Critical Issues List 2022
Bankruptcy Section for
Commercial Law League of America

Introduction

This paper contains recommendations from the Bankruptcy Section for the Commercial Law League of America for proposed legislative and regulatory actions. The proposals are not meant to be definitive positions, but rather are designed to identify issues and areas of concern for further development and appropriate legislative action.

THE CRITICAL ISSUES:

1. Subchapter V

The Small Business Reorganization Act of 2019 (SBRA), in effect as of February 19, 2020, was enacted to provide small business debtors with a more streamlined path for restructuring their debts. SBRA introduced an innovation: Subchapter V of Chapter 11, a new type of bankruptcy designed to make reorganization under the Bankruptcy Code faster and less expensive for America's small businesses. Subchapter V defined a "small business debtor"[1] as "a person engaged in commercial or business activities … that has aggregate noncontingent liquidated secured and unsecured debts… in an amount not more than $2,725,625." At least half of those debts must have been incurred from business activity. About a month after the SBRA's February 2020 effective date, the COVID-19 pandemic upended the country. In response, Congress and the President acted swiftly to enact the CARES Act,[2] which increased Subchapter V's debt limits to $7.5 million for two years.[3] When Subchapter V's increased debt limits lapsed in March of 2022, Congress and the President acted again, albeit not as swiftly as before, and enacted the Bankruptcy Threshold Adjustment and Technical Corrections Act (the "Act")[4] on June 21, 2022, extending the increased $7.5 million Subchapter V debt limit for another 2

[1] For purposes of Subchapter V. Bankruptcy Code section 101(51C) defines a small business case slightly more broadly than Subchapter V, and meeting this definition allows debtors the option to use the Bankruptcy Code's previous (and unrepealed) small business provisions of the Bankruptcy Code. However, dissatisfaction with the ineffectiveness of those provisions helped motivate the SBRA and Subchapter V.

[2] Coronavirus Aid, Relief, and Economic Security Act. Public Law 116-123.

[3] The initial expiration of the $7,500,000.00 Subchapter V debt limit was March 27, 2022.

[4] Public Law No. 117-151.

years.[5]As Congress was considering the Act, the CLLA wrote a letter to members of Congress, expressing its support of this proposed legislation. The CLLA further supported an increase in the debt limitation to $10 million, which also aligns with the increased debt limitation in Chapter 12 cases. Last year there were 31.7 million small businesses[6] in the United States. Between 2000 and 2019, these small businesses created 10.5 million net new jobs and accounted for 65.1% of the net new job creation since 2000.[7] Small businesses face many challenges, and yet make such a large impact on the country's economy. Through further Subchapter V legislation, Congress should support American small businesses by: (i) increasing its debt limit to match that of Chapter 12; and (ii) making that debt limit increase permanent.

2. Student Loan Crisis

The amount of educational-related debt has recently surpassed the outstanding credit card obligations.[8] This situation is of national concern since graduating students, overburdened with educational debt, can become hampered while they attempt to enter the workforce and/or delayed in making major purchases (e.g. houses and cars). Since these debts are non-dischargeable obligations, with very limited exceptions, graduating students can be adversely impacted for a lifetime. Based on the foregoing, the CLLA believes that the grounds for non-dischargeability should be relaxed, allowing for the bankruptcy courts to ascertain relief for appropriate debtors.

In 2019, the CLLA's Student Loan Sub-Committee proposed a relaxed standard, such that students can obtain a bankruptcy hardship discharge if all of the following are present:

1. Bankruptcy filed 10 years after loan is first due;
2. The debtor cannot maintain an adequate standard of living for the debtor and the debtor's dependents if required to pay such debts; and
3. This state of affairs is likely to persist for at least five years.

The proposal which seeks to amend 11 U.S.C. § 523(a)(8), reclassifies "Hardship" from the current standard of "undue hardship" to "substantial hardship". Substantial hardship will be presumed if any one of the following criteria are met:

[5] The $7,500,000.00 Subchapter V debt limit will expire on March 27, 2024.

