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Problems in the Code

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Oversight Results in Uncertainty for Small Business Owners Converting to Subchapter V

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In February 2020, Congress codified the Small Business Reorganization Act of 2019 (SBRA) as subchapter V of chapter 11 of the Bankruptcy Code.[1] In doing so, Congress established a relative safe haven for eligible small businesses that provides a more streamlined and less costly chapter 11 relief process.[2]

However, in its haste to "permit qualifying small business debtors to file [for] bankruptcy in a timely, cost-effective manner,"[3] Congress seemingly failed to amend § 348(b) — a critical Code section that grants timeline extensions in most instances when cases are converted from one chapter to another.[4] As a result, many small businesses converting their cases to subchapter V quickly find themselves mired in a purgatory of rapidly expiring deadlines and additional litigation, with no consensus on a solution.[5] Whether Congress's omission regarding § 348(b) is by oversight or intent,[6] the recommended solution remains the same: Congress must amend § 348(b) to allow for extensions in subchapter V conversion cases, as they already do with other chapter 11 conversions, to provide judicial clarity and meet the SBRA's intent.

Section 348

Section 348 provides clarity regarding the "effects of conversion" on a debtor's case. Debtors often convert their bankruptcy cases to different chapters of the Bankruptcy Code for various reasons, including unforeseen ineligibility under the original chapter filing or changed circumstances.[7] However, while converting a case to another chapter may be necessary or beneficial to the debtor, conversions present several new complexities. For example, conversions often result in shifting rules regarding the property that makes up the estate, and the passage of time prior to the conversion frequently conflicts with filing deadlines under the new chapter. Section 348 anticipates these issues and provides statutory remedies for most of them.

Section 348(f)(1)(A) clarifies what property makes up the estate in cases converted from chapter 13 to another chapter.[8] In addition, § 348(b) addresses expired — or rapidly expiring — filing deadlines under enumerated sections that arise when debtors convert to a new chapter.[9] For example, § 1121(b) provides that under a chapter 11 case, "only the debtor may file a plan until 120 days after

1 *See* Small Bus. Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 1079.
2 *In re Thurmon*, 625 B.R. 417, 419 (Bankr. W.D. Mo. 2020).
3 *In re Keffer*, 628 B.R. 897, 905 (Bankr. S.D. W.Va. 2021) (quoting *In re Seven Stars on the Hudson Corp.*, 618 B.R. 333, 339-40 (Bankr. S.D. Fla. 2020)).
4 *Id.*; *see also* 11 U.S.C. § 348(b).
5 *See generally Keffer*, 628 B.R. 897; *In re Seven Stars on the Hudson Corp.*, 618 B.R. 333; *In re Trepetin*, 617 B.R. 841 (Bankr. D. Md. 2020); *In re Tibbens*, No. 19-80964, 2021 WL 1087260 (Bankr. M.D.N.C. Mar. 19, 2021). The court in each of these cases comes to its conclusion in a different manner.
6 It is difficult to know whether Congress's failure to amend § 348(b) was intentional or not, but circumstantial evidence indicates that it was most likely unintentional. First, § 348 was originally drafted in 1978 and last amended in 2010 (*see* Pub. L. No. 95-598, 92 Stat. 2568; Pub. L. No. 111-327, 124 Stat. 3558), while the SBRA was not even drafted until 2019. *Supra* n.1. In addition, aside from § 348, the key language — "the order for relief under this chapter" — is only contained in 16 other sections. *See* §§ 701, 727, 923, 1102, 1110, 1121, 1141, 1188, 1189, 1192, 1201, 1221, 1228, 1301, 1305 and 1328. Of those 16 sections, 11 are incorporated into § 348(b). *Id.*; *see also* § 348(b). Of the five unincorporated sections, three of them are from the newly codified subchapter V. *See* §§ 1188, 1189 and 1192. This is noteworthy because *all* other chapter 11 sections using the key language are incorporated into § 348. *See* §§ 348(b), 1102, 1110, 1121 and 1141. Thus, to find that Congress's omission was intentional, one would have to assume that Congress intended to incorporate all other relevant chapter 11 sections but chose to exclude the relevant subchapter V sections. The more plausible explanation is that Congress simply failed to account for amending § 348 when it created subchapter V with the SBRA.
7 *Supra* n.5.
8 11 U.S.C. § 348(f)(1)(A).
9 *See* 11 U.S.C. § 348(b) ("Unless the court for cause orders otherwise, in sections 701(a), 727(a)(10), 727(b), 1102(a), 1110(a)(1), 1121(b), 1121(c), 1141(d)(4), 1201(a), 1221, 1228(a), 1301(a), and 1305(a) of this title, "the order for relief under this chapter" in a chapter to which a case has been converted under section 706, 1112, 1208, or 1307 of this title means the conversion of such case to such chapter.").

the date of *the order for relief under this chapter*" to file a plan.[10] After a debtor converts their case to chapter 11, confusion is likely to ensue over when the 120-day deadline to file a new plan began. Was it the date that the order for relief under the *original* chapter was granted, or the date of conversion? If the former, this could be particularly stressful for a debtor when a substantial amount of time has passed since the original filing, and a filing deadline under the new chapter is either looming or lapsed.

