Business Disputes in Bankruptcy Court in the Era of COVID-19

July 10, 2020

Speaker:

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Woods Oviatt Gilman LLP

[with additional materials by Joseph W. Allen, Esq., Office of the U.S. Trustee, and Garry M. Graber, Esq., Hodgson Russ LLP]

UB Law Alumni Association and GOLD Group

William F. Savino, Esq.

William F. Savino is a Partner in the Litigation Department of Woods Oviatt Gilman LLP. His practice focuses on matters involving business litigation (including construction, corporate and partnership dissolution, accounting malpractice, and Uniform Commercial Code matters) and insolvency (both debtor and creditor) with an emphasis on reorganizations. Mr. Savino also mediates corporate and commercial disputes, including those arising out of the organization, operation and dissolution of corporations, partnerships, limited liability companies and joint ventures.

In May of 2019 Mr. Savino was named the recipient of the Ken Joyce Excellence in Teaching Award by the University at Buffalo School of Law. This award is given to a member of the adjunct faculty for excellent teaching and longstanding service to the School of Law. In May of 2014, he was honored as a Distinguished Alumni for Business at the 52nd annual University at Buffalo Law School alumni dinner. Mr. Savino has repeatedly earned the designation as a Top 10 Upstate New York Attorney and was ranked third in 2013 by *Super Lawyers* magazine. He has also been named as one of the 2017 Top 50 Upstate New York Attorneys. Mr. Savino has also been selected by his peers for inclusion in this year's edition of The Best Lawyers in America® in the fields of Commercial Litigation, Litigation - Construction, Litigation - Bankruptcy and Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law. Mr. Savino has been named in the Best Lawyers' 2018 Buffalo Litigation - Construction "Lawyer of the Year" and was named Best Lawyers' 2020 Buffalo Litigation - Bankruptcy "Lawyer of the Year." Additionally, he has been listed as one of Business First of Buffalo's Who's Who in Law" List for the past seven years. He has also been named a Legal Elite in Western New York for 2019.

Honors

Mr. Savino has repeatedly earned the designation as a Top 10 Upstate New York Attorney and was ranked third in 2013 by *Super Lawyers* magazine. He was named as one of the Top 50 Upstate New York Attorneys in 2015. Mr. Savino has also been selected by his peers for inclusion in The Best Lawyers in America® in the fields of Commercial Litigation, Litigation - Construction, Litigation - Bankruptcy and Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law. Mr. Savino has been named in the Best Lawyers' Buffalo Litigation current edition - Bankruptcy "Lawyer of the Year." Additionally, he has been listed as one of Business First of Buffalo's Who's Who in Law" List for the past seven years. Mr Savino is ranked in *Chambers* annually.

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PART I

EXHIBIT A

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

ADMINISTRATIVE ORDER

COURT PROCEEDINGS DURING COVID-19
PUBLIC HEALTH EMERGENCY

The State of New York has declared a public health emergency as a result of the introduction of the COVID-19 virus into the general population. In order to facilitate the continuance of its operations during this time of crisis, the Court will immediately implement the following procedures with regard to all matters assigned for consideration by Chief Bankruptcy Judge Carl L. Bucki, Bankruptcy Judge Paul R. Warren or Bankruptcy Judge Michael J. Kaplan:

1. Unless the presiding judge directs otherwise in a particular case, the Court will allow only telephonic appearances for the duration of this order. To appear telephonically, parties should call the telephone conference system sufficiently in advance of the assigned time by (1) dialing (571)353-2300; (2) when prompted for the "number you wish to dial" dial 066128168# for Judge Bucki, 222186610# for Judge Warren and 790038600# for Judge Kaplan; and (3) when prompted for the security pin enter 9999#. Parties are encouraged to advise chambers of their intent to participate, in order to allow the Court to anticipate their presence.

2. Telephonic appearances will connect directly to the Court's audio and electronic recording equipment to create an official record. To facilitate the creation of that record, it is necessary to avoid background noise. For this reason, the Court discourages the use of speaker phones, public telephones, and phones while driving or in a public place.

3. Telephonic attendance at any proceeding will continue to be subject to the Local Bankruptcy Rules for the Western District of New York. In particular, parties are reminded of the applicability of Local Rule 5073-1, which prohibits the making of

oral or video tape recordings or radio or television broadcasting of courtroom proceedings.

4. The Court hereby suspends all requirements for submission of paper copies of documents that have been duly filed with the Clerk of Court. Parties are encouraged to submit proposed orders electronically. Arrangements for such submissions should be made with the chamber staff of the presiding judge.

5. Any party required to appear at a scheduled hearing or conference may request a continuance by submitting an adjournment request setting forth the basis for the continuance and indicating whether the consent of all other interested parties has been obtained. After taking into account all relevant health concerns, the court will give appropriate consideration to the requests for adjournment.

6. Matters scheduled for consideration in Batavia, Mayville, Niagara Falls or Olean will be the subject of separate direction from the Court.

7. This order shall remain in effect until June 30, 2020, but may be extended to the extent that circumstances compel.

8. During these times of health emergency, the Court may find it necessary to change its practices on short notice. For updated information, please access the court's website at www.nywb.uscourts.gov. This website will also contain links to notices regarding policies adopted by the Office of the United States Trustee and the Office of the Chapter 13 Trustee.

Dated: May 28, 2020

HONORABLE CARL L. BUCKI
Chief Judge, United States Bankruptcy Court

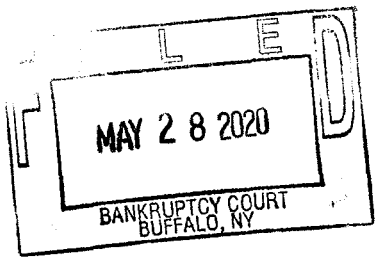

EXHIBIT B

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

ADMINISTRATIVE ORDER 20-3

COURT PROCEEDINGS DURING COVID-19
PUBLIC HEALTH EMERGENCY

WHEREAS, New York State has declared a public health emergency due to the introduction of the COVID-19 virus ("Virus") into the general population; and

WHEREAS, to safeguard the population and avoid the further spread of the Virus, public health officials have advised as a precautionary measure to limit the number of persons who gather in one place; and

WHEREAS, parties in bankruptcy matters pending in all three divisions of the United States Bankruptcy Court for the Northern District of New York ("Court") regularly appear in person for scheduled hearings and conferences at which multiple matters are heard and numerous parties are present in the courtrooms; now, therefore, to comply with the health recommendations, beginning the week of Monday, March 23, 2020, and until further notice, it is

ORDERED that all scheduled Court hearings and conferences held in any courthouse in the Northern District (James M. Hanley United States Courthouse & Federal Building in Syracuse, Alexander Pirnie United States Courthouse & Federal Building in Utica; and the James T. Foley United States Courthouse in Albany), will be conducted telephonically.[1] The Albany and Syracuse Divisions shall conduct hearings by use of an AT&T conference line, with the call-in numbers

[1] Because telephonic appearances connect directly to the Court's audio and electronic recording equipment to create an official record, all participants must be able to hear the proceeding without difficulty or echo. For this reason, the use of speakerphones and public phones is prohibited and the use of phones while driving or in public places is discouraged.

circulated to the general attorney bar by means of Gov.Delivery. The Utica Division shall continue to use its standard CourtCall procedures which can be found on the Court's website. (https://www.nynb.uscourts.gov/content/judge-diane-davis under the tab, "Telephone Appearances").

Any party required to appear at a scheduled hearing or conference may request a continuance by filing the normal adjournment request setting forth the basis for the requested continuance and indicating whether the consent of all other interested parties has been obtained. Subject to the discretion of the presiding judge, adjournment requests will be viewed favorably; and it is further

ORDERED that evidentiary hearings and trials may proceed as scheduled. The parties are directed to contact the courtroom deputy in the division of the Court in which the matter is scheduled to confirm, as the date approaches, that the evidentiary hearing or trial will proceed as scheduled. Contact information for the courtroom deputies is as follows:

Syracuse Division:	NYNBCRD@nynb.uscourts.gov
Albany Division:	Theresa_O'Connell@nynb.uscourts.gov
Utica Division:	Colleen_Johnson@nynb.uscourts.gov

And, it is further ORDERED that the Court shall remain open for all other business—staff in the Clerk's Office shall be available by email and telephone, mail will be received and processed, intake desks will remain open and electronic filings and access shall continue through the CM/ECF system; and it is further

ORDERED that as the public continues to utilize Court services and interact with court personnel, users shall follow all applicable public health guidelines.

