

# Small Chapter 11/Big Chapter 11: A Tale of Two Cities

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# Size Matters

Within the universe of commercial bankruptcy chapter 11 cases, there are at least three tranches:

- The “small business case” involving a “small business debtor”.
- A small commercial case – but larger than a “small business case”.
- Everything else.

# Small Business Case

**Bankruptcy Code Sec. 101(51D) defines a “small business debtor”:**

**The term "small business debtor" –**

**(A) subject to paragraph (B), 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) that has aggregate non-contingent 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 \$2,343,300 (excluding debts owed to 1 or more affiliates or insiders) for a case in which the United States trustee has not appointed under section 1102(a)(1) a committee of unsecured creditors or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor; and**

## Small Business Case Continued-

- **(B) does not include any member of a group of affiliated debtors that has aggregate non-contingent liquidated secured and unsecured debts in an amount greater than \$2,343,300 (excluding debt owed to 1 or more affiliates or insiders).**

# Large Business Case

Arguably, a “large business case” is every commercial chapter 11 that does not qualify as a “small business case.” In practice, however, practitioners tend to lump larger chapter 11 cases into these categories:

- Small commercial case – assets and debts from \$2 million to \$10 million
- Mid-market case – assets and debts from \$10 million to \$50 million
- Large case – assets and debts \$50 million to \$500 million
- Mega-case – assets and debts greater than \$500 million

# Small Business Case

Bankruptcy Rule 1020(c) provides that a small business case must not have:

- A creditors' committee, OR
- A creditors' committee that is "sufficiently active" to provide oversight of debtor

*Therefore, a "small business debtor" risks losing that status if a committee is appointed*

The debtor can challenge the appointment of a creditors' committee and can raise the issue of an appointed committee's level of interest and activity at any time.

## Small Business Case

- The definition of a small business may be problematic at times. For the debtor to be a "small business debtor," the U.S. trustee may not have appointed a creditors' committee. Further, if a committee has been appointed, it is necessary that the committee not be "sufficiently active and representative to provide effective oversight of the debtor." It is conceivable, therefore, that a case might be filed with the debtor otherwise meeting the definition of a small business debtor but losing that status if and when a committee is appointed. Might it reacquire the status of a small business debtor if and when the committee becomes insufficiently active and representative? It is hard to imagine how to apply the strict small business rules applicable under such circumstances.
- Rule 1020(c) allows the debtor to seek a determination of a committee's interest and activity at any time, but a party in interest must do so within a reasonable time after the committee has become inactive and unrepresentative.

## Large Business Case

Bankruptcy Code 1102(a)(1) provides that a US Trustee “**shall** appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or equity security holders” as may be appropriate (emphasis added).

*Therefore, the appointment of a creditor’s committee in a larger chapter 11 case is mandatory (subject, of course, to at least three creditors being willing to serve).*

# Small Business Case

## Timing of designation as a “small business case” (Bankruptcy Rule 1020):

- **Voluntary debtor – made in the petition (BR 1020(a))**
- **Involuntary debtor – made within 14 days after order of relief (BR 1020(b))**
- **Objections to designation – must be lodged by later of (a) 30 days after conclusion of 341 meeting, or (b) after designation statement or amendment to same (BR 1020(b))**
- **Bankruptcy Rule 1020(a) requires a debtor to identify in its petition, whether or not they are a small business debtor. Such a designation controls unless and until the court determines it is not correct. Rule 1020(b) requires a party in interest to object within 30 days after the Section 341a meeting or a voluntary change to the statement. Section 1102(a)(3) provides the debtor or a party in interest may seek an order to prevent appointment of a committee.**

# Reporting Obligations

## Small Business Chapter 11

**Bankruptcy Code Sec. 308(b) provides that a debtor in a small business case shall file “periodic financial and other reports” detailing:**

- **Profitability**
- **Projections of future receipts and disbursements**
- **Actual v. projected receipts and disbursements**
- **Compliance (reporting, etc)**