Luckily, § 348(b) provides a cogent solution to this common issue. To resolve the possible ambiguity, § 348(b) provides that in cases that have been converted under §§ 706, 1112, 1208 or 1307, "the order for relief under this chapter" in § 1112(b) — and 12 other enumerated sections of chapters 7, 11, 12 and 13 — "means the conversion of such case to such chapter."[11] Thus, in effect, § 348(b) grants automatic extensions to debtors under these enumerated sections by "resetting the clock" for filing deadlines to the date of conversion.

The Omission

Unfortunately, when Congress codified the SBRA, it did not amend § 348(b) to incorporate the sections of subchapter V containing deadlines.[12] For example, § 1189, which provides for a 90-day deadline for debtors to file a plan under subchapter V, is not incorporated in § 348(b). As a result, after converting to subchapter V proceedings, small business debtors are not eligible for the same "extension" to file a plan under § 1189 that § 348(b) automatically grants under § 1121(b) for debtors who convert to chapter 11. Instead, they find themselves immediately scrambling to file for an extension before the 90-day deadline lapses, if it has not already.[13]

Although the requirement for additional litigation to attain an extension is not an insurmountable death knell,[14] at a minimum it frustrates Congress's intent for a streamlined and cost-effective proceeding for qualified small businesses.[15] This frustration is amplified by the fact that the additional litigation would be wholly unnecessary if a debtor had converted the case to a general, *non-small-business-friendly* chapter 11 proceeding, and so is only necessary due to Congress's failure to amend § 348(b) when codifying the SBRA.

How Courts Have Dealt with the Omission

Although only a handful of courts have issued opinions on a debtor's request for extensions under § 1189 after converting to subchapter V, the disparate results of those courts underscore the urgency of the issue at hand.[16] One court adopted a strict interpretation and held that debtors immediately placed themselves in default of § 1189(b) when they elected to convert to subchapter V, claiming that "Congress purposefully set a short deadline for a debtor to file a plan" and "set a very high standard for an extension of that deadline."[17]

Another court held that a "court may extend deadlines in § 1189 even after the periods have lapsed" when the need for the extension is "due to circumstances for which the debtor should not justly be held accountable."[18] However, the judge in that case went on to deny the requested extension because numerous delays were "fully within the debtor's control," before offering limited consolation that his ruling was not fatal to the debtor's case because "a late-filed plan [does not] doom a subchapter V case."[19]

In another case, which cited both aforementioned cases, the court noted that no courts "have articulated any kind of step-by-step basis upon which to evaluate motions to convert filed after deadlines ... have passed" before establishing its own "evaluative device."[20] Although the court's analysis is coherent, metered and fair — and arguably debtor-friendly — its complex evaluation also provides the best possible illustration for understanding the necessity for Congress to amend § 348(b) to incorporate §§ 1188 and 1189.[21] The court started with an analysis of whether conversion was appropriate under § 1307(d) — the chapter in which the debtor initially filed — before moving on to the question of whether conversion or immediate dismissal was proper in the new chapter under § 1112(b).[22]

Before deciding on § 1112(b), the court engaged in a circular analysis by first ensuring that the debtor did not run afoul of § 1189 to confirm that § 1112(b)(4)(j) was not triggered.[23] Next, after determining whether conversion was proper, the court finally engaged in evaluating the request for extension, but noted that the extension request must be made by a *separate motion*, and still left open the possibility that the extension request may be denied by the court for cause, fault or other bad faith.[24]

The Practical Effect of an Overly Complicated Judicial Analysis

Although the *Keffer* court provides an effective analysis that may offer the best option for courts evaluating these cases in the future, it should be noted that the resulting "evaluative device" is overly complex and inconsistent with the principles of judicial efficiency and consistency.[25] In fact, some debtors might even hesitate to convert to the streamlined subchapter V proceeding designed specifically for them due to this uncertainty of outcome.[26] Moreover, the litigious framework made necessary by the omission of subchapter V