[6] Defined by the U.S. Small Business Administration, Office of Advocacy as an independent business having fewer than 500 employees. https://cdn.advocacy.sba.gov/wp-content/uploads/2020/11/05122043/Small-Business-FAQ-2020.pdf

[7] *Id.*

[8] https://www.newyorkfed.org/newsevents/news/research/2022/20220802

1. The debtor is receiving disability benefits under the Social Security Act; or The debtor has received a 100% disability rating or has been determined to be unemployable under the VA disability compensation program; or

2. In the seven years before filing bankruptcy, the borrower's household income averaged less than 175% of the federal poverty guidelines, or

3. At the time of filing bankruptcy, the debtor's household income is less than 200% of federal poverty guideline and: (a) the debtor's only source of income is from Social Security benefits or a retirement fund; or (b) the debtor provides support for an elderly, chronically ill, or disabled household member or member of the borrower's immediate family.

The proposal also provides for discharge of any student loan in a Chapter 11, 12, or 13, where the debtor has paid under a confirmed plan at least 10% of the principal balance of the loan owing on the petition date.

CLLA believes that by including a precise definition of hardship, courts will be able to more objectively determine dischargeability of student loan debt and afford a "fresh start" to debtors who would never be able to pay those loans, while preventing outright abuse of the loan system to discharge debts not causing hardship. It further provides some lending security and a mechanism for lenders (including the schools) to clear their books of uncollectible debt. Given the various bills being introduced in Congress (many of which propose elimination of § 523(a)(8) in its entirety), it is important for the CLLA to take a position, as it is unlikely that the status quo will be maintained.

3. Third Party Releases

In March 2021, lawmakers introduced a bill named the SACKLER Act, which was designed to prevent members of the Sackler family, who own OxyContin-maker Purdue Pharma LP, from using the bankruptcy process to obtain legal releases from governmental lawsuits. This bill was followed by the Nondebtor Release Prohibition Act of 2021, which proposes a ban on nonconsensual third-party releases and other abusive practices. Given the potential abuse of non-debtors in obtaining third party releases in Chapter 11 cases, from government and non-government creditors, the CLLA believes it is important to take a position with regard to this important issue. The Bankruptcy Section has appointed a subcommittee to propose a compromise position on this issue.

4. Limitations on Bankruptcy Venue

Since bankruptcy is essentially a local concern, corporations should file only where either their principal place of business or principal assets are located. The current language of 28 U.S.C. § 1408 permits an entity to commence a bankruptcy case in the district where that entity was incorporated or formed. Venue based on place of incorporation should be eliminated. S 2827 and HR 4193 are identical bills now pending in Congress which would amend § 1408 to

eliminate venue based on place of incorporation. This amendment to bankruptcy venue will insure going forward the greatest possible involvement of creditors, shareholders, employees and other interested parties, while the bankruptcy case is conducted and supervised within the communities that are most interested in the outcome. In addition, affiliate filings are adjusted to make sure that subsidiaries follow parent companies into bankruptcy and motions to transfer are quickly resolved. The League supports current legislation pending in the 117th Congress (S 2827 and HR 4193).

5. Effective Date of Chapter 11 Plans

On February 23, 2021, Belk, Inc. and its affiliates filed a Chapter 11 bankruptcy petition, along with a proposed "pre-packaged" plan of reorganization. Plan confirmation was determined the next day and the plan became effective that afternoon, just 20 hours after the Chapter 11 cases were filed. The speed in which the plan became effective raises due process and other concerns, and the CLLA believes it is important to take a position with respect to the notice period prior to the effective date of a Chapter 11 plan.

6. Preference Reform.

Despite the changes to the Bankruptcy Code in the Small Business Reorganization Act of 2019, adversary proceedings to recover alleged preferences and fraudulent transfers are still properly filed in the venue of the bankruptcy case. An amendment to 28 U.S.C. § 1409(b) should be considered, to close the loophole. The revised language should provide that any such actions that are under $25,000 should be brought in the district in which the defendant resides.

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