## Large Business Chapter 11

**Monthly reports of cash receipts and disbursements (operating reports)**

- **No profitability reports**
- **No projections**
- **No actual v. projected reports**
- **No compliance reports**

# Reporting Obligations - Small Business Debtor

**Bankruptcy Code § 308 imposes reporting requirements on small business debtors. Sec. 308 (b) requires the filing of periodic financial and other reports containing information including:**

- (1) The debtor's profitability**
- (2) Reasonable approximations of the debtor's projected cash receipts and cash disbursements over a reasonable period**
- (3) Comparisons of actual cash receipts and disbursements with projections in prior reports**
- (4) Whether or not the debtor is:  
-in compliance with post-petition requirements  
-Timely filing tax returns and other required government filings; paying taxes and their administrative expenses when due  
-If not in compliance with requirements, what are the failures and how, at what cost, and when the debtor plans to remedy the failures.**
- (5) Such other matters as are in the best interest of the debtor and creditors, and in the public interest in fair and efficient procedures.**

# Reporting Obligations – Small Business Debtor

The draconian nature of the Sec. 308 reporting requirements is underscored by the fact that the unexcused failure to meet them is grounds for conversion or dismissal of the case under Sec. 1112(b)(4)(F).

Sec. 1112(b)(2)(B)(i) - provides that the Court may not dismiss or convert the case if the debtor or party in interest proves a “reasonable justification” for the act or omission that otherwise would be grounds for dismissal or conversion, other than the “cause” items listed in Sec. 1112(b)(4).

Sec. 1112(b)(4) – provides a list of acts or omissions that constitute “cause” for dismissal or conversion, which includes “the unexcused failure to satisfy any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter[.]” Sec. 1112(b)(4)(F).

# Reporting Obligations – Small Business Debtor

**Apart from the possibility that the court might consider the interests of other creditors or constituencies that would be harmed by conversion or dismissal as a part of its assessing the "reasonableness" of a justification for missing the deadline, there is no provision in the amended Code for considering those interests or balancing the gravity of the error and the consequences.**



# Reporting Obligations – Small Business Debtor

Moreover, these deadlines are established by the Code rather than by the Rules of Bankruptcy Procedure. Therefore, it is debatable whether any such deadlines can be extended by application of Rule 9006.

- Missed deadlines under Bankruptcy Rule 9006 can sometimes be excused by its "excusable neglect" provision (see *Pioneer Inv. Services Co. v. Brunswick Associates Ltd. Partnership*, 507 U.S. 380, 113 S.Ct. 1489, 123 L. Ed. 2d 74, 24 Bankr. Ct. Dec. (CRR) 63, 28 Collier Bankr. Cas. 2d (MB) 267, Bankr. L. Rep. (CCH) P 75157A, 25 Fed. R. Serv. 3d 401 (1993)).
- However, a statutory decline is much more problematic. See *In re Butcher*, 829 F.2d 596, 16 Bankr. Ct. Dec. (CRR) 821, 17 Collier Bankr. Cas. 2d (MB)1204, Bankr. L. Rep. (CCH) P 71989, 9 Fed. R. Serv. 3d 68 (6th Cir. 1987) (abrogated by, *Bartlik v. U.S. Dept. Of Labor*, 62 F.3d 163, 10 I.E.R. Cas. (BNA) 1571, 130 Lab. Cas. (CCH) P 11407, 32 Fed. R. Serv. 3d 1032, 1995 FED App. 0247P (6th Cir. 1995)) (holding preference deadline "jurisdictional" and therefore not subject to Rule 9006).

