



AMERICAN
BANKRUPTCY
INSTITUTE

Consumer Practice Extravaganza

13 or V? Putting Your Debtor in the Right Case

Anerio V. Altman

Lake Forest Bankruptcy | Laguna Hills, Calif.

Sumner A. Bourne

Rafool & Bourne | Peoria, Ill.

David A. Mawhinney

Standing Chapter 13 Trustee and Subchapter V Trustee | Sudbury, Mass.

Hon. Kesha L. Tanabe

U.S. Bankruptcy Court (D. Minn.) | St. Paul

13 OR V?

PUTTING YOUR SMALL BUSINESS DEBTOR IN THE RIGHT CASE



HON. KESHA TANABE, UNITED STATES BANKRUPTCY COURT DISTRICT OF MINNESOTA

ANERIO V. ATLMAN, LAKE FOREST BANKRUPTCY, FOOTHILL RANCH, CA

SUMNER A. BOURNE, SUBCHAPTER V TRUSTEE, PEORIA, IL

DAVID A. MAWHINNEY, STANDING CHAPTER 13 TRUSTEE, WORCESTER, MA

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- Attorneys Fees and Pre-Petition Transactions

HYPOTHETICAL #1 NANCY DEBTOR – NANCY’S PIZZERIA

- ❖ **Business:** Sole proprietorship, restaurant and frozen pizza sales, leased location/factory, generates **\$3,500 per month** net income after **NANCY**’s modest living expenses (she is well below median). **NANCY** leases a house and car, and has no retirement funds or other exempt funds available. **NANCY**’s spouse has outside wage income of \$12,000 per month, making her household income above median.
- ❖ **Assets:** \$200,000 in equipment, \$20,000 in operating deposit account
[Net Value in Chapter 7 (Auctioneer/Admin Costs): **\$187,750**]
- ❖ **Debts:** \$500,000 past due vendor debt (now on COD with different supplier), \$1,000,000 loan from her brother **MARK**. **NANCY** and **MARK** had a falling out, and he has now filed a lawsuit on the note (she has no defenses, and the amount due is clear from the note).
- ❖ **Administrative Costs:**
[Chapter 13 Trustee Commission: 10%]
[Sub V Trustee Hourly Rate: \$300 per hour]
[Debtor Counsel Hourly Rate: \$300 per hour]


HYPOTHETICAL #2

DAN DEBTOR – OWNER OF ACTION DAN SPORTS, INC.

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- ❖ **Closed Business:** DAN is winding down Action Dan Sports Inc., which was a small chain of sporting goods stores that closed six months ago. DAN has a personal guaranty with ALPHA BANK on a secured line of credit, and he is liquidating the remaining \$500,000 in inventory. After the inventory is sold, ALPHA BANK will be owed about \$1,000,000.
 - ❖ DAN has just been sued by a former landlord (another personal guaranty) for \$500,000. DAN has \$100,00 in credit card and other consumer debt. ALPHA BANK tells DAN that so long as he continues to cooperate liquidating collateral that the bank will “support” a personal bankruptcy.
 - ❖ **Assets:** DAN is renting, and owns a vehicle worth \$50,000 beyond his allowed exemption. DAN has an out of state family farm worth \$150,000 that he wants to protect. [Net Value in Chapter 7 (Liquidation/Admin Costs): **\$125,000**]
 - ❖ **Income/Disposable Income:** DAN quickly found work after closing the business, and has a salary of \$150,000 per year (he is above median). Both the means test and I/J show disposable **monthly income of \$5,000**
 - ❖ **Administrative Costs:**
 - [Chapter 13 Trustee Commission: 10%]
 - [Sub V Trustee Hourly Rate: \$300 per hour]
 - [Debtor Counsel Hourly Rate: \$300 per hour]
- 

HYPOTHETICAL #3

ALLAN ALIBI – SELF-EMPLOYED MORTGAGE BROKER

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- ❖ Independent mortgage broker. Income ranges greatly from year to year, but on the whole he averages around \$200,000 a year. For example, in 2018 he earned \$450,000 and 2021 he earned \$30,000.
 - ❖ Outstanding tax returns.
 - ❖ Chapter 7 Discharge. Mortgage matured and foreclosure is next week.
 - ❖ Home is worth \$1,000,000. First mortgage is a debt of \$250,000, and second mortgage lender also has a debt of \$250,000. In California, where Allan lives, Allan is able to exempt the remainder of the equity in his home and his prior Chapter 7 was a “no asset” matter. Allan’s household has no other significant non-exempt assets.
 - ❖ In between the filing of his prior petition and this filing, Allan had sued his prior attorney for malpractice for pre-Chapter 7 activities and lost, and further lost on a malicious prosecution claim counterclaimed by the attorney. This claim proceeded to a five day jury trial in which Allan participated and represented himself. Allan now owes this attorney \$300,000 pursuant to that judgment.
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2023 CONSUMER PRACTICE EXTRAVAGANZA

