

**BANKRUPTCY FUNDAMENTALS
DURING THE HEALTH CRISIS:
DEALING WITH THE
FINANCIAL DISTRESS CAUSED
BY COVID-19**

By

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BANKRUPTCY PROCEEDINGS-----WHO, WHERE, WHAT

The Bankruptcy Court

Federal bankruptcy judges, but not appointed for life, which limits their judicial power

Appeals are taken to the U.S. District Court, then the Circuit Court of Appeals

The Debtor

An individual, corporation or a business entity

The Creditors

Anyone and everyone with a claim of any kind against the debtor, sometimes working collectively as a Creditors Committee

The Trustee

A court-appointed official, supervising the debtor's affairs. Always in a liquidation case, rarely in a reorganization case

THE BANKRUPTCY CODE

Chapters 1, 3, and 5

The “toolboxes” of bankruptcy, telling you what to do in a bankruptcy case, how to do it, when and where to do it

Chapters 7, 11, and 13

The types, kinds or varieties of bankruptcy that an individual or a business files under

CHAPTER 13

Never for businesses, solely for individuals

The “wage earner” or “regular income” type of bankruptcy

Essentially a court-supervised budget plan for 3 to 5 years whereby the debtor pays nearly everything into court, and creditors are paid in installments

Creditors accept an agreed-upon percentage, the remainder of the debt is erased, and the debtor retains her property

Success is utterly dependent upon the debtor's ability to stick with the budget and make payments under the plan until it is completed

Notorious for a high failure rate, with unfulfilled Chapter 13 degenerating into Chapter 7s

CHAPTER 7

The liquidation chapter

Available to individuals and businesses

Individuals lose *everything*, except for their *exempt property*. This is the price they pay for the *discharge* of the portion of the debt that goes unpaid

The individual emerges from the Chapter 7 with only her exempt property, but debt-free

Creditors share *pro rata*; they recover the same percentage, and they lose the same percentage of the debt owed

Business Chapter 7----no mercy

All assets are liquidated. There is no such thing as exempt property for businesses. The business is defunct, and never survives. Creditors recover what they can, again sharing *pro rata*. What they cannot recover is gone forever, since the debtor does not survive.

CHAPTER 11

The reorganization chapter

The objectives are: save the business; restructure its finances, reorganize its operations, and restore profitability; the reorganized debtor emerges from Chapter 11, and rejoins the economy once more as a viable entity, thereby saving jobs, customers, and tax revenue.

The “Debtor in Possession” can obtain fresh financing, and is temporarily relieved of its obligation to repay past debt, until it can devise a plan for exiting Chapter 11.

This is the Chapter 11 plan, arrived at by strenuous negotiation with creditors, who are typically represented by a Creditors Committee.

The Chapter 11 plan provides for a scheme of repayment of debt over a number of years. Creditors seek to maximize recovery, while the debtor is motivated to minimize same.

The Chapter 11 plan must be approved by a vote of creditors, at least 51% in number, with that 51% or more holding at least two-thirds of the dollar amount of claims.

If the vote is successful, the plan is still subject to review by the Bankruptcy Judge for legal compliance, and then approved by the court in a final step called “confirmation.”

Once confirmed, the debtor emerges from Chapter 11 as a new entity, and fulfills its payment obligations to creditors.

Note that shareholders of the former debtor are wiped out.

If the debtor cannot be reorganized, most likely it descends into a Chapter 7 and is liquidated.

STATUTES COMMON TO ALL BANKRUPTCIES

Section 362---the Automatic Stay

All litigation against the debtor is halted for the duration of the case. All obligations to pay prebankruptcy debt are put on hold. Only secured creditors have a basis for “lifting” the automatic stay, and proceeding with collection actions, foreclosures, and the like.

Section 541----property of the estate

Anything and everything the debtor owns becomes part of the “estate,” the pool of property available to pay creditors in a liquidation or to reorganize the debtor in a Chapter 11.

Section 522---exempt property (for individual debtors only)

A very limited category of property which only individual debtors may retain, including a homestead exemption for a specific dollar amount of equity, certain household possessions, and the like. Essentially, the bare minimum to carry on with postbankruptcy.