# Reporting Obligations – Conclusions

- **Larger commercial debtor faces fewer mandatory requirements and less risk that the US Trustee will file a motion to convert or dismiss.**
- **As a practical matter, filing and reporting deficiencies may be funding related, and a larger debtor has more resources to ensure compliance.**

# Other Matters Unique to Small Business Cases

## Initial Debtor Interview - 28 U.S.C. Sec. 586(a)(7)

**Sec. 586 generally details the administrative and legal duties of the US Trustee. Sec. 586(a)(7) obligates the U.S. trustee to conduct initial interviews with small business debtors prior to the meeting of creditors under Bankruptcy Code § 341.**

**The interview is to evaluate the debtor's financial viability and business plan and to reach an agreement on scheduling.**

**The U.S. trustee is also given an opportunity at this meeting to advise the debtor of its reporting and filing obligations, which, as described above, are significant.**

**The U.S. trustee must also move promptly for conversion or dismissal whenever he or she discovers that there are grounds for such a motion.**

# Other Matters Unique to Small Business Cases

## Initial Debtor Interview - 28 U.S.C. Sec. 586(a)(7)

28 U.S.C. Sec 586(a) provides in relevant part:

Each United States Trustee, within the region for which such United States Trustee is appointed, shall –

(7) in each of such small business cases –

(A) Conduct an initial debtor interview... after the date of the Order for relief, but before the first meeting scheduled under Section 341(a) of title 11, at which time the United States Trustee shall-

- (i) begin to investigate the debtor's viability
- (ii) inquire about the debtor's business plan
- (iii) explain the debtor's obligations to file monthly operating reports and other required reports
- (iv) attempt to develop an agreed scheduling order; and
- (v) inform the debtor of other obligations.

# Other Matters Unique to Small Business Cases

## Bankruptcy Code Sec. 1116 – Duties of Trustee or Debtor in Possession in Small Business Cases

**Sec. 1116 aggregates a list of express duties of the small business debtor. Only a few of these duties are unique to small business cases, but the aggregation of these duties into one provision is unique to the qualifying “small business debtor.”**

**The overall effect is to make the chapter 11 process more tightly structured – and arguably more burdensome - for the small business debtor than other chapter 11 enterprises.**

# Other Matters Unique to Small Business Cases

**Sec. 1116 requires the small business debtor to:**

**(1) append to the voluntary petition or, in an involuntary case, filed not later than seven days after the date of the order for relief--**

**(A) its most recent balance sheet, statement of operations, cash-flow statement, and Federal income tax return; or**

**(B) a statement made under penalty of perjury that no balance sheet, statement of operations, or cash-flow statement has been prepared and no Federal tax return has been filed;**

**(2) attend, through its senior management personnel and counsel, meetings scheduled by the Court or the United States trustee, including initial debtor interviews, scheduling conferences, and meetings of creditors convened under § 341 unless the court, after notice and a hearing, waives that requirement upon a finding of extraordinary and compelling circumstances.**

# Other Matters Unique to Small Business Cases

## Sec. 1116 (continued):

- (3) timely file all schedules and statements of financial affairs, unless the court, after notice and a hearing, grants an extension, which shall not extend such time period to a date later than thirty days after the date of the order for relief, absent extraordinary and compelling circumstances.**
- (4) file all post-petition financial and other reports required by the Federal Rules of Bankruptcy Procedure or by local rule of the district court.**
- (5) subject to § 363(c)(2), maintain insurance customary and appropriate to the industry;**

# Other Matters Unique to Small Business Cases

## **Sec. 1116 (continued):**

- (6) (A) timely file tax returns and other required government filings;  
and**
- (B) subject to § 363(c)(2), timely pay all taxes entitled to  
administrative expense priority except those being contested  
by appropriate proceedings being diligently prosecuted; and**
- (7) allow the United States trustee, or a designated  
representative of the United States trustee, to inspect the  
debtor's business premises, books, and records at  
reasonable times, after reasonable prior written notice,  
unless notice is waived by the debtor.**

# Other Matters Unique to Small Business Cases

## **Bankruptcy Code Sec. 1116 – Duties of Trustee or Debtor in Possession in Small Business Cases (continued)**

**Remember, it may be difficult at a given moment in some cases to determine whether the debtor is a small business debtor. So the existence of these duties may vary from time to time.**

