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. In response to the economic distress caused by the COVID-19 coronavirus pandemic, the CARES Act was enacted on March 27, 2020, increasing the eligibility limit for small businesses looking to file under SBRA's Subchapter V from $2,725,625 of debt to $7,500,000. On March 28, 2022, the threshold returned to $2,725,625, pending the proposed legislation described below.

On March 14, 2022, Sen. Charles Grassley (R-IA) introduced bipartisan legislation, which would, among other things, make permanent the $7.5 million debt limit for the Small Business Reorganization Act. The legislation, which is co-sponsored by Senate Judiciary Chair Richard Durbin (D-IL) and Sens. Sheldon Whitehouse (D-RI) and John Cornyn (R-TX), is the "Bankruptcy Threshold Adjustment and Technical Corrections Act" (S. 3823).

The proposed legislation would continue to allow greater access to the SBRA, allowing small businesses and individuals engaged in business a greater opportunity to successfully reorganize, pay creditors' claims and save jobs. On March 18, 2022, 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.

2. Student Loan Crisis

The amount of educational-related debt has recently surpassed the outstanding credit card obligations. 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. 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.

Hardship will be presumed if one of the following criteria are met:

1. SSI Disability;
2. 100% disability rating under VA; OR
3. Household income is less than 200% of fed poverty guideline.

CLLA believes that by defining hardship, the goal of a "fresh start" will be achieved for those who will never be able to pay the loans, while preventing outright abuse of the loan system to discharge debts not causing hardship. It further provides some lending security and provides a mechanism for lenders (including the schools) to clear their books of uncollectible debt. Given the various bills being introduced in Congress, 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. Venue based on place of incorporation should be eliminated. 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.

7. Increasing Chapter 13 Eligibility Limits.

The "Bankruptcy Threshold Adjustment and Technical Corrections Act", described above, would also raise the debt limit for Chapter 13 bankruptcy eligibility to $2.75 million, and remove the distinction between secured and unsecured debt for that calculation. The current debt limitation is $419,275 of noncontingent, liquidated and unsecured debt or $1,257,850 of noncontingent, liquidated and secured debt. These debt limitations are adjusted for inflation. Under the proposed legislation, the debt limitation would be $2.75 million of noncontingent and liquidated debts, regardless of whether the debt is secured or unsecured.

This debt limitation has become outdated for several reasons, including the fact that home prices have exceeded the rate of inflation, and continue to rise. When home prices rise, the amount that homeowners need to borrow for mortgages rise as well, which has the result of putting these homeowners over the secured debt limit. When home prices fall, existing mortgages can create large deficiency claims, possibly putting these homeowners over the unsecured debt limit. Furthermore, the student loan debt crisis in this country has increasingly pushed consumers over the unsecured debt limit.

In these circumstances, the alternatives to Chapter 13 are poor substitutes. Although consumers can file Chapter 11, that is a more cumbersome, burdensome and costlier process. Another alternative is Chapter 7 bankruptcy; however, a debtor may lose non-exempt assets in that process. Chapter 13, on the other hand, allows a debtor to repay creditors' claims over a period of time. The current alternatives create a situation where debtors must choose a less-than-ideal

chapter of bankruptcy or do not file bankruptcy at all. A bankruptcy system that diverts individuals away from the appropriate relief they need through artificially low debt limits is poor public policy.

Finally, the proposed bipartisan legislation eliminates the distinction between secured and unsecured debts in considering the debt limitation. This serves the purpose of eliminating litigation as to what counts as a secured and unsecured debt, creating delay and unnecessary litigation to these types of cases. Having an increased and uniform debt limitation would be more in line with the debt limitations in Chapter 12 and Subchapter V bankruptcy cases.

For these reasons, on March 18, 2022, the CLLA wrote a letter to members of Congress, expressing its support of this proposed legislation.

8. Tax Claims in Subchapter V cases

The Bankruptcy Section has also supported de-prioritizing tax claims to make Subchapter V consistent with 11 U.S.C. § 1232.