

BURR ALERT

You Can Come In, But You Can't Stay - Judge Grossman Dismisses Debtor's Case for Re-designating Under the SBRA After Deadlines Have Passed. Seven Stars on the Hudson Corp., Case No. 19-17544-SMG (Bankr. S.D. Fla. Aug. 7, 2020).

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"Timing in Life Is Everything" – John Sculley

Relying on a plain reading of Sections 1188 and 1189 of the Bankruptcy Code, Bankruptcy Judge Scott M. Grossman dismissed the *Seven Stars* bankruptcy case¹ based on the debtor's election to proceed under Subchapter V of Chapter 11² after the expiration of the statutory deadlines for filing a plan and holding a status conference. Judge Grossman declined to extend these statutory deadlines since the timing of the debtor's election to proceed under Subchapter V – several months after the expiration of these deadlines – was the debtor's voluntary decision and not a "circumstance beyond the debtor's control." The Court expressly disagreed with three decisions by bankruptcy judges in other states that have permitted debtors to re-designate their cases under Subchapter V and liberally granted extensions of these statutory deadlines.³

The Small Business Reorganization Act

The Small Business Reorganization Act of 2019 (the "SBRA") was enacted on August 23, 2019, with an effective date of February 19, 2020.⁴ The SBRA created a new Subchapter V of the Bankruptcy Code to "streamline the bankruptcy process by which small business debtors reorganize and rehabilitate their financial affairs."⁵ The SBRA is silent on whether it applies to pending cases or only cases filed after the effective date. This silence has led to litigation in several courts around the nation as "straddle" debtors⁶ seek to take advantage of the SBRA's procedural efficiencies and reduced costs during the COVID-19 pandemic.⁷

The SBRA provides qualifying debtors with "the opportunity to use new, powerful tools to reorganize and save its business; but it must do so quickly."⁸ The SBRA does not require the appointment of a

¹ *In re Seven Stars on the Hudson Corp.*, 19-17544-SMG (Bankr. S.D. Fla. Aug. 7, 2020).

² 11 U.S.C. §§ 1181-1195 (2020).

³ See *In re Trepetin*, 20-11718, 2020 WL 3833015 (Bankr. D. Md. July 7, 2020); *In re Ventura*, 18-77193, 2020 BL 134496, 2020 WL 1867898 (Bankr. E.D.N.Y. April 10, 2020); and *In re Twin Pines LLC*, 19-10295, 2020 Bankr. Lexis 1217 (Bankr. D.N.M. April 30, 2020).

⁴ Small Business Reorganization Act of 2019, Pub. L. No. 116-54, Aug. 23, 2019, 133 Stat. 1079, 1087.

⁵ H.R. Rep. No. 116-171, at 1 (2019).

⁶ A debtor whose bankruptcy case was filed before the effective date, but is still pending after the effective date.

⁷ *Seven Stars*, ECF 193, at 10, n. 51-53 for collection of cases. See also Dana L. Robbins & Jonathan Sykes, *Congress Giveth and Congress Taketh Away: The "Retroactive" Availability of Subchapter V*, AM. BANK. INST. J., July 2020, at 16 (a detailed analysis of these cases and the retroactive application of the SBRA to pending bankruptcy cases).

⁸ *Seven Stars*, ECF 193, at *20.

creditors committee⁹ or the filing of a disclosure statement.¹⁰ Further, a debtor has the exclusive right to file a plan,¹¹ does not need to comply with the absolute priority rule,¹² may stretch out payment of certain administrative expense claims,¹³ and can confirm a plan without the vote of creditors.¹⁴

But, in return for these benefits, the SBRA imposes strict deadlines on debtors. Among other things, a debtor must file a plan no later than 90 days after the order for relief¹⁵ and the court must hold a status conference no later than 60 days after the order for relief.¹⁶ The court may extend these deadlines only upon a finding “the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable.”¹⁷

So, what happens when a debtor seeks to re-designate its pending case under Subchapter V after these deadlines have already expired? While three other courts have freely granted extensions of the statutory deadlines, Judge Grossman declined to grant such extensions under a plain reading of the applicable statutes and rules. Without these extensions, the *Seven Stars* case was dismissed for cause under Section 1112(b)(4)(J).