# Other Matters Unique to Small Business Cases

## **Bankruptcy Code Sec. 1125 Expedited Plan and Disclosure Statement Process in Small Business Cases**

**Bankruptcy Code § 1125 establishes the basis for a more flexible confirmation process in small business cases. The court may determine that the plan contains sufficient information, and, in that event, no disclosure statement is required. Disclosure statements can also be submitted on standard forms.**

# Other Matters Unique to Small Business Cases

## Bankruptcy Code Sec. 1125 – Expedited Plan and Disclosure Statement Process in Small Business Cases

- **Conditional approval of a disclosure statement may be allowed with final approval to be given at the confirmation hearing.**
- **It is also possible now to combine the hearing on approval of the disclosure statement and the confirmation hearing itself.**
- **These improvements are designed to allow the case confirmation process in a small business case to operate at reduced cost to all participants.**

## **Case Management and Arc: 5 Areas of Distinction**

**We've identified five areas in which case management and arc generally differ between the small business case and the larger case. Some of these differences are also true between smaller (but not "small business") chapter 11 cases and larger ones.**

**Commercial debtors in that first tranche of size above the limitations that apply to the "small business debtor" – between \$2,343,000 in assets/debt and \$10 million – share many of the resource-related obstacles to rescue or recovery with that of the small business debtor.**

**In Chapter 11, as in business generally, analog to "too big to fail" is "too small to survive."**

# Case Management and Arc: 5 Areas of Distinction

1. Purpose and Planning
2. Debtor Governance and Authority
3. 1<sup>st</sup> Day Motions
4. Disclosure Statement and Plan
5. Committees

\* \* \*

The distinctions are driven only in part by statutory requirements unique to small business cases.

# Purpose and Planning

## Small Business Chapter 11

Chapter 11 for the small business debtor or smaller company is often a lifeboat (or a cliff):

- **Emergency filings common - no exit strategy**
- **No leverage with lender or landlord pre-bankruptcy? Chapter 11 will not help.**
- **Demanding initial and near term deadlines for small business debtor exacerbate pressure**

## Large Business Chapter 11

Chapter 11 generally used as a business strategy:

- **Typically planned for months (6 to 12+ is common)**
- **Foster a sale – structured liquidation**
- **Force corporate change / remake capital structure**
- **Restructure lease and contract obligations**
- **Bust a union ... contract, at least**

# Debtor Governance and Authority

## Small Business Chapter 11

- **Closely held**
- **Family run – friends and family employment issues**
- **Personal tax and estate issues may be in play**
- **Poor financial records and internal controls plague attempts to meet chapter 11 reporting requirements**

## Large Business Chapter 11

- **Board approval**
- **Shareholder issues**
- **Public reporting / shareholder matters**
- **Unions, pensions, and WARN act concerns**
- **More sophisticated financial and operational controls ease compliance with reporting requirements**

# First Day Motions

## Small Business Chapter 11

### Limited “first day” filings:

- Cash collateral (typically no DIP)
- Bank account
- Employee
- Retention

## Large Business Chapter 11

### Expansive “first day” filings:

- Cash collateral/DIP
- Bank account
- Employee
- Retention
- Interim compensation
- Ordinary course professional
- Key vendor
- Utilities
- Customer accounts
- Administrative consolidation (multiple debtors)
- Bid procedures/sale (planned liquidation cases)

# Disclosure Statement and Plan

## **Small Business Debtor - Unique Exclusivity Requirements**

The exclusive period in § 1121 within which the debtor may file a plan is cut off by at 180 days after the order for relief. A plan and disclosure statement (if any), by whomever filed, must be filed no later than 300 days after the order for relief. Both of these deadlines may be extended but only by an order entered before the existing deadline expires and setting a new date, and only upon the debtor's showing "by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time." § 1121(e)(3) (A). A motion for an extension must therefore be made in time to allow the court to hear and determine whether an extension is warranted.