SO ORDERED.

Dated: March 17, 2020
Syracuse, NY

Margaret Cangilos-Ruiz
Chief United States Bankruptcy Judge, N.D.N.Y.

EXHIBIT C

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	:	
	:	
CORONAVIRUS/COVID-19 PANDEMIC,	:	
COURT OPERATIONS UNDER THE EXIGENT	:	General Order M-543
CIRCUMSTANCES CREATED BY COVID-19	:	
	:	

In order to protect public health, and in recognition of the national emergency that was declared by the President of the United States on March 13, 2020, the United States Bankruptcy Court for the Southern District of New York ("Bankruptcy Court") hereby issues the following order:

IT IS HEREBY ORDERED, effective immediately and until further notice, that:

1. **Hearings and Conferences**. All hearings and conferences scheduled to be held in courthouses comprising the Manhattan Division, White Plains Division, and Poughkeepsie Division of the Bankruptcy Court will be conducted **telephonically** pending further Order of the Bankruptcy Judge assigned to the matter ("Bankruptcy Judge"). Any party wishing to appear in person at a hearing or conference shall file or submit an appropriate motion or request, which will be considered by the Bankruptcy Judge. Any party may request an adjournment of a hearing or conference by filing or submitting an appropriate motion or request setting forth the basis for the adjournment in conformity with the Bankruptcy Judge's procedures for requesting adjournments. All attorneys, witnesses and parties wishing to appear at, or attend, a telephonic hearing or conference must refer to the Bankruptcy Judge's guidelines for telephonic appearances and make arrangements with **Court Solutions LLC**. Pro se parties, Chapter 7 Trustees and Ch 13 Trustee may participate telephonically in hearings free of charge using Court Solutions. The instructions for registering with Court Solutions are attached hereto.

2. **Evidentiary Hearings and Trials**. Parties should contact the Bankruptcy Judge's courtroom deputy or law clerk assigned to the case to inquire about whether an upcoming evidentiary hearing or trial will proceed as scheduled and be prepared to discuss procedures and technology for conducting the evidentiary hearing remotely.

3. **Official Record**. In order to assist the Bankruptcy Court in creating and maintaining the official record of proceedings before it, and to facilitate the availability of official transcripts of the proceedings, Bankruptcy Court personnel are permitted to utilize tools made available through Court Solutions to record telephonic hearings, conferences and trials. Such recordings shall be the official record. Transcripts can be ordered and corrected in the same way as before the issuance of this Order.

4. **Clerk's Office and *Pro Se* Filings**. Until further notice, the three Divisions of the Bankruptcy Court will remain open for all other business. Clerk's Office personnel are available by telephone, mail will be received, and the intake desks will remain open to receive *pro se* filings. *Pro se* filers can also continue to utilize the drop boxes located in the lobbies of the Daniel Patrick Moynihan United States Courthouse, 500 Pearl Street, New York, NY 10007 or the Honorable Charles L. Brieant Jr. Federal Building and Courthouse, 300 Quarropas Street, White Plains, NY 10601 for delivery of documents after 5:00 pm. Any documents submitted for filing in a drop box must be time-stamped, sealed in an envelope addressed to the Clerk of Court of the Bankruptcy Court, and must include the filer's contact information.

Dated: March 20, 2020
New York, New York

/s/ Cecelia G. Morris
Cecelia G. Morris
United States Bankruptcy Chief Judge

Instructions to register for CourtSolutions.

1. Create a CourtSolutions account online.
Logon to https://www.court-solutions.com/ to "Signup" for an account and to register a telephonic appointment for an upcoming hearing. Registration for a hearing must occur no later than 12:00 noon on the business day prior to the hearing date.

2. Register for a hearing with CourtSolutions.
After creating and signing into their CourtSolutions account at https://www.court-solutions.com/, a party must register for a hearing.
a. Enter the last name of the Judge to appear before and then select the appropriate name from the list.
b. Enter the time and date of the hearing.
c. Select participation status: Live or Listen Only.
d. Enter the case name, case number, and, if applicable, the name of client.
e. There is a box to click to agree to terms/conditions, and then press "Register".
f. CourtSolutions will send an email confirmation of the participation request.
g. The court staff will first confirm that a granted motion to appear telephonically is on the docket. If there exists a granted motion, the court staff will approve the reservation.
h. CourtSolutions will then send another email confirmation.
Note that the reservation received for a registered hearing may NOT be transferred to another person. If someone dials in with someone else's registration information, the caller information presented to the court will not match the correct person.

3. Charges.
For lawyers and participants, registration and reservations are free.
Once a party dials into a call, the cost is a flat fee of $70, per reservation, per judge, per day. If the hearing is adjourned for a break and the party rejoins the call later that day, there is no additional charge to rejoin the call. If the hearing is continued to another day, lawyers and participants will need to re-register and the flat fee will apply again when dialing in.
If a party does not timely join a call, no fee is charged. The Judge will have the party listed as having made a reservation, but the party is not charged. However, the hearing may proceed in their absence, and they may face sanctions from the Court.
Additionally, a party may notice that there is a charge on their card after making a reservation. When making a reservation, CourtSolutions places an authorization hold on the card. If the party does not join the call, the pending hold will be removed automatically several days later, and there will be no charge.
Any issues with billing shall be directed to the vendor. The Court is not responsible for the billing or collection of the fees incurred with CourtSolutions.

4. Order of Proceeding.
CourtSolutions does not place a call to counsel on the day of the hearing. It is counsel's responsibility to dial into the call not later than 10 minutes prior to the scheduled hearing. Logging into the CourtSolutions website for the hearing is not required but is helpful to unmute your line if the Court mutes it or to raise your hand to be recognized during the hearing.

Upon connecting to the call and at the time of the hearing, a party may hear the activity in the courtroom. Unless a joining party mutes their line, he/she joins the call as an active participant and can be heard. Failure to act appropriately on the line may result with the party being disconnected by Court. When the judge is ready to hear the case, appearances will be called. Each time a telephonic party speaks, he/she should identify them self for the record. The court's teleconferencing system allows more than one speaker to be heard, so the judge can interrupt a speaker to ask a question or redirect the discussion. When the judge informs the participants that the hearing is completed, the telephonic participant may disconnect, and the next case will be called.

5. Failure to appear.
If a party does not timely call and connect to the scheduled hearing, the hearing may proceed in their absence, and they may face sanctions from the Court for their failure to appear.

6. Other/Miscellaneous.
Telephonic appearances by multiple participants are only possible when there is compliance with every procedural requirement. Sanctions may be imposed when there is any deviation from the required procedures or the Court determines that a person's conduct makes telephonic appearances inappropriate. Sanctions may include denying the matter for failure to prosecute, continuing the hearing, proceeding in the absence of a party who fails to appear, or a monetary sanction.

Exhibit D

[Discussion of experience with Bankruptcy
Judge Robert R. Drain, S.D.N.Y.]

EXHIBIT E

The Small Business Reorganization Act of 2019 Makes a Timely Arrival; SECURED TRANSACTIONS

New York Law Journal

April 2, 2020 Thursday

New York Law Journal

Section: CORPORATE UPDATE; Pg. p.5, col.2; Vol. 263; No. 63

Length: 1505 words

Byline: Barbara M. Goodstein

Body

T he international health pandemic brought about by COVID-19, more commonly known as the coronavirus, has created fear and uncertainty not only as to the health and well-being of the general public, but the stability of the U.S. economy.

While it's difficult to forecast with certainty the number of retailers and other businesses that will shut their doors due to COVID-19, it will clearly have a significant effect on consumer spending, with the related negative repercussions in particular on small businesses. Reportedly, more than 170,000 small businesses in the United States closed during the recession years of 2008-2010. Between 2005 and 2017, only about 20% of small businesses survived more than 1 year and only 33% survived up to 10 years.

The U.S. Bankruptcy Code provides relief for small businesses facing insolvency. Chapters 11 and 13 of the Code permit a debtor to reorganize and emerge post-bankruptcy to continue operations. The only other alternative for a small business under the Bankruptcy Code is to liquidate under Chapter 7.