Seven Stars Bankruptcy Case

Seven Stars on the Hudson Corp. (“Seven Stars”) filed its Chapter 11 case on June 5, 2019. Seven Stars operated a trampoline park in Broward County, Florida. A central dispute in the case was whether Seven Stars could assume its real property lease with its landlord MDG Powerline Holdings, LLC (“MDG”). Seven Stars filed a motion to assume on October 3, 2019, which was opposed by MDG. The hearing was continued several times with the last requested continuance being granted on March 3, 2020, with a rescheduled hearing date of April 29, 2020. Shortly after this continuance, President Trump declared a national emergency due to the COVID-19 pandemic and Broward County ordered the closure of non-essential businesses, including Seven Stars’ business. Seven Stars remained closed well into June 2020.

The parties continued to litigate the lease assumption issue during the government-ordered closure. After extensive briefing and argument, the Court granted Seven Stars’ motion to assume on June 1, 2020. The Court permitted Seven Stars to defer the payment of accrued and unpaid post-petition rent (*i.e.*, April and May rent) until no later than the effective date of a Chapter 11 plan à la *Pier 1 Imports*.¹⁸ This would require Seven Stars to pay \$130,000 in unpaid post-petition rent no later than the effective date of a Chapter 11 plan.

On June 19, 2020, Seven Stars amended its voluntary petition to re-designate as a debtor under Subchapter V of Chapter 11, which was “over a year after its petition date, four months after the February 19, 2020, effective date of the [SBRA], and about three weeks after the Court ruled that it

⁹ 11 U.S.C. § 1181(b), 1102(a)(3).

¹⁰ 11 U.S.C. § 1181(b).

¹¹ 11 U.S.C. § 1189(a).

¹² 11 U.S.C. §§ 1181(a), 1191(b).

¹³ 11 U.S.C. § 1191(e).

¹⁴ 11 U.S.C. § 1191(b).

¹⁵ 11 U.S.C. § 1189(b).

¹⁶ 11 U.S.C. § 1188(a).

¹⁷ 11 U.S.C. §§ 1188(b), 1189(b) (the sections use identical language except Section 1188(b) uses “an” instead of “the” before the word extension).

¹⁸ *In re Pier 1 Imports, Inc.*, 615 B.R. 196, 202 (Bankr. E.D. Va. 2020).

must pay MDG \$130,000 on the effective date of a Chapter 11 plan.”¹⁹ Seven Stars was well beyond the Section 1188 and 1189 statutory deadlines for filing a plan and holding a status conference, respectively, at the time of making its election. Seven Stars would need a Court extension of these deadlines to avoid a dismissal of its bankruptcy case.

Judge Grossman's Plain Reading of the SBRA

Judge Grossman focused his analysis on the plain reading of the statute and therefore did not dive into an analysis of the amorphous concepts surrounding “vested rights” and “retroactivity” present in other recent opinions.²⁰ The Court first addressed Seven Stars’ ability to amend its voluntary petition to elect treatment under Subchapter V. Judge Grossman quickly found that Seven Stars possessed the ability to amend its voluntary petition to elect Subchapter V status pursuant to Bankruptcy Rule 1009 and Interim Rule 1020.²¹ Nothing in these rules prevents such an election, notwithstanding Subchapter V was not available at the time of the initial bankruptcy filing.²²

But, just as quickly, Judge Grossman found that Seven Stars, by making this election more than a year after the order for relief, immediately placed itself in default of the Sections 1188(b) and 1189(b) deadlines.²³ On June 24, 2020, the Court issued an *Order to Show Cause Why Case Should Not Be Dismissed*²⁴ since “cause” facially existed for dismissal under Section 1112(b)(4)(J) due to Seven Stars’ failure to file a plan within the Section 1189(b) deadline.²⁵