# Disclosure Statement and Plan

## Small Business Chapter 11

Debtor has exclusivity for 180 days (Sec. 1121(e)(1)). Exclusivity can be extended after notice and hearing (Sec. 1121(e)(1)(A)), or extended or shortened by the court for cause (Sec. 1121(e)(1)(B)).

Order extending either deadline must be entered prior to deadline, on showing that "by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time."

§ 1121(e)(3)(A).

## Large Business Chapter 11

Debtor has exclusive right to file plan within 120 days of petition date if confirmed within 180 days (Secs. 1121 (b), 1121 (c)(3)). Dates can be extended to 18 months (Sec. 1121(d)(2)(A)) and 20 months (Sec. 1121(d)(2)(B)) respectively.

# Disclosure Statement and Plan

## Small Business Chapter 11

**A plan / DS must be filed by debtor or party in interest within 300 days but can be extended for cause shown (Sec. 1121(e))**

**Disclosure statement requirement may be waived if plan contains “adequate” information (Sec. 1125(f))**

**Court can conditionally approve disclosure statement (Sec. 1125(f)(3)(A))**

## Large Business Chapter 11

**No hard outside deadline for filing of plan or disclosure statement**

**Disclosure statement is required**

**No conditional approval**

# Disclosure Statement and Plan

## Small Business Chapter 11

**Combined hearing on adequacy (DS) and confirmation (plan) (Sec. 1125(f)(3)(C))**

**Expedited confirmation - court shall confirm compliant plan within 45 days of filing unless time extended for cause shown (Secs. 1129(e) and 1121(e)(3))**

## Large Business Chapter 11

**Combined hearing possible – two step process far more common**

**No requirement for expedited confirmation**

# Disclosure Statement and Plan

## Small Business Chapter 11

Like the deadlines for the exclusivity period and the time for filing plans, this time for confirmation of a filed plan can only be extended upon a showing by the debtor that confirmation of a plan will result at the end of the time.

§1121(e)(3).

## Large Business Chapter 11

No comparable requirement.

# Disclosure Statement and Plan

## Small Business Case – Plan Deadlines May be Deadly

Remember that an order extending these exclusivity and plan deadlines must be signed before the existing deadline has expired. § 1121(e)(3). The consequence of missing the deadline would seem to be that the debtor would not have a confirmable plan, providing a basis for conversion or dismissal of the case. § 1112(b)(4)(J). Again, the consequence of this may be harsh. The confirmation deadline can be extended only if the *debtor* demonstrates that it is more likely than not that confirmation of a plan would occur within a reasonable time (as well as again showing "reasonable justification" for the missed deadline), a new deadline is imposed when the extension is granted, and the extension order is entered before the existing deadline has expired.

# Official Committees

## Small Business Chapter 11

**Small business case - no committee allowed, or if formed, committee must be inactive (BR 1020(d))**

**Party in interest in small business case may move that a committee not be formed (Sec. 1102((a)(3))**

**Small (but not small business) chapter 11 – committee may be formed but activity generally very limited due to lack of funding for professionals and inertia**

## Large Business Chapter 11

**Creditor’s committee “shall” be appointed (Sec. 1102(a)(1))**

**Committee formation meeting typically set within days of commencement of case**

**7 members (the 7 largest by debt) is the default criteria – Sec. 1102(b)(1)) - but committee may be formed with as few as 3 members**

**Can and should be active in the case.**

# SMALL BUSINESS DEBTOR ADVANTAGES AND DISADVANTAGES OF ELECTION

## Advantages

- Expedited confirmation process
- Court can limit information required by a disclosure statement or eliminate need if plan contains sufficient information.
- Disclosure statement and confirmation hearings may occur simultaneously/concurrently.

## Disadvantages

- Small business debtors often have poor financial records
- Small size often means inactive creditor constituencies
- Burden on U.S. Trustee and taxing authorities
- Very expensive
- Demanding deadlines and reporting requirements
- Exclusivity is 180 days, plan and disclosure statement 300 days.