Chapter 13 is for individual debtors only; corporations, partnerships and trusts may not reorganize under this chapter. Accordingly, insolvent small business entities seeking to avoid liquidation need to invoke Chapter 11 to reorganize. But Chapter 11 involves a complex process-one requiring appointment of a creditors' committee for unsecured creditors, a plan of reorganization subject to stringent standards that can be proposed by the debtor or, in certain circumstances, its creditors, approval by creditors of such plan by solicitation through a disclosure statement, monthly reporting and the involvement of a court-appointed U.S. trustee throughout. Clearly this can be an overwhelming process for a small business. Although Congress amended the Bankruptcy Code in 2005 (pursuant to the Bankruptcy Abuse Prevention and Consumer Protection Act) to make Chapter 11 more user-friendly to small business entities, the costly and litigious nature of the Chapter 11 process, which can run 10 times the cost of a Chapter 13 reorganization in fees and expenses, pushed reorganization out of the reach of many small business owners. As a result, too many small businesses that could have reorganized instead wound up liquidating.

To address this predicament, and in a moment of true prescience in light of current circumstances, last year Congress amended the U.S. Bankruptcy Code by enacting the Small Business Reorganization Act of 2019 (SBRA). The SBRA was signed into law on Aug. 23, 2019 and became effective Feb. 20, 2020. The SBRA is the federal

government's latest effort to make bankruptcy reorganization a more attractive option for small businesses, something particularly important given the potential crippling economic effects of the current pandemic.

The stated purpose of the SBRA is to "expedite and reduce the cost of bankruptcy" for small businesses. It creates a new ***subchapter V*** of Bankruptcy Code Chapter 11 specifically for small business debtors, whether companies or individuals. It also renders inapplicable numerous sections of Chapter 11 that continue to make reorganization unduly burdensome and costly for a small business. As enacted in 2019, the statute applied to businesses with not more than $2.7 million ($2,725,625 to be precise) in secured and unsecured debts. Effective March 27, 2020, pursuant to the just-enacted Coronavirus Aid, Relief and Economic Security Act (CARES Act), that ceiling has been raised to $7.5 million, widening its potential reach to a much larger group of businesses.

The biggest structural change stemming from the act is the ability of a debtor to move forward with a reorganization plan without creditor confirmation. In the past, a debtor was only able to proceed with a Chapter 11 plan if at least one class of impaired creditors voted to accept its plan. Now, as described further below, a debtor is able to adopt a plan without a creditor vote so long as certain other requirements are met. Some of the biggest benefits small business owners can expect to see (with, in certain instances associated trade-offs), in comparison to Chapter 11, are:

(1) Debtor Can Propose Plan. Only the debtor is allowed to propose a plan of reorganization. By contrast, Chapter 11 allows the creditors to propose a plan if the debtor has not done so within 120 days. The trade-off is that debtor must propose its plan within 90 days of commencement of its bankruptcy proceeding.

(2) Elimination of Creditors' Committee. A creditors' committee is a common feature of a Chapter 11 reorganization proceeding. As noted above, under ***subchapter V***, there will be no creditors' committee for unsecured creditors unless ordered by the bankruptcy court-a huge potential expense savings for the debtor since it typically has to pay the fees and expenses of professional advisors to that committee. The trade-off is that a plan will be confirmed only as long as it provides that all projected disposable income of the debtor for three to five years will be used to make payments under the plan. "Disposable income" is defined to mean income that is not "reasonably necessary to be expended" for continuation, preservation or operation of the debtor's business, maintenance or support of the debtor or a dependent, or a domestic support obligation payable after filing of the debtor's bankruptcy petition.

(3) Creditor Approval of Plan/Modified Cramdown Rule. As noted above, the debtor's plan need not be approved by its creditors, eliminating the requirement for a court-approved disclosure statement and the costly process of soliciting creditor votes (although creditors can object if not all of the debtor's projected disposable income for a period of at least three years is to be used for repayment).

(4) Elimination of U.S. Trustee. Chapter 11's automatic imposition of a U.S Trustee (with its associated quarterly trustee fees and reporting requirements) to oversee the debtor's business has been eliminated. Again, the trade-off is that a private trustee (from among candidates approved by the Department of Justice under its U.S. Trustee program) is required, but under the SBRA, the private trustee is there solely to facilitate a plan of reorganization rather than oversee or operate the debtor's business.

(5) Elimination of the Absolute Priority Rule. The absolute priority rule is used to decide what portion of payments will be received by which creditors. Here, the SBRA's elimination of this rule allows the debtor to retain its ownership interest in its business through the bankruptcy proceeding even if it fails to contribute "new value" towards a reorganization plan or offer a plan that will not pay its creditors in full. The trade-off, if it can be considered one, is that the plan cannot discriminate unfairly, and instead must be adjudged to be fair and equitable, with respect to each class of impaired creditors.

(6) Deferral of Administrative Claim Payments. The debtor is allowed to pay its administrative claims over the term of its plan, as opposed to on the date of confirmation of the plan (as is the case in a Chapter 11).

EXHIBIT F

The Small Business Reorganization Act of 2019: Subchapter V

New York Law Journal (Online)

June 5, 2020 Friday

New York Law Journal

Length: 1645 words

Body

On Aug. 23, 2019, the Small Business Reorganization Act of 2019 (SBRA) was signed into law and created a new ***Subchapter V***. The general purpose of ***Subchapter V*** was to streamline the Chapter 11 bankruptcy process for small businesses and individuals engaged in business to administer their bankruptcy estate in an efficient and less costly manner.

The debt ceiling for a small business to file under ***Subchapter V*** was recently increased temporarily to $7.5 million under the Coronavirus Aid, Relief and Economic Security act of 2020 (the CARES Act). This debt ceiling increase expands access to bankruptcy relief to thousands of small businesses.

However, there is a remarkable irony between the laudable purpose of this legislation to help small businesses navigate efficiently through bankruptcy and its execution in the COVID-19 environment. One fly in the ointment is whether small business debtors can use PPP loans in bankruptcy.

By way of background, the CARES Act provided $349 billion for financing "small businesses" under the Paycheck Protection Program (PPP). Under the PPP, eligible small businesses are entitled to receive loans up to $10 million guaranteed by the Small Business Administration (SBA).

Neither the CARES Act nor the Small Business Act, however, expressly prohibits companies who have filed for bankruptcy from receiving PPP loans but this is undercut by the fact that the SBA requires that lenders use an SBA loan application form that expressly disqualifies any small business in bankruptcy. To reinforce this position the SBA promulgated an interim final rule that makes debtors ineligible to receive PPP loans.

The reason for the rule was that PPP loans to entities in bankruptcy would present an unacceptably high risk of an "unauthorized use" of funds or non-repayment of unforgiven loans. But does this make sense? Under the CARES Act, PPP loans are really not loans, but instead are treated as grants if 75% of the loan proceeds are used for payroll and the remaining 25% for rent, utilities and other operating expenses. If the borrower complies with these guidelines, the loan essentially will be forgiven. So, do small businesses that file bankruptcy really presents an unacceptably high risk of unauthorized use of funds or non-payment of unforgiven loans? One could argue to the contrary that a small business with bankruptcy court supervision and a standing trustee is under more scrutiny than a non-debtor. Quite frankly, small businesses in bankruptcy are likely less risky.

In the interim, bankruptcy courts are actively addressing this issue. There are a number of cases percolating through the system with respect to the use of PPP loans by Chapter 11 debtors. In some cases, Chapter 11 debtors

BERNARD SCHENKLER

sought approval to use PPP loans for DIP financing. In other instances, the debtors filed motions to turn over the loans proceeds that had been approved but not funded. One interesting issue being raised in a number of cases is whether the SBA's position violates *§525(a) of the Bankruptcy Code* which in substance prohibits the government from unfairly discriminating against any entity that was or is in bankruptcy.

In this regard one court recently allowed two hospitals (Calais Regional Hospital, 19-10486), and (Penobscot Valley Hospital, 19-10034) to seek PPP loans by issuing TRO's requiring the SBA to allow each hospital to apply for PPP funding. The SBA argued it was immune from the debtor hospitals' claims for injunctive relief under the anti-injunction provision of *15 U.S.C §634(b)*. Judge Fagone dismissed this argument, noting that any anti-injunction language "should not be interpreted as a bar to judicial review or agency actions that exceed agency authority where the remedies would not interfere with internal agency operations." Judge Fagone further found that the SBA's refusal to extend funds to bankrupt debtors likely violated §525(a) because, in his view, the SBA is not administrating a loan program under the PPP but is rather administering a grant program.