10 11 U.S.C. § 1121(b) (emphasis added).
11 11 U.S.C. § 348(b).
12 *Id.*; *see also* 11 U.S.C. § 1189.
13 *See, e.g., In re Keffer*, 628 B.R. at 899.
14 *See In re Tibbens*, 2021 WL 1087260, at *6 (stating that Congress did not intend to have late-filed plan doom subchapter V case).
15 *Keffer*, *supra* n.3.
16 *Supra* n.5.
17 *In re Seven Stars on the Hudson Corp.*, 618 B.R. at 338-39, 345.
18 *In re Tibbens*, 2021 WL 1087260, at *8.
19 *Id.* at *6, *9.
20 *In re Keffer*, 628 B.R. at 909.
21 *Id.*
22 *Id.*
23 *Id.* Section 1112(b)(4)(j) states that "failure to ... file or confirm a plan, within the time fixed by this title," is grounds for "cause" to dismiss under § 1112(b)(1), thus a debtor requesting conversion after the expiration of the 90-day timeline to file a plan under § 1189 might automatically qualify for dismissal. However, the court reasoned that as long as the grounds for the requested extension are "attributable to circumstances for which the debtor should not justly be held accountable" per § 1189, § 1112(b)(4)(j) is not triggered, and conversion — rather than dismissal — is proper.
24 *Id.*; *see also In re Tibbens*, 2021 WL 1087260, at *9 (declining to extend deadlines, stating that numerous delays "occurred in the administration of the chapter 13 case that were fully within the debtor's control and for which he should be held accountable").
25 *In re Keffer*, 628 B.R. at 909; *see also In re Seven Stars on the Hudson Corp.*, 618 B.R. 333; *In re Trepetin*, 617 B.R. 841; *In re Tibbens*, No. 19-80964, 2021 WL 1087260 (noting disparate analyses and outcomes in various jurisdictions).
26 *Id.*

sections from § 348(b) is inconsistent with congressional intent regarding subchapter V. While denial of a § 1189 extension following conversion might not be fatal to a debtor's case *per se*, debtors are nonetheless required to litigate the same things multiple times, which results in additional filings, time and costs.[27] This runs in direct contradiction to Congress's noted intent for subchapter V to "permit qualifying small business debtors to file [for] bankruptcy in a timely, cost-effective manner."[28]

Even the *Keffer* court noted that "it would have been helpful for Congress to [have provided] some guidance with respect to conversion from other bankruptcy chapters" before arriving at the conclusion that "it is up to the courts to interpret those laws" as best they can when unforeseen circumstances require debtors to convert their proceedings midstream.[29] In *Trepetin*, the court noted that Congress expressed "significant concern for small business debtors, wanting to provide them with a *realistic option* for reorganizing and saving their business operations" that "balance[d] the ... goals of speed and access."[30] Thus, it stands to reason that Congress did not intend the current result where debtors face the prospect of potential *denial* of conversion to subchapter V or, at best, the prohibitively expensive purgatory of *additional litigation* necessitated by compulsory extensions due to an unanticipated conversion.

The Recommendation

As the *Keffer* court noted, "[s]ubchapter V is a valuable tool for qualifying debtors and will facilitate reorganizations that were not possible before."[31] However, it is not a valuable tool for small business owners when a small oversight in the process of statutory amendment leaves them in a purgatory of uncertainty, time and cost. Therefore, consistent with congressional intent for the SBRA and in the interests of judicial efficiency, it is imperative that Congress amend § 348(b) to incorporate the relevant sections from subchapter V conversion cases as they already do with all other chapter 11 conversions. abi

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27 *In re Keffer*, 628 B.R. at 909 (noting that *Keffer* court framework requires that appropriateness of conversion be evaluated under two different chapters and § 1189 be litigated at two different steps in framework, with second final, dispositive § 1189 analysis requiring *separate motion*).
28 *Id.* at 905 (quoting *In re Seven Stars on the Hudson Corp.*, 618 B.R. at 339-40).
29 *In re Keffer*, 628 B.R. at 910; *see also In re Tibbens*, 2021 WL 1087260, at *4. In *Keffer*, the debtor did not know they could not file under chapter 13 until after the Internal Revenue Service processed their tax returns, while the debtor in *Tibbens* had to convert from chapter 13 because they discovered that they exceeded the debt limitations of chapter 13 cases after filing.
30 *In re Trepetin*, 617 B.R. at 846-47 (emphasis added).
31 *In re Keffer*, 628 B.R. at 910.