Chapter 13 v. Subchapter V

	Chapter 13 Business Debtor	Subchapter V Individual Debtor
Eligibility	<p>Individual with regular income and noncontingent, liquidated debts of less than \$2,750,000.</p> <p>Excluded if debtor is a stockbroker or commodity broker.</p> <p>No requirement to be presently “engaged in business.”</p> <p>Primary business activity can be owning SARE.</p>	<p>Individual with noncontingent, liquidated, secured and unsecured debts of not more than \$7,500,000 where not less than 50% of which arose from commercial or business activities.</p> <p>Excluded if individual is a member of a group of affiliated debtors (who filed at the same time or before the individual) whose aggregate noncontingent liquidated secured and unsecured debts exceed \$7,500,000.</p> <p>Excluded if individual is an affiliate of a publicly traded corporation in bankruptcy.</p> <p>Excluded if individual’s primary business activity is owning SARE.</p> <p>No “regular income” requirement but must be “engaged” in business or commercial activity on the petition date. 11 U.S.C. § 1182(a).</p>
Pre-petition Disclosures	Profit and Loss	Profit and Loss, Income Statement, and Balance Sheet (if available).
Reporting	Periodic operating reports required. <i>See</i> 11 U.S.C. §§ 1304(c) and 704(a)(8). Reporting delivered to chapter 13 trustee.	Periodic operating reports required with monthly operating reports until confirmation. <i>See</i> 11 U.S.C. §§ 1184, 1106(a), and 704(a)(8).

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	Chapter 13 Business Debtor	Subchapter V Individual Debtor
Means Test	<p>Must be completed. If the Debtor is “above median” the applicable commitment period of the plan is 5 years.</p> <p>Debtors’ gross business income might have to be counted without deduction for ordinary and necessary expenses.</p>	Does not apply.
Disposable Income Commitment Period	If debtor is “above median” 5 years or until creditors paid in full; if debtor is “below median” 3 years or until creditors paid in full.	No minimum period for “consensual” plans confirmed under section 1191(a). If impaired creditor objects the debtor must commit disposable income for 3 years. Court may extend to 5 years, but is unlikely to do so without cause. <i>See In re Urgent Care Physicians, Ltd.</i> , 2021 WL 6090985 (Bankr. E.D. Wis. Dec. 20, 2021).
Debtor Powers	<p>The exclusive right to use, sell, or lease property of the estate and borrow money. 11 U.S.C. §§ 1303 and 1304(b).</p> <p>Debtor does not have the power to sell both the estate interest and the interest of any co-owner in property under section 363(h).</p> <p>Chapter 5 avoidance powers only if there is an exemption available in recovered property. <i>See</i> 11 U.S.C. § 522(h).</p>	<p>All rights and powers of a chapter 11 trustee, including power to operate business, use, sell, or lease property and borrow money. <i>See</i> 11 U.S.C. § 1184.</p> <p>Chapter 5 avoidance powers.</p>

2023 CONSUMER PRACTICE EXTRAVAGANZA

	Chapter 13 Business Debtor	Subchapter V Individual Debtor
Trustee Powers	Trustee cannot use, sell, or lease property of the estate. Cannot collect or liquidate property of the estate. Trustee can investigate the acts, conduct, assets, liabilities, and financial condition of the debtor and report on the desirability of the continuance of the debtor's business, and any other matter relevant to the case or to the formulation of a plan.	For cause, trustee can replace the debtor as a debtor-in-possession with power to use, sell, or lease property of the estate and operate the debtor's business and borrow money. 11 U.S.C. §§ 1183(b)(5), 363(c), and 364. For cause, trustee can investigate the acts, conduct, assets, liabilities, and financial condition of the debtor and report on the desirability of the continuance of the debtor's business, and any other matter relevant to the case or to the formulation of a plan.
Payment Obligations	Begin within 30 days of Petition Date.	Payments not required prior to confirmation of Plan, unless creditor obtains adequate protection order.
Modification of Mortgage on Principal Residence.	Not allowed if only collateral is the homestead. <i>See</i> 11 U.S.C. § 1322(b)(2).	Allowed if the value received in connection with the security interest was not used to buy the property and was used primarily in connection with the small business of the debtor. <i>See</i> 11 U.S.C. § 1190(3). This allows Subchapter V debtors to cram down or strip off business loans secured by residence.
1111(b) Election	Does not apply.	Applies.
Disposable Income	If the Debtor is "above median" the Means Test controls; if the Debtor is "below median" Schedules I and J determine disposable income.	All income received by the debtor that is not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor, post-petition domestic support obligations, or for the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor.
Post-Petition Property	All property of the kind described in section 541 becomes property of the estate, and earnings from services performed by the debtor post-	In the plan is confirmed "nonconsensually" under section 1191(b), all property of the kind described in section 541