In In re Hidalgo County Emergency Service Foundation (Bankr. S.D. Tex. April 25, 2020), the court issued a TRO ordering the SBA to accept debtor's PPP application, finding that the SBA position that the PPP loan applicant certify that is not involved in any bankruptcy proceeding to qualify was not required under CARES Act or Small Business Act

In In re Village East 20-31144 (Bankr. W.D. Ky.), the debtor initially was approved for PPP loan and then filed Chapter 11. The bank cancelled the loan based upon "material change in circumstances." The debtor moved for a turnover of the loan but the motion was denied, presumably because of the SBA interim final rule.

Despite struggling to obtain PPP loans what are the good things small businesses can expect under ***Subchapter V***? Some highlights follow.

Debtor Eligibility for and Election of ***Subchapter V*** Treatment

Eligibility for ***Subchapter V*** relief involves several criteria. First, debt must be incurred in connection with commercial or business activities. One court, however, has recently determined that a debtor is not required to be conducting business when filing its original petition. In re Wright 20-01035 (Bankr. D.S.C. April 27, 2020) dealing with a defunct business is enough to qualify. Second, the debt ceiling of $7.5 million must be satisfied. Third, not less than 50% of that debt must arise from commercial or business activities. And finally, a debtor whose primary activity is to own or operate more than one real property is now eligible for ***Subchapter V***.

In order to proceed under ***Subchapter V*** a debtor must opt in as part of its voluntary bankruptcy petition. The U.S. Trustee or other parties can object to the debtor's self-designation.

Case Administration, Retention of Professionals, Committees and Standing Trustee

The debtor generally has the powers to perform the functions of a debtor-in-possession. A 60-day mandatory conference and filing a pre-conference report by the debtor 14 days before the conference describing the efforts taken and to be taken to reach a consensual plan of reorganization is required. This conference provides the bankruptcy court with information about whether the debtor is on track to timely file its plan.

In a ***Subchapter V*** case a standing trustee is automatically appointed to "facilitate the development of a consensual plan of reorganization." The standing trustee has certain duties including being accountable for all property received, examining proofs of claim and objecting as required, opposing discharge if advisable, furnishing information about the estate and its administration and preparing and filing a final report. One very important role for the standing trustee is to collect and retain plan payments until confirmation of a plan and to make sure that the debtor makes timely payments as required under a confirmed plan.

Plan, Disclosure Statement, Property of the Estate and Confirmation

There are two ways in which a ***Subchapter V*** plan can be confirmed-consensually or through cramdown. A consensual plan is accepted by all classes of claims. A cramdown plan does not have an impaired accepting class of claims, but can be confirmed if the plan does not discriminate unfairly and is fair and equitable. The term fair and equitable has special meaning in a ***Subchapter V*** case. For example, as to each class of secured creditors the plan must satisfy the requirements of §11229(b)((2)(A) and as to other classes of creditors the plan as of the effective date must provide that (1) all of the projected disposable income of the debtor to be received will be applied to make payments under the plan, or (2) the value of property to be distributed under the plan is no less that the projected disposable income of the debtor.

No competing plans are allowed. The debtor can modify a plan before confirmation, after confirmation or even after substantial consummation if circumstances warrant such modification. The absolute priority rule does not apply and therefore equity owners can retain their interests in the debtor.

The SBRA generally eliminates the requirement of a disclosure statement. Instead, the plan must contain a brief history of the debtor's business, operations during the case, feasibility projections and a liquidation analysis.

Treatment of Claims

In a non-consensual plan, a debtor can pay administrative claims over the three- to five-year life of the plan but under a consensual plan such claims must be paid at confirmation.

Modification of a claim secured by the debtor's principal residence is permitted under ***Subchapter V*** so long as the mortgage was not used to purchase the residence and the new value received in connection with granting the security interest was used primarily in connection with the debtor's business.

By way of example, In re Ventura, 2020 WL 1867898 (E.D. N.Y. April 10, 2020) presents some novel issues as to whether a debtor can amend a prior petition to elect ***Subchapter V*** treatment and can strip down mortgage on her principal residence which was also used as a bed and breakfast. The court found in favor of the debtor with respect to amendment and further indicated that the debtor would have the opportunity to make a case for modification. These favorable rulings suggest that bankruptcy courts are inclined to not only apply the statute but also to follow the spirit of the statute to allow small business a reasonable chance to reorganize in Chapter 11.

Conclusion

EXHIBIT G

AMERICAN BANKRUPTCY INSTITUTE

Rochelle's DAILY WIRE

June 17, 2020

Debtors and the SBA Fight to a Draw Last Week on PPP 'Loans'

> Courts still have no consensus about debtors' right to receive PPP 'loans' under the Cares Act.

Bill Rochelle
EDITOR-AT-LARGE, ABI
@BillRochelle

An insightful writer known for his authoritative take on legal developments affecting bankruptcy practice, Bill Rochelle published for Bloomberg every day from 2007 through 2015.

Prior to his second career in journalism, he practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP.

Last week, the debtors won twice and the government prevailed on two occasions when businesses in chapter 11 demanded "loans" under the Paycheck Protection Program, or PPP.

Notably, Bankruptcy Judge Whitman Holt of Spokane, Wash., authorized a direct appeal to the Ninth Circuit from his opinion and order granting a preliminary injunction based on a finding that the Small Business Administration, or SBA, violated the Administrative Procedures Act, or APA, by denying a PPP "loan" solely because the applicant was in bankruptcy.

'Loans' Under the Cares Act

The $2.2 trillion Coronavirus Aid, Relief and Economic Security Act became law on March 27 and provided for the SBA to make PPP "loans." Although denominated as loans, the SBA says on its website that PPP loans will be "fully forgiven" if at least 75% was spent for payroll. The remainder may be used for interest on mortgages, rent and utilities. Section 1102 of the legislation, known as the CARES Act, contains the provisions regarding the PPP "loans."

The SBA issued an application form requiring the applicant to state whether it is "presently involved in any bankruptcy." If the answer is "yes," the form goes on to say that "the loan will not be approved." However, the legislation itself said nothing about excluding companies in bankruptcy from the PPP "loan" program.

Pursuant to statutory rulemaking authority, the SBA issued revised regulations on April 28, saying that debtors are excluded because they "would present an unacceptably high risk for an unauthorized use of funds or non-repayment of unforgiven loans."

The Debtors' Two Victories

Bankruptcy Judge Michael G. Williamson of Tampa, Fla., wrote a comprehensive, 46-page decision in favor of the debtor on June 8. He concluded that the SBA violated the APA by exceeding its authority and was arbitrary and capricious in excluding debtors from the program.

Underpinning his decision, Judge Williamson concluded that PPP "loans" function like grants. He also ruled that the anti-injunction provisions in 15 U.S.C. § 634(b)(1) did not preclude him "from enjoining the SBA Administrator from exceeding her statutory authority . . . ."

Bankruptcy Judge Whitman L. Holt of Yakima, Wash., was likewise in the debtor's camp with his June 10 decision handed down from the bench.

Judge Holt concluded that the debtor had no claim for discrimination under Section 525(a). Unlike Judge Williamson, he decided that the PPP "loans" were properly classified as loans.

On the other hand, Judge Holt ruled that the SBA had violated the APA. In that regard, Judge Holt adopted the analysis by Bankruptcy Judge David T. Thuma of Albuquerque, N.M., in *Roman Catholic Church of the Archdiocese of Santa Fe v. U.S. (In re Roman Catholic Church of the Archdiocese of Santa Fe)*, 20-1026 (Bankr. D.N.M. May 1, 2020). To read ABI's report on the decision by Judge Thuma, click here.

Like Judge Williamson, Judge Holt ruled that the bankruptcy court had power to enter a preliminary injunction despite 15 U.S.C. § 634 (b)(1).

Judge Holt denied the government's motion for a stay pending appeal but authorized a direct appeal to the Ninth Circuit.

The Government's Champions

District Judge Elizabeth A. Wolford of Rochester, N.Y., granted the SBA's motion for summary judgment in a case with an interesting procedural twist.

The chapter 11 debtor sued the SBA in district court. *Sua sponte*, Judge Wolford examined whether the suit was automatically referred to the bankruptcy court and, if it were, whether she should withdraw the reference.

Judge Wolford decided in her June 10 decision that the suit should have been referred automatically to the bankruptcy court since there was bankruptcy jurisdiction and some of the claims were "core." If the debtor had wanted to be in district court, she said the debtor should have filed a motion to withdraw the reference.

Nevertheless, Judge Wolford said that the debtor's failure to employ the correct procedure "does not prevent the Court from determining *sua sponte* that withdrawal is appropriate."

