her debts, as she had always identified the property as an operating inn.[46] The court also had taken "no specific action" based on the debtor's representations and therefore had not been misled.[47] The court concluded that the debtor was not attempting to take unfair advantage of Gregory Funding, but simply sought relief under a statute that did not exist at the time she filed her case.[48]

Finally, the court considered whether the debtor could utilize § 1190(3) to modify Gregory Funding's loan. After a painstaking analysis of statutory construction, the court proposed a multi-factor test: "(1) Were the mortgage proceeds used primarily to further the debtor's business interests?"; "(2) Is the property an integral part of the debtor's business?"; "(3) The degree to which the specific property is necessary to run the business"; "(4) Do customers need to enter the property to utilize the business?"; and "(5) Does the business utilize employees and other businesses in the area to run its operations?"[49] Applying these factors, the court found cause sufficient to warrant an evidentiary hearing.

Ventura provides additional support for *Moore*, and it is the first decision to dig into whether the SBRA should apply to a long-pending case. *Progressive Solutions* also involved such a case, but its denial of the debtor's motion on procedural grounds blunted the utility of its analysis. *Ventura* afforded firmer procedural footing.

Ventura also offers a test for determining whether a debt can be modified under § 1190(3). Although it ultimately did not decide this question, other courts are likely to refer to these factors.

However, most striking are the extraordinary steps that the court took in suggesting the SBRA as a path forward. Rather than confirm Gregory Funding's plan, the court offered the debtor time to figure out whether she could make her strategy work under the SBRA. Many judges might not be so generous, but if *Ventura* offers even a modest clue as to the attitude of the bankruptcy bench toward the SBRA, that statute could serve as a powerful tool for years to come.

Conclusion

Decisions issued since the SBRA's enactment offer meaningful guidance. *Progressive Solutions* instructs debtors on how to make an SBRA election in cases pending before the statute's effective date. *Moore* lays out a sound analysis, already followed by three other courts, of when and why to apply the SBRA in such cases. *Body Transit* discusses the burden of proof. Plus, all of these decisions, but particularly *Ventura*, suggest that the bankruptcy bench believes that the SBRA will provide much-needed relief for small business debtors, which is exactly what Congress intended. abi

44 2020 WL 1867898 at 12.

45 Judicial estoppel applies where "(i) a party's later position is clearly inconsistent with its earlier position, (ii) the party's former position has been accepted in some way by the court in the earlier proceeding, such that judicial acceptance of an inconsistent position in a later proceeding would create the perception that either the first or the second court was misled, and (iii) the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped." 2020 WL 1867898 at 13 (citing *New Hampshire v. Maine*, 532 U.S. 742, 750-51) (internal quotation marks omitted).

46 2020 WL 1867898 at 14.

47 *Id.*

48 *Id.*

49 2020 WL 1867898 at 16-17.