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	Chapter 13 Business Debtor	Subchapter V Individual Debtor
	petition. 11 U.S.C. § 1306. Unless court orders otherwise, it reverts in the debtor at confirmation. <i>Note many districts have local rules that provide for the reversion of property of the estate at discharge.</i>	becomes property of the estate, and earnings from services performed by the debtor post-petition. 11 U.S.C. § 1186.
Plan Term	Maximum of 5 years. Long-term secured debt can be maintained beyond expiration of plan under terms of loan agreement.	No maximum for modified secured debt. Maximum of 5 years for unsecured debt.
Plan Exclusivity	Only the Debtor may file a plan.	Only the Debtor may file a plan.
Plan Voting	Not required.	Required.
Disbursing Agent	Chapter 13 Trustee who takes a fee on each plan payment received.	The Debtor if there is acceptance by all impaired classes, and Subchapter V Trustee if there is not. Subchapter V Trustee is normally paid on an hourly basis. No U.S. Trustee fees. <i>See</i> 11 U.S.C. § 1194.
Post-Confirmation Reporting	At request of party in interest, the debtor must file copies of tax returns during the term of the plan, and a statement under penalty of perjury of income and expenses for each year of the plan term. 11 U.S.C. § 521(f). Debtor must disclose amount and sources of income, and identity of any person who contributed, and the amount contributed to the household. § 521(g). Official Local Form 4 in Massachusetts requires the Debtor to “promptly” inform the Trustee of any material increase in income and/or any acquisition of assets during the case.	A debtor’s projected disposable income becomes a component of the plan payment. <i>See</i> 11 U.S.C. § 1191(c)(2). The provisions of the plan bind the debtor and all creditors. <i>See</i> § 1141(a). The debtor has no obligation to provide post-confirmation reporting about its actual income. <i>But see In re Hamilton Staples</i> , 2023 WL 119431 (M.D. Fla. Jan. 6, 2023) (court may order subchapter V debtor to pay the greater of actual and projected disposable income).

2023 CONSUMER PRACTICE EXTRAVAGANZA

	Chapter 13 Business Debtor	Subchapter V Individual Debtor
Attorney's Fees	Practices vary by district. Many districts have "no look" fee for which no application is required. Some courts allow counsel to decline "no look" in business case and allow hourly fee applications. Counsel get fees on pre-confirmation dismissal if they file a section 503(b) motion. <i>See</i> 11 U.S.C. § 1326(a)(2).	Hourly fee applications with interim application and other procedures varying by district.
Transactions with Attorneys Pre-Petition	Attorney holding claim against debtor may be disqualified from employment. 11 U.S.C. § 327.	Attorney is not disqualified if they hold a claim of less than \$10,000. 11 U.S.C. § 1195.
Post-confirmation modification	Plan may be modified any time after confirmation but before completion of payments under the plan. 11 U.S.C. § 1329(a). Debtor, trustee, or unsecured creditor may request plan modification. § 1329(a).	If plan is consensually confirmed, the debtor may not modify after it has been substantially consummated. 11 U.S.C. § 1193(b). If plan is nonconsensually confirmed, the debtor may modify it at any time within the term. § 1193(b). No express standing for anyone other than the debtor to move to modify the plan.
Dismissal	Debtor may dismiss at any time. 11 U.S.C. § 1307(b).	On request of party in interest court may convert or dismiss, which ever is in best interest of creditors. 11 U.S.C. § 1112(b). Debtor may have constitutional argument against remaining in subchapter V against their will.

HYPOTHETICAL #1
NANCY DEBTOR – NANCY’S PIZZERIA

Business: Sole proprietorship, restaurant and frozen pizza sales, leased location/factory, generates **\$3,500 per month** net income after **NANCY**’s modest living expenses (she is well below median). **NANCY** leases a house and car, and has no retirement funds or other exempt funds available. **NANCY**’s spouse has outside wage income of \$12,000 per month, making her household income above median.