Judge Wolford said it was "not clear" whether the bankruptcy court would have had power to enter a final order on all claims. For the sake of "judicial efficiency" and to "avoid unnecessary delay," she withdrew the reference.

On the merits, Judge Wolford invoked the so-called *Chevron* deference in concluding that the SBA had not violated the APA. She also found no improper discrimination under Section 525(a).

Finally, Chief Bankruptcy Judge Thomas J. Catliota of Greenbelt, Md., ruled in favor of the government but employed a procedural dipsy-do to resurrect the debtor's ability to both draw a PPP "loan" and reorganize in bankruptcy court.

In his June 8 opinion, Judge Catliota decided that Fourth Circuit precedent under Section 634(b)(1) of the Small Business Act precluded him from enjoining the SBA. He therefore did not reach the question of whether the SBA had violated the APA.

On the debtor's claim of discrimination under Section 525(a), Judge Catliota decided that a PPP "loan" was not "a 'license, permit, charter, [or] franchise' to be protected from discrimination under § 525(a)."

At the debtor's behest, Judge Catliota dismissed the chapter 11 case, finding "cause" given that "the PPP funds will provide a substantial benefit to the estate that is not available to debtor while it remains in bankruptcy."

Once out of bankruptcy, the debtor intended to apply for and banked on receiving a PPP loan. If necessary, the debtor will refile in chapter 11, this time under the newly enacted small business provisions of subchapter V of chapter 11.

According to Judge Catliota, the debtor believed that proceeding under subchapter V, coupled with a PPP "loan," would substantially enhance the debtor's probability of a successful reorganization.

Please find each opinion linked below:

- *Gateway Radiology Consultants PA v. Carranza (In re Gateway Radiology Consultants PA)*, 20-00330 (Bankr. M.D. Fla. June 8, 2020)

- *Astria Health v. S.B.A. (In re Astria Health)*, 20-20016 (Bankr. E.D. Wash. June 10, 2020)

- *Diocese of Rochester v. S.B.A*, 20-06243 (W.D.N.Y. June 10, 2020)

- *iThrive Health LLC v. Carranza (In re iThrive Health LLC)*, 20-00151 (Bankr. D. Md. June 8, 2020).

Case Details

Case Citation	Gateway Radiology Consultants PA v. Carranza (In re Gateway Radiology Consultants PA), 20-00330 (Bankr. M.D. Fla. June 8, 2020); Astria Health v. S.B.A. (In re Astria Health), 20-20016 (Bankr. E.D. Wash. June 10, 2020); Diocese of Rochester v. S.B.A, 20-06243 (W.D.N.Y. June 10, 2020); and iThrive Health LLC v. Carranza (In re iThrive Health LLC), 20-00151 (Bankr. D. Md. June 8, 2020).
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	(In re Astria Health), 20-20016 (Bankr. E.D. Wash. June 10, 2020); Diocese of Rochester v. S.B.A, 20-0
Case Type	Business
Court	11th Circuit Florida Florida Northern District
Bankruptcy Tags	Practice and Procedure Business Reorganization Finance and Banking Small Business

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EXHIBIT H

Neutral
As of: June 18, 2020 5:02 PM Z

Diocese of Rochester v. United States SBA

United States District Court for the Western District of New York

June 10, 2020, Decided

6:20-CV-06243 EAW

Reporter
2020 U.S. Dist. LEXIS 101694 *

THE DIOCESE OF ROCHESTER and THE DIOCESE OF BUFFALO, N.Y., Plaintiffs, v. U.S. SMALL BUSINESS ADMINISTRATION and JOVITA CORRANZA, solely as the Administrator of the U.S. Small Business Association, Defendants.

Prior History: Diocese of Rochester v. United States SBA, 2020 U.S. Dist. LEXIS 67042 (W.D.N.Y., Apr. 16, 2020)

Core Terms

eligible, injunction, quotation, withdraw, forgiveness, irreparable, borrower, Diocese, Interim, referral, Notice, capricious, recipient, non-core

Counsel: **[*1]** For The Diocese of Rochester, The Diocese of Buffalo, N.Y., Plaintiffs: Brian J. Butler, LEAD ATTORNEY, Charles J. Sullivan, Stephen A. Donato, Bond, Schoeneck & King, Syracuse, NY.

Judges: ELIZABETH A. WOLFORD, United States District Judge.

Opinion by: ELIZABETH A. WOLFORD

Opinion

DECISION AND ORDER

INTRODUCTION

Plaintiffs the Diocese of Rochester and the Diocese of Buffalo, N.Y. (collectively "Plaintiffs") seek a preliminary injunction against defendants U.S. Small Business Administration ("SBA") and Jovita Corranza (the "Administrator") (collectively "Defendants") related to Defendants' establishment of criteria for participation in the Paycheck Protection Program (the "PPP"). (Dkt. 17). Plaintiffs assert that Defendants violated the Administrative Procedure Act, 5 U.S.C. §§ 701 et seq. (the "APA") and Section 525(a) of the Bankruptcy Code, 11 U.S.C. § 525(a), by determining that debtors in bankruptcy are not eligible for loans issued in connection with the PPP. Plaintiffs ask the Court to enjoin Defendants from (1) denying Plaintiffs a PPP loan or otherwise interfering with the processing of their applications due to their status as chapter 11 bankruptcy debtors and (2) "disbursing from the PPP an amount equal to the total amount requested in [Plaintiffs'] combined loan applications, or **[*2]** $2,836,096." (Dkt. 17 at 1).

Following oral argument on Plaintiffs' amended motion for a preliminary injunction, the Court issued a Notice pursuant to Federal Rule of Civil Procedure 56(f)(3) advising the parties that it intended to consider granting summary judgment with respect to the following issues: (1) whether the SBA exceeded its statutory authority under the Coronavirus Aid, Relief, and Economic Security Act ("CARES"), Pub. L. No. 116-136, 134 Stat. 281 (2020), by excluding debtors in bankruptcy from participation in the PPP; and (2) whether the SBA violated 11 U.S.C. § 525(a) by excluding debtors in bankruptcy from participation in the PPP. (Dkt. 35)

BERNARD SCHENKLER

For the reasons set forth below, the Court concludes that those legal questions must be resolved in favor of Defendants—the SBA did not exceed its statutory authority under the CARES Act nor did it violate 11 U.S.C. § 525(a) when it adopted the bankruptcy exclusion to the PPP. As a result, the Court grants summary judgment to Defendants to the extent Plaintiffs seek a declaratory judgment otherwise. The Court further denies Plaintiffs' amended motion for a preliminary injunction because they have not demonstrated a likelihood of success as to the remaining claims in this matter nor have they established irreparable harm.

FACTUAL BACKGROUND

Plaintiffs **[*3]** are Roman Catholic dioceses and not-for-profit religious corporations under New York law. (Dkt. 10 at ¶¶ 4-5). Both Plaintiffs are chapter 11 bankruptcy debtors, with the Diocese of Buffalo having filed its voluntary petition on February 28, 2020 (Dkt. 2-5 at ¶ 3) and the Diocese of Rochester having filed its voluntary petition on September 12, 2019 (Dkt. 2-7 at ¶ 3).

On March 20, 2020, as a result of the ongoing global COVID-19 pandemic,[1] New York State Governor Andrew M. Cuomo signed the "New York State on PAUSE" Executive Order, which, among other things, mandated a 100% closure of non-essential businesses statewide and temporarily banned all non-essential gatherings of individuals of any size for any reason other than the provision of essential services. Executive Order [Cuomo] No. 202.8 (Mar. 20, 2020), https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/EO_202.8.pdf; *see New York State on PAUSE*, New York State: Novel Coronavirus, https://coronavirus.health.ny.gov/new-york-state-pause (last visited June 10, 2020). Plaintiffs allege that this had a significant impact on their revenue sources. (Dkt. 10 at ¶ 38).

Specifically, a "primary source **[*4]** of revenue" for Plaintiffs is "parish assessments" which are collected from parishes on a monthly basis and are "based primarily on historical parish offertory." (Dkt. 2-5 at ¶ 5; *see also* Dkt. 2-7 at ¶ 5). In turn, the parishes "derive a significant portion of their revenue from offertory collection during masses," particularly "during Holy Week which includes Easter Sunday mass." (Dkt. 2-5 at ¶ 7). However, because the New York State on PAUSE Order prevented the parishes from holding masses or services, including on Easter Sunday (which occurred on April 12, 2020), "it is estimated that the parish offertory collections and contributions from parishioners are 90-95% lower than average." (*Id.* at ¶ 8). The Diocese of Buffalo employs 108 full-time employees and 48 part-time employees. (*Id.* at ¶ 10). The Diocese of Rochester employs "60 to 70 fulltime equivalent employees. . . ." (Dkt. 2-7 at ¶ 9).