Section 548---fraudulent conveyances

An extraordinarily powerful weapon to prevent debtors from hiding or transferring assets that should otherwise be available to pay creditors. The statute permits creditors to recover such wrongfully transferred assets, restore them to the Section 541 estate, and thus increase the creditors’ recovery.

Section 547----preferences

Predicated upon the statutory edict that every amount disbursed by a debtor in the 90 days before it files for bankruptcy was “preferential,” *i.e.*, some creditors were paid while others received nothing. Section 547 restores balance, by returning that money to the Section 541 estate, thereby assuring that all creditors share equally in such sums.

Section 365-----assumption or rejection of executory contracts and Unexpired leases of real property

Debtors are uniquely empowered to keep the contracts and leases they want (assumption), jettison the ones they no longer want (rejection), and keep and then assign to another for consideration accords which they can no longer use, but which others find worth acquiring (assumption and assignment). A number of complex statutory tests apply to each option in order to obtain necessary court approval.

The disposition of unexpired leases of real estate is fraught with complexity, especially for retail space in a shopping mall.

Section 507-----order of priority of payment

Creditors are paid in a strict order, which is (or should be) inviolate.

Sections 1107 and 1108 (for Chapter 11 only)-----authority to maintain possession of Assets and continue to operate the business

The key to Chapter 11. After all, a Chapter 11 debtor cannot reorganize if it must shut down and/or is deprived of its assets. The statute permits the debtor to “keep the doors” open until it can propound a Chapter 11 plan.

THE FUTURE...

In all likelihood, the current health crisis (now receding, thankfully) shall not provoke significant change, if any at all, in the Nation’s bankruptcy law itself. Yet while the Bankruptcy Code itself remains stable, it remains to be see how the litigation of this new wave of bankruptcy cases impacts the bankruptcy system, and the economy in general.

ANTHONY MICHAEL SABINO

BIOGRAPHY

ANTHONY MICHAEL SABINO, Dean of the Nassau Academy of Law, is a practicing attorney and nationally recognized expert on a variety of legal subjects, and a tenured full Professor of Law, St. John's University, Tobin College of Business. Formerly judicial law clerk for a prominent federal judge, he has published well over one hundred articles for the nation's leading law reviews and journals, which in turn have been cited by some of the country's highest federal appellate courts, including the Fifth and Seventh Circuit Courts of Appeals, the D.C. Circuit by now-Justice Ruth Bader Ginsburg, as well as by many Ivy League and other renowned law reviews. Prof. Sabino has written some of the leading articles on white collar crime, securities fraud, arbitration, bankruptcy, and corporate law. In recent years, he has authored no less than six *amicus curiae* briefs in cases of constitutional import pending before the U.S. Supreme Court.

Professor Sabino has been interviewed on television (including ABC, NBC, CBS, CNN, Bloomberg TV, CNBC, Fox News, and the BBC) and radio (including WCBS, WINS, WWOR, WABC, KABC (Los Angeles), Bloomberg Radio, AP Radio, and NPR) as an expert on: numerous "white collar" and securities fraud trials, including those implicating Bernard Madoff, Raj Rajaratnam, and Martha Stewart; the GM, Chrysler, Enron, WorldCom, and airline bankruptcies; the Microsoft antitrust cases; and many other legal controversies. He has been quoted by the Wall Street Journal, New York Times, Bloomberg.com, Forbes, MarketWatch, Dow Jones, Washington Post, Chicago Tribune, Boston Globe, Miami Herald, and other newspapers and publications across the nation and the world.

He practices law with Sabino & Sabino, P.C., Mineola, New York, and maintains a vigorous legal practice in a variety of fields, representing corporate and individual clients in the federal courts, in arbitrations and mediations at the stock exchanges, and elsewhere. He is a fully trained arbitrator and mediator for FINRA, the Southern District of New York, the Nassau County state Supreme Court, and other organizations.

Professor Sabino currently serves as Associate Dean of the Nassau Academy of Law, and frequently organizes and lectures at continuing legal education seminars. He has chaired the Federal Courts, ADR, and Corporate, Business & Securities Law Committees of the Nassau County Bar Association, and is a former NCBA director. He is active in numerous other charitable and civic organizations, and is an elected Trustee of the Village of Munsey Park, New York.

Professor Sabino is admitted to practice before the United States Supreme Court, the New York bar, and numerous federal appellate and district courts across the nation.

Please visit our website at www.sabinolaw.com for more details.