To avoid dismissal under Section 1112(b)(4)(J), Seven Stars would need the Court to extend the Section 1188(a) and 1189(b) deadlines. As stated previously, the statutory ground for granting an extension of these deadlines is “the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable.”²⁶ Judge Grossman concluded a plain reading of this phrase implies a “clearly higher standard than the mere ‘for cause’ standard” in other parts of the Bankruptcy Rules and Bankruptcy Code.²⁷ Further, although this phrase is not defined in Subchapter V, the identical phrase is used in Section 1221 of the Bankruptcy Code. By looking to cases interpreting Section 1221 and *Collier on Bankruptcy*, Judge Grossman found the standard is a stringent burden that requires finding the delay necessitating the extension was caused by “circumstances beyond the debtor’s control.”²⁸

Judge Grossman ruled that Seven Stars’ election to proceed under the SBRA was not a circumstance beyond the debtor’s control.²⁹ Quite the contrary, Seven Stars’ decision to elect SBRA treatment after the expiration of these deadlines was completely within its control.³⁰ When making the election, Seven Stars (or its counsel) was fully aware that these deadlines had expired many months ago. The Court

¹⁹ *Seven Stars*, ECF 193, at *5.

²⁰ *Id.* at *12-13, n. 60 & *20, n. 82. *See also*, n. 6 *supra*.

²¹ Fed.R.Bankr.P. 1009, Interim Bankruptcy Rule 1020.

²² *Seven Stars*, ECF 193, at *12.

²³ 11 U.S.C. §§ 1188(b), 1189(b).

²⁴ *Seven Stars*, ECF 179.

²⁵ *See* 11 U.S.C. § 1112(b)(4)(j) (“[T]he term ‘cause’ includes . . . (J) failure to file a disclosure statement or to file or confirm a plan, within the time fixed by this title or by order of the court.”).

²⁶ 11 U.S.C. §§ 1188(b), 1189(b).

²⁷ *Seven Stars*, ECF 193, at *15.

²⁸ *Id.*

²⁹ *Id.* at *21.

³⁰ *Id.*

refused to extend these statutory deadlines by finding “[t]he debtor *should* justly be held accountable for those circumstances; the debtor made this election after the deadlines expired.”³¹

Judge Grossman expressly disagreed with *Trepetin, Ventura, Twin Pines*, and other cases that liberally interpret Sections 1188(b) and 1189(b) to permit extensions of these deadlines for a debtor who elects Subchapter V treatment after these deadlines have already passed.³² The Court rejected the notion that a debtor’s compliance with these deadlines was excused due to the SBRA being enacted only after these deadlines had expired in these cases.³³ In fact, when discussing the *Trepetin* decision, Judge Grossman states “[t]hat new Subchapter V became available after [the debtor] filed his Chapter 7 case is not – in this Court’s view – such a circumstance beyond the debtor’s control that would justify an extension.”³⁴ The Court felt these other courts were “picking and choosing” which Subchapter V provisions to apply to a debtor’s case.³⁵ The Court disagreed and held that “if a debtor elects to proceed under Subchapter V, it must comply with *all* its provisions, including statutory timelines.”³⁶

Judge Grossman also dismissed the notion that the COVID-19 pandemic created a circumstance that would justify an extension of the deadlines. The Court provided a hypothetical of a debtor who filed a Chapter 11 case under Subchapter V shortly after the SBRA’s effective date (one day after the effective date, in fact) and began to work diligently with the Subchapter V trustee to prepare financial projections and negotiate plan terms with creditors.³⁷ For this hypothetical debtor, the ensuing COVID-19 pandemic and subsequent closure of non-essential business would establish sufficient grounds for an extension of the statutory deadlines.³⁸ This debtor would need to rework financial projections and renegotiate with creditors based upon the financial impact of the COVID-19 pandemic and government-ordered closures.³⁹ These circumstances would prevent the debtor from meeting the statutory deadlines and establish “the need for an extension attributable to circumstances for which the debtor should not just be held accountable.”⁴⁰

Judge Grossman found this hypothetical situation very different from Seven Stars’ current predicament. Seven Stars’ inability to meet the statutory deadlines was not due to the COVID-19 pandemic or that Subchapter V was not available when it first filed its case. Seven Stars’ inability to meet the deadlines was due to its decision to re-designate under Subchapter V when it already knew these deadlines had passed. It was simply too late for Seven Stars to take advantage of Subchapter V when it made the election. Judge Grossman acknowledged the potential unfairness of this timing issue, but dismissed it as dictated by proper statutory interpretation.⁴¹

Observations

Subsequent litigation will reveal which interpretation becomes the majority approach and which is shunted to the minority approach. Will Judge Grossman’s “plain reading” interpretation prevail in the

³¹ *Id.*

³² *Id.*

³³ *Id.* at *17.