On March 27, 2020, the President signed into law the CARES Act which, among other things, established the PPP. The PPP is "a convertible loan program under *§ 7(a)* of the Small Business Act (15 U.S.C. § 633(a))." In re Springfield Med. Care Sys., Inc., No. 19-10285, 2020 WL 2311881, at *5 (Bankr. D. Vt. May 8, 2020). As another federal court recently explained:

> The PPP is a new loan program to be administered by the SBA **[*5]** under *Section 7(a) of the Small Business Act* (codified at *15 U.S.C. § 636(a)*). Its purpose is to assist small businesses during the COVID-19 crisis by immediately extending them loans on favorable terms. The loans are made by the SBA's participating banks and guaranteed by the SBA itself. Section 1106 of the CARES Act provides that a borrower's indebtedness under a PPP loan will be forgiven to the extent that the borrower uses the funds to pay expenses relating to payroll, mortgage interest, rent, and utilities during the eight-week period following the loan's origination. CARES Act § 1106. If a borrower qualifies for loan forgiveness, the SBA must pay the lender an amount equal to the amount forgiven, plus any interest accrued through the date of payment. *Id.* § 1106(c)(3).

Camelot Banquet Rooms, Inc. v. United States SBA, F. Supp. 3d , 2020 U.S. Dist. LEXIS 76713, 2020 WL 2088637, at *2 (E.D. Wis. May 1, 2020), *appeals filed*, Nos. 20-1729, 20-1730 (7th Cir. May 4, 2020).[2]

[1] On March 13, 2020, the President declared a National Emergency concerning COVID-19. Proclamation No. 9994, 85 Fed. Reg. 15337 (Mar. 13, 2020). According to the World Health Organization's website, as of June 10, 2020, there were 7,145,539 confirmed cases of COVID-19 worldwide, with 408,025 confirmed deaths. *See Coronavirus (COVID-19)*, World Health Org., https://covid19.who.int/ (last visited June 10, 2020).

[2] As discussed further below, certain aspects of the PPP, including the eight-week period for using the funds, have been modified by the enactment of the Paycheck Protection Program Flexibility Act of 2020 on June 5, 2020.

Congress initially provided the SBA with $349 billion for PPP loan guarantees, but those funds were quickly exhausted, and "Congress then appropriated an additional $310 billion for loan guarantees under the PPP." *DV Diamond Club of Flint, LLC v. United States SBA, No. 20-CV-10899, F. Supp. 3d , 2020 U.S. Dist. LEXIS 82213, 2020 WL 2315880, at *3 (E.D. Mich. May 11, 2020)*, *appeal filed*, *No. 20-1437, 2020 U.S. App. LEXIS 15822 (6th Cir. May 15, 2020)*.

The CARES Act grants the SBA emergency rule-making authority to issue regulations necessary to administer the PPP. CARES Act § 1114. On April 2, 2020, the **[*6]** SBA issued an interim final rule (the "First Interim Rule") that provided guidance on the eligibility requirements for participation in the PPP. (*See* Dkt. 2-3 at 2-32). The First Interim Rule was subsequently published in the Federal Register on April 15, 2020. *Business Loan Program Temporary Changes; Paycheck Protection Program, 85 Fed. Reg. 20811 (Apr. 15, 2020)* (to be codified at 13 C.F.R. pt. 120); (*see* Dkt. 24 at 12-13). The First Interim Rule makes reference to the "Paycheck Protection Application Form" (SBA Form 2484), First Interim Rule, 85 Fed. Reg. at 20816, which in turn requires a potential borrower to certify that it is "not presently involved in a bankruptcy," (Dkt. 24-1 at 29).

On April 28, 2020, SBA posted a new interim final rule.[3] Business Loan Program Temporary Changes; Paycheck Protection Program—Requirements—*Promissory Notes, Authorizations, Affiliation, and Eligibility, 85 Fed. Reg. 23450 (Apr. 28, 2020)* (to be codified at 13 C.F.R. pts. 120-21) (hereinafter the "Fourth Interim Rule"). The Fourth Interim Rule expressly excludes debtors in bankruptcy from receiving a PPP loan, stating that "[t]he Administrator . . . determined that providing PPP loans to debtors in bankruptcy would present an unacceptably high risk of an unauthorized use of funds or non-repayment of unforgiven loans." *Id. at 23451*.

The Diocese of Buffalo has completed a PPP loan application and, but for the disqualification of debtors in bankruptcy by SBA, would be eligible **[*7]** to receive a PPP loan in the amount $1,736,408. (Dkt. 17-1 at ¶ 4). The Diocese of Rochester has completed a PPP loan application and, but for the disqualification of debtors in bankruptcy by SBA, would be eligible to receive a PPP loan in the amount $1,100,000. (Dkt. 17-2 at ¶ 4).

PROCEDURAL BACKGROUND

Plaintiffs commenced the instant action on April 15, 2020, and concurrently filed a motion for a preliminary injunction and a motion to expedite. (Dkt. 1; Dkt. 2; Dkt. 3). The Court granted the motion to expedite on April 16, 2020, and ordered Defendants to respond to the motion for a preliminary injunction by April 24, 2020. (Dkt. 6).

Plaintiffs filed an Amended Complaint on April 20, 2020. (Dkt. 10). Then, on April 24, 2020, the parties requested and the Court entered a stipulated motion scheduling order governing the filing of an amended motion for a preliminary injunction. (Dkt. 15; Dkt. 16). Pursuant to the stipulated motion scheduling order, Plaintiffs filed the pending amended motion for a preliminary injunction on April 27, 2020. (Dkt. 17). Defendants filed a response on May 8, 2020 (Dkt. 24), and Plaintiffs filed a reply on May 11, 2020 (Dkt. 26). Oral argument on the amended **[*8]** motion for a preliminary injunction was held on May 15, 2020, and continued on May 19, 2020. (Dkt. 30; Dkt. 32).

At oral argument, the Court informed the parties that it was considering issuing a notice pursuant to *Federal Rule of Civil Procedure 56(f)(3)* identifying matters as to which summary judgment was potentially appropriate, and asked the parties to file letters as to their positions on whether there were any issues of material fact that would preclude the issuance of such notice. The parties filed the requested letters on May 21, 2020. (Dkt. 33; Dkt. 34). The Court issued its *Rule 56(f)(3)* Notice on May 22, 2020. (Dkt. 35). Defendants filed a supplemental brief on May 28, 2020 (Dkt. 36), and Plaintiffs filed a supplemental brief on May 29, 2020 (Dkt. 37).

On June 5, 2020, the President signed into law the *Paycheck Protection Program Flexibility Act of 2020, Pub. L. 116-142 (2020)* (hereinafter the "PPPFA"), which modifies the forgiveness requirements for PPP loans. With leave of Court (Dkt. 39), the parties filed letter briefs addressing the impact of the PPPFA on the instant litigation on June 8, 2020. (Dkt. 40; Dkt. 41).

[3] SBA issued second and third interim final rules that do not address issues relevant in this litigation. (*See* Dkt. 24 at 13 n.1); *see also Business Loan Program Temporary Changes; Paycheck Protection Program, 85 Fed. Reg. 20817 (Apr. 15, 2020)* (to be codified at *13 C.F.R. pt. 121*); Business Loan Program Temporary Changes; Paycheck Protection Program—*Additional Eligibility Criteria and Requirements for Certain Pledges of Loans, 85 Fed. Reg. 21747 (Apr. 20, 2020)* (to be codified at 13 C.F.R. pt. 120).