Assets: \$200,000 in equipment, \$20,000 in operating deposit account
[Net Value in Chapter 7 (Auctioneer/Admin Costs): **\$187,750**]

Debts: \$500,000 past due vendor debt (now on COD with different supplier), \$1,000,000 loan from her brother **MARK**. **NANCY** and **MARK** had a falling out, and he has now filed a lawsuit on the note (she has no defenses, and the amount due is clear from the note).

Administrative Costs:

[Chapter 13 Trustee Commission: 10%]

[Sub V Trustee Hourly Rate: \$300 per hour]

[Debtor Counsel Hourly Rate: \$300 per hour]

- 1) **What Chapter Do You Advise?** Chapter 11 (Sub V) or Chapter 13?
- 2) **VARIABLE:** **NANCY** owns her home which is worth \$500,000, took out a \$1M mortgage on the home with **ALPHA BANK** and used the loan proceeds to buy restaurant equipment. Due to the lawsuit, **ALPHA BANK** declines to renew the loan and it has matured.
- 3) **VARIABLE:** **MARK** is owed **\$10M** (rather than \$500,000) on the promissory note.
- 4) **VARIABLE:** **NANCY** does not own a computer, does her books on a paper ledger, operates mostly in cash, and there is no UST authorized DIP account bank within 100 miles of the restaurant.

HYPOTHETICAL #2
DAN DEBTOR – owner of Action Dan Sports, Inc.

Closed Business: DAN is winding down Action Dan Sports Inc., which was a small chain of sporting goods stores that closed six months ago. DAN has a personal guaranty with **ALPHA BANK** on a secured line of credit, and he is liquidating the remaining \$500,000 in inventory. After the inventory is sold, **ALPHA BANK** will be owed about \$1,000,000.

DAN has just been sued by a former landlord (another personal guaranty) for \$500,000. DAN has \$100,00 in credit card and other consumer debt. **ALPHA BANK** tells DAN that so long as he continues to cooperate liquidating collateral that the bank will “support” a personal bankruptcy.

Assets: DAN is renting, and owns a vehicle worth \$50,000 beyond his allowed exemption. DAN has an out of state family farm worth \$150,000 that he wants to protect. [Net Value in Chapter 7 (Liquidation/Admin Costs): **\$125,000**]

Income/Disposable Income: DAN quickly found work after closing the business, and has a salary of \$150,000 per year (he is above median).

Both the means test and I/J show disposable **monthly income of \$5,000**

Administrative Costs:

[Chapter 13 Trustee Commission: 10%]

[Sub V Trustee Hourly Rate: \$300 per hour]

[Debtor Counsel Hourly Rate: \$300 per hour]

- 1) **What Chapter Do You Advise?** Chapter 11 (Sub V) or Chapter 13?
- 2) **VARIABLE:** **ALPHA BANK** has an SBA guaranty on its loan.
- 3) **VARIABLE:** DAN owes \$250,000 (all unsecured priority) to the IRS.
- 4) **VARIABLE:** DAN was unable to find work after closing the business and has no income. He has been living off non-retirement account savings, which is now fully used (other than what you request for a retainer).

HYPOTHETICAL #3

Allan Alibi-Self Employed Mortgage Broker

Allan has worked as an independent mortgage broker for many years. His income ranges greatly from year to year, but on the whole he averages around \$200,000 a year. For example, in 2018 he earned \$450,000 and 2021 he earned \$30,000.

Allan has taken a very Laissez-Faire approach toward paying taxes and has not filed a tax return since 2018. As a result, the IRS has utilized his income from 2017 and filed substitute for returns resulting in a tax liability of \$240,000 as of today. Allan's current wife has filed returns every year separately and earns about \$100,000 a year. Allan still has not filed tax returns for those missing years, although he purports to have the paperwork to provide to a tax return preparer when necessary.

Last year, Allan and his wife filed a Chapter 7 and wiped out all of his dischargeable unsecured obligations at that time. Allan is looking to file again because the second mortgage lender on his home is attempting to complete a non-judicial foreclosure. The loan on the second mortgage is matured and was originally incurred for a business purpose years ago. Allan's home is worth \$1,000,000. Allan's first mortgage is a debt of \$250,000, and Allan's second mortgage lender also has a debt of \$250,000. In California, where Allan lives, Allan is able to exempt the remainder of the equity in his home and his prior Chapter 7 was a "no asset" matter. Allan's household has no other significant non-exempt assets.

In between the filing of his prior petition and this filing, Allan had sued his prior attorney for malpractice for pre-Chapter 7 activities and lost¹, and further lost on a malicious prosecution claim counterclaimed by the attorney. This claim proceeded to a five day jury trial in which Allan participated and represented himself. Allan now owes this attorney \$300,000 pursuant to that judgment.