³⁴ *Id.*

³⁵ *Id.* at *18.

³⁶ *Id.*

³⁷ *Id.* at *18-19.

³⁸ *Id.* at *19.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.* at *20 (“Does this create an unfair distinction? Perhaps it does. But does it dictate the right result under the statute? This Court thinks it does.”).

long term or will the “liberal interpretation” of the *Trepetin* line of cases prevail? In the short term, the *Trepetin* line of cases may seem to yield a fairer result. Is it fair to hold debtors to Subchapter V statutory deadlines that were not even available at the time of their bankruptcy filing? These debtors were simply caught in an unfortunate straddle period that was not addressed by Congress when enacting the SBRA.⁴² Should bankruptcy courts liberally grant extensions to help these debtors? Are they victims of circumstance attributable to Congress’ oversight of these straddle period issues?

Perhaps. But, Judge Grossman is taking a longer view of the issue that will be with the courts for years after the straddle period has passed into history. The Court has told us as much,

While issues of retroactive application to pending cases and related due process implications are certainly important, they will, over time, be less important to SBRA jurisprudence as we get further away from the SBRA’s effective date. But the issue addressed by the Court here – the effect of amending a petition to elect Subchapter V status after the expiration of the Section 1188 and 1189 statutory deadlines – could arise in the future regardless of whether a case was filed before or after the SBRA effective date.⁴³

The Court is addressing the specter of a much larger threat to the bankruptcy system: the waste of limited judicial resources and abuse of the bankruptcy process. The Court was concerned that Seven Stars was seeking re-designation under Subchapter V to avoid Judge Grossman’s earlier ruling that Seven Stars would need to pay \$130,000 in accrued unpaid rent on the effective date of a Chapter 11 plan.⁴⁴ Was Seven Stars re-designating to Subchapter V in the hopes of stretching out the repayment of this administrative expense claim over time? Judge Grossman did point out in a lengthy footnote that, although Subchapter V permits debtors to stretch out the repayment of certain administrative expenses over the life of a plan, unpaid administrative rent is not one of these types of administrative expense claims.⁴⁵ In other words, re-designation was not going to be this debtor’s panacea even if the extensions were granted. Which begs the question, why the Court did not grant the extensions and address the administrative rent issue directly?

The *Seven Stars* decision is a warning to debtors who run through a traditional Chapter 11 case (or, under any other chapter) and, when unable to achieve their desired goals, seek to re-designate as a Subchapter V case to take a second bite at the apple long after the Subchapter V statutory deadlines have passed.⁴⁶ Yes, Subchapter V provides new, powerful tools to debtors to reorganize and save their business. But, a debtor will not be permitted to “foist upon creditors all of the added powers of a Subchapter V debtor without one of the most significant protections afforded to creditors under the SBRA – that the case proceeds expeditiously.”⁴⁷

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⁴² Congress did raise the Subchapter V debt limit from \$2,725,625 to \$7,500,000 in response to the COVID-19 pandemic, but did not address the retroactive application issue. Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, March 27, 2020, 134 Stat. 281, 310-311 (the “CARES ACT”).

⁴³ *Seven Stars*, ECF 193, at *10, n. 53.

⁴⁴ See *Seven Stars*, ECF 193, at *5 (“Due to an apparent inability to make that payment . . . it elected to proceed under Subchapter V of Chapter 11 of the Bankruptcy Code.”).

⁴⁵ *Id.* at *20, n. 82 (discussion of interplay between 11 U.S.C. § 1191(e) and 11 U.S.C. § 365).

⁴⁶ *Id.* at *20-21.

⁴⁷ *Id.* at *21.

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