DISCUSSION

I. Referral to Bankruptcy Court

Although no party raised the issue in their briefing, the Court notes as an initial matter **[*9]** that pursuant to 28 U.S.C. § 157(a), "[e]ach district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district." This District has exercised such authority, providing in Local Rule of Civil Procedure 5.1(f) that "any and all cases under Title 11 and any and all proceedings arising under Title 11 or arising in or related to a case under Title 11 are referred to the Bankruptcy Judges for this district." "An action is considered 'related to' a bankruptcy proceeding if the outcome of the litigation 'might have any "conceivable effect" on the bankrupt estate,' or has 'any significant connection with the bankrupt estate.'" Pennock v. Dean, No. 06-CV-266S F, 2007 U.S. Dist. LEXIS 11244, 2007 WL 542132, at *3 (W.D.N.Y. Feb. 15, 2007) (quoting In re Cuyahoga Equip. Corp., 980 F.2d 110, 114 (2d Cir. 1992) (internal quotation omitted)). Here, it indisputable that this action is, at a minimum, related to the bankruptcy proceeding, particularly because Plaintiffs acknowledge that even if they were eligible to receive a PPP loan, they would need to make a motion to the Bankruptcy Court seeking "approval of the loan pursuant to section 364 of the Bankruptcy Code before consummating the loan." (Dkt. **[*10]** 2-5 at ¶ 17; Dkt. 2-7 at ¶ 17). Moreover, Plaintiffs' claim that Defendants have violated 11 U.S.C. § 525(a), a provision of the Bankruptcy Code, arises under Title 11. Accordingly, pursuant to Local Rule 5.1(f), the matter has been referred to the Bankruptcy Court.

The referral having been made, this Court may withdraw it "in whole or in part, . . . on its own motion or on timely motion of any party, for cause shown." 28 U.S.C. § 157(d). In other words, while Plaintiffs should have requested a withdrawal of the referral when they commenced the action, their failure to do so does not prevent the Court from determining *sua sponte* that withdrawal is appropriate.

"Section 157 does not define the term 'cause.'" In re Bernard L. Madoff Inv. Secs. LLC, 612 B.R. 257, 262 (S.D.N.Y. 2020). However: "[i]n deciding whether there is 'cause' to withdraw a bankruptcy reference, the Second Circuit has outlined several factors a district court should consider," which include "whether the claim or proceeding is core or non-core, whether it is legal or equitable, and considerations of efficiency, prevention of forum shopping, and uniformity in the administration of bankruptcy law." *Id.* (quoting In re Orion Pictures Corp., 4 F.3d 1095, 1101 (2d Cir. 1993)). "[T]he Court has broad discretion to withdraw the reference for cause." *Id.* (citations omitted).

Turning first to the issue of whether the claims **[*11]** are core or non-core, the Court notes that "[w]hile most courts continue to follow some version of the Orion framework, the Supreme Court's subsequent decision in Stern v. Marshall, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011) has called into question the usefulness of asking whether a claim is 'core' or 'non-core' in evaluating a motion to withdraw." In re Jacoby & Meyers-Bankr. LLP, No. 14-10641 (SCC), 2017 U.S. Dist. LEXIS 176970, 2017 WL 4838388, at *3 (S.D.N.Y. Oct. 25, 2017). In Stern, the Supreme Court held that "the mere characterization of a claim as 'core' or 'non-core' . . . does not suffice to determine whether a bankruptcy court has the constitutional authority to adjudicate it." *Id.* (footnote omitted); *see* Stern, 564 U.S. at 469. As such, following Stern, courts in this Circuit have "updated the first factor in the *Orion* analysis, asking not whether the claim is core or noncore, but rather whether the bankruptcy court has authority to finally adjudicate the matter." *Id.* (citation and quotation omitted).

Here, it is not clear whether the Bankruptcy Court would have the authority to finally adjudicate Plaintiffs' claims under the APA. *Compare* In re Skefos, No. 19-29718-L, 2020 Bankr. LEXIS 1479, 2020 WL 2893413, at *3 (Bankr. W.D. Tenn. June 2, 2020) (concluding that the bankruptcy court did have such authority), *with* Schuessler v. United States SBA, No. AP 20-02065-BHL, 2020 Bankr. LEXIS 1347, 2020 WL 2621186, at *2 (Bankr. E.D. Wis. May 22, 2020) (concluding with respect to the plaintiff's APA claims that "the bankruptcy court may hear them, **[*12]** but cannot issue final orders or judgments without the parties' consent"). This lack of clarity supports withdrawing the referral, to avoid a potential scenario in which arguments over the scope of the Bankruptcy Court's jurisdiction consume time and resources.

Withdrawing the referral in this case will also promote judicial efficiency, ensure uniformity in the treatment of both Plaintiffs' claims, and avoid unnecessary delay. Further, when the Court raised the issue at oral

argument, both sides agreed that withdrawal of the referral was appropriate. For all these reasons, the Court withdraws the referral of this matter to the Bankruptcy Court in its entirety.

II. Summary Judgment

Pursuant to Federal Rule of Civil Procedure 56(f)(3), "[a]fter giving notice and a reasonable time to respond, the court may . . . consider summary judgment on its own after identifying for the parties material facts that may not be genuinely in dispute." In this case, as set forth above, the Court—after confirming with the parties that there were no material facts genuinely in dispute—notified the parties that it intended to consider whether summary judgment was warranted on two of Plaintiffs' claims: (1) whether the SBA exceeded its statutory authority **[*13]** under the CARES Act by excluding debtors in bankruptcy from participation in the PPP; and (2) whether the SBA violated 11 U.S.C. § 525(a) by excluding debtors in bankruptcy from participation in the PPP. (Dkt. 35). The Court further afforded the parties the opportunity to file additional briefs following issuance of its Rule 56(f)(3) Notice. (*Id.* at 2). Accordingly, the requirements of Rule 56(f)(3) have been met.

"Questions of statutory construction and legislative history present legal issues that may be resolved by summary judgment." Heublein, Inc. v. United States, 996 F.2d 1455, 1461 (2d Cir. 1993); *see also* In re Asher, 488 B.R. 58, 64 (Bankr. E.D.N.Y. 2013) ("Because the Defendants and the Plaintiff have themselves defined the relevant issue as a question of statutory construction, this dispute is particularly well-suited for resolution by summary judgment."). Here, with respect to the two issues set forth in the Court's Rule 56(f)(3) Notice, the parties and the Court are in agreement that there are no material factual disputes and that the questions of statutory construction are dispositive. The Court accordingly resolves those questions below.

A. Statutory Authority Under the CARES Act

The APA empowers courts to "hold unlawful and set aside agency action, findings, and conclusions found to be . . . in excess of statutory jurisdiction, authority, or limitations, **[*14]** or short of statutory right." 5 U.S.C. § 706(2)(C). Courts in the Second Circuit "evaluate challenges to an agency's interpretation of a statute that it administers within the two-step Chevron [U.S.A., Inc. v. NRDC, 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984)] deference framework." Catskill Mts. Chptr. of Trout Unlimited, Inc. v. United States EPA, 846 F.3d 492, 507 (2d Cir. 2017), *cert. denied sub nom. New York v. E.P.A.*, 138 S. Ct. 1164, 200 L. Ed. 2d 314 (2018), and *cert. denied sub nom. Riverkeeper, Inc. v. E.P.A.*, 138 S. Ct. 1165, 200 L. Ed. 2d 314 (2018). At step one, the Court asks whether the relevant statutory language is "silent or ambiguous" regarding the issue at hand. *Id.* (quoting Chevron, 467 U.S. at 843). At step two, the Court askes "whether the agency's answer is based on a permissible construction of the statute at issue . . . *i.e.*, if it is not arbitrary, capricious, or manifestly contrary to the statute." *Id.* (quotations and citations omitted). If the agency's interpretation is permissible, the Court will accord it deference "so long as it is supported by a reasoned explanation, and so long as the construction is a reasonable policy choice for the agency to make." *Id.* (quotation omitted). "If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." Chevron, 467 U.S. at 842-43 (footnote omitted).

Here, Plaintiffs argue that the exclusion of debtors in bankruptcy from participation in the PPP contravenes Congress' **[*15]** clear, unambiguous intent as reflected in the CARES Act. (Dkt. 18 at 12-14). This argument has been accepted by other federal courts. For example, the *DV Diamond* court held that, in enacting the CARES Act, "Congress . . . establish[ed] only two criteria for PPP loan guarantee eligibility and provid[ed] that *any* business concern *shall* be eligible for a PPP loan guarantee if it met those criteria." 2020 U.S. Dist. LEXIS 82213, 2020 WL 2315880, at *1 (citations and alterations omitted). Those two criteria are purportedly derived from § 1102(a)(2)(36)(D)(i)(I) of the CARES Act, which provides as follows:

> During the covered period, in addition to small business concerns, any business concern, nonprofit organization, veterans organization, or Tribal business concern described in section 657a(b)(2)(C) of this title shall be eligible to receive a covered loan if the business concern, nonprofit organization, veterans organization, or Tribal business concern employs not more than the greater of--
> (I) 500 employees; or
> (II) if applicable, the size standard in number of employees established by the Administration for the industry in which the business concern, nonprofit organization, veterans organization, or Tribal

business concern operates.