Allan can only deposit a retainer of \$10,000 plus the filing fee for whatever Chapter you advise him to file.

The foreclosure is next week (of course).

Questions:

1. Do you take the case?
2. What Chapter do you advise he file?
3. If a further retainer cannot be provided by him, is there any information you would still require before filing that would otherwise prohibit you from filing?

¹ Presume the Chapter 7 Trustee examined the cause of action and abandoned it back to him.

Faculty

Anerio V. Altman is the supervising bankruptcy attorney at Lake Forest Bankruptcy in Laguna Hills, Calif., and has been an attorney of record on more than 900 bankruptcy cases throughout California under chapters 7, 11 and 13. He has also appeared in numerous bankruptcy trials and contested matters in bankruptcy court and has appeared in four published cases as of December 2012. Mr. Altman sits on the board of the Orange County Bar Association's Commercial Law and Bankruptcy Section and on the Orange County Bankruptcy Forum. He also sits on the California Central District Rules Committee for the Bankruptcy Courts. Mr. Altman was admitted to the Southern, Eastern and Northern Districts of California by 2005. He received his J.D. from Case Western University School of Law.

Sumner A. Bourne is a partner with Rafool & Bourne, P.C. in Peoria, Ill., where he primarily represents debtors in chapter 7, 11 and 13 cases, and has confirmed several subchapter V plans. He also is a subchapter V trustee in downstate Illinois, accepting trustee appointments in the Central and Southern Districts of Illinois. Mr. Bourne has experience in representing chapter 7 trustees in preference and other asset-recovery litigation. He is a past chair of the Illinois State Bar Association's section on Bankruptcy practice, and he is a frequent lecturer on bankruptcy issues, having presented for ABI, the Illinois State Bar Association (ISBA), the office of the Illinois Attorney General and the National Association of Bankruptcy Trustees (NABT), among other organizations. Mr. Bourne is a frequent author on bankruptcy issues, most recently focusing on subchapter V, and has been published in the *ABI Journal* and the journal of the NABT. He received his B.S. from the University of Illinois in 1990 and his J.D. *magna cum laude* in 1994 from Boston University School of Law.

David A. Mawhinney is the subchapter V trustee for Region One in Sudbury, Mass., and the standing chapter 13 trustee for the Central and Western Divisions of the District of Massachusetts. He began his career clerking for Hon. Frank J. Bailey of the U.S. Bankruptcy Court for the District of Massachusetts, and he was an associate in the restructuring and insolvency group at K&L Gates LLP in Boston and the bankruptcy, restructuring and workout group at Bowditch & Dewey LLP in Framingham. Mr. Mawhinney is a board member of the National Association of Bankruptcy Trustees, and he is a member of the National Association of Chapter 13 Trustees and the Boston and Worcester County Bar Associations. In 2019, he was honored as one of ABI's "40 Under 40." He was also named one of *Super Lawyers'* 2020 and 2021 "Rising Stars" for Bankruptcy: Business, and he was part of the National Conference of Bankruptcy Judges 2018 Next Generation Program. Prior to entering law school, Mr. Mawhinney worked as a professional actor in New York City. He is a graduate of the American Repertory Theater Institute in Cambridge, Mass., and of Boston College, holds an M.F.A. from the Moscow Art Theater in Russia, and received his J.D. from Boston College Law School.

Hon. Kesha L. Tanabe is a U.S. Bankruptcy Judge for the District of Minnesota in St. Paul, appointed on Jan. 7, 2022, and the first Asian-American woman on the federal bench in Minnesota. She previously was a bankruptcy attorney with Tanabe Law in Minneapolis and is licensed in North Dakota, Minnesota and New York. Judge Tanabe started her career as an assistant attorney general in New York. Prior to starting her own firm, she was a partner at ASK LLP, Maslon LLP and Faegre

Baker Daniels. Additionally, she was a subchapter V trustee in Region 12 and taught bankruptcy law at the University of St. Thomas School of Law. Judge Tanabe is a board-certified business bankruptcy specialist, a former member of the Bankruptcy Practice Committee for the District of Minnesota and a former co-editor in chief of the *MSBA Bankruptcy Bulletin*. She is a frequent lecturer on bankruptcy topics nationwide, and she is a member of several legal and community organizations, including the Japanese American Citizens League, International Women's Insolvency & Restructuring Confederation, Minnesota Asian Pacific American Bar Association and Minnesota Lavender Bar Association. She also served as a Special Projects Leader for ABI's Bankruptcy Litigation Committee. Judge Tanabe is a graduate of the University of St. Thomas and the London School of Economics, and she received her J.D. in 2005 from Cardozo School of Law.