15 U.S.C. § 636(a)(36)(D)(i). Thus, according to this reasoning, so long as a **[*16]** business satisfies the two criteria identified in this section (*i.e.*, (1) during the covered period (2) it must have less than 500 employees or less than the size standard in number of employees established by the Administration for the industry in which the business operates), then the business qualifies for loan guarantee eligibility under the PPP. *DV Diamond, 2020 U.S. Dist. LEXIS 82213, 2020 WL 2315880, at *10*.

The reasoning employed by the *DV Diamond* court, among others, is not unpersuasive on its face. As the *DV Diamond* court noted, the Supreme Court has held that, "the word 'any' naturally carries an expansive meaning" and "[w]hen used (as here) with a singular noun in affirmative contexts, the word 'any' ordinarily refers to a member of a particular group or class without distinction or limitation and in this way implies *every* member of the class or group." *SAS Inst., Inc. v. Iancu, 138 S. Ct. 1348, 1354, 200 L. Ed. 2d 695 (2018)* (citations, quotations, and original alterations omitted); *see DV Diamond, 2020 U.S. Dist. LEXIS 82213, 2020 WL 2315880, at *10*. In other words, the argument goes, when Congress says "any business concern, nonprofit organization, veterans organization, or Tribal business concern," it means any.

However, "[i]n making the threshold determination under *Chevron*, a reviewing court should not confine itself to examining a particular statutory provision **[*17]** in isolation." *Nat'l Ass'n of Home Builders v. Defs. of Wildlife, 551 U.S. 644, 666, 127 S. Ct. 2518, 168 L. Ed. 2d 467 (2007)* (quotation omitted). To the contrary, "[i]t is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Id.* (quotation omitted). And in this case, when examined in the context of the statutory scheme as a whole, it becomes clear that *15 U.S.C. § 636(a)(36)(D)(i)* is properly understood not as setting forth the exclusive criteria for participation in the PPP, but merely as expanding the size limitations that would otherwise have been in place.

The PPP is "administered by the SBA under *Section 7(a)* of the Small Business Act." *Camelot Banquet Rooms, 2020 U.S. Dist. LEXIS 76713, 2020 WL 2088637, at *2*. Under normal circumstances, loans under *Section 7(a)* are available only to "small business concerns," as defined in applicable SBA regulations. *See 15 U.S.C. § 632(a)(1)*; *id. § 636(a)*; *see, e.g.*, How Does SBA Define "Business Concern or Concern"?, *13 C.F.R. § 121.105 (2005)*. In establishing the PPP, Congress expanded the size restrictions found in those regulations to allow larger businesses to qualify for participation. *See 15 U.S.C. § 636(a)(36)(D)(i)* (providing that larger businesses are eligible for PPP participation "in addition to small business concerns"). However, the Court disagrees with Plaintiffs that in expanding the size restrictions, Congress unambiguously **[*18]** provided that there could be no other eligibility criteria. *See Schuessler, 2020 Bankr. LEXIS 1347, 2020 WL 2621186, at *11 (Bankr. E.D. Wis. May 22, 2020)* ("Given . . . the speed with which Congress adopted the CARES Act and wanted funds to be disbursed in the light of the pandemic, it is understandable that Congress did not spell out in the statute all requirements for PPP participation. Instead, Congress entrusted the details to the SBA, engrafting the PPP on to the SBA's existing *section 7(a)* lending program, and giving the SBA emergency rulemaking authority.").

Other provisions of the CARES Act clearly anticipate the existence of additional eligibility criteria. For example, § 1102(a)(2)(36)(D)(ii)(I) of the CARES Act provides that "[d]uring the covered period, individuals who operate under a sole proprietorship or as an independent contractor and eligible self-employed individuals shall be eligible to receive a covered loan." *15 U.S.C. § 636(a)(36)(D)(ii)(I)*. Further, § 1102(a)(2)(36)(I) of the CARES Act waives the requirement that a small business concern be unable to obtain credit elsewhere in order to be eligible for a covered loan. *15 U.S.C. § 636(a)(36)(I)*. These waivers of otherwise applicable eligibility requirements would be superfluous if, in fact, § 1102(a)(2)(36)(D)(i) unambiguously eliminated any requirement beyond size. It is "one of the most basic interpretive canons . . . that a statute **[*19]** should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant." *Corley v. United States, 556 U.S. 303, 314, 129 S. Ct. 1558, 173 L. Ed. 2d 443 (2009)* (quotation and original alterations omitted).

Moreover, as Defendants correctly point out, in interpreting statutes the Court must be mindful that "Congress . . . does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes." *Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 468, 121 S. Ct. 903, 149 L. Ed. 2d 1 (2001)*. In this case, in issuing loans under *Section 7(a)*, the SBA

is statutorily required to ensure such loans "shall be of such sound value or so secured as reasonably to assure repayment." *15 U.S.C. § 636(a)(6)*. "[N]either the CARES Act nor the PPP expressly state that the SBA cannot consider creditworthiness of potential PPP borrowers or that it is relieved from its obligation to assure that all loans made under *§ 636(a)* be of sound value to assure repayment." *Henry Anesthesia Assocs. LLC v. Carranza (In re Henry Anesthesia Assocs. LLC), No. 19-64159-LRC, 2020 Bankr. LEXIS 1471, 2020 WL 3002124, at *9 (Bankr. N.D. Ga. June 4, 2020)* (quotations and original alteration omitted). The Court will not presume that simply by using the phrase "any business" concern in one part of the CARES Act, Congress meant to implicitly eliminate the long-standing statutory requirements for *Section 7(a)* loans. *See Jones v. United States, 526 U.S. 227, 234, 119 S. Ct. 1215, 143 L. Ed. 2d 311 (1999)* ("Congress **[*20]** is unlikely to intend any radical departures from past practice without making a point of saying so.").

Plaintiffs have also argued that the bankruptcy exclusion is inconsistent with § 1102(a)(2) of the CARES Act, which provides as follows:

> BORROWER REQUIREMENTS.—
>
> (i) CERTIFICATION.—An eligible recipient applying for a covered loan shall make a good faith certification—
>
> (I) that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient;
>
> (II) acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments;
>
> (III) that the eligible recipient does not have an application pending for a loan under this subsection for the same purpose and duplicative of amounts applied for or received under a covered loan; and
>
> (IV) during the period beginning on February 15, 2020 and ending on December 31, 2020, that the eligible recipient has not received amounts under this subsection for the same purpose and duplicative of amounts applied for or received under a covered loan.

15 U.S.C. § 636(a)(36)(G). Plaintiffs contend that by setting forth these limited certification requirements, "Congress **[*21]** chose not to make creditworthiness—or risk of nonrepayment—a factor in determining borrower eligibility." (Dkt. 18 at 14). This argument is misplaced. Section 1102(a)(2) of the CARES Act does not establish eligibility criteria for participation in the PPP—to the contrary, the use of the phrase "[a]n eligible recipient" presupposes that eligibility has already otherwise been ascertained. Nothing in § 1102(a)(2) addresses the issue of whether the SBA may exclude debtors in bankruptcy from participation in the PPP—instead, this section concerns the information a borrower must provide after eligibility has been determined.

For all these reasons, the Court concludes at step one of the *Chevron* analysis that the CARES Act is silent regarding the eligibility of debtors in bankruptcy to participate in the PPP. Put differently, nothing in the CARES Act requires that a bankrupt debtor be eligible for participation in the PPP—this detail was left by Congress for determination by the SBA. *See Penobscot Valley Hosp. v. Carranza, No. 19-10034, 2020 Bankr. LEXIS 1464, 2020 WL 3032939, at *8 (Bankr. D. Me. June 3, 2020)* ("Congress did not explicitly say whether debtors in bankruptcy are categorically excluded from the PPP. . . . Congress intended the SBA to fill a statutory gap and determine whether debtors in bankruptcy would be eligible for the PPP. **[*22]** As a result, in evaluating the APA claim, the Court proceeds to the second step of the *Chevron* framework.").

The Court thus turns to step two of the *Chevron* analysis and asks whether the SBA's adoption of the bankruptcy exclusion was "arbitrary, capricious, or manifestly contrary to the statute. . . ." *Catskill Mts., 846 F.3d at 520* (quotation omitted). As a threshold issue, the Court notes that the inquiry into arbitrariness at *Chevron* step two is distinct from the inquiry into arbitrariness under *§ 706(2)(A)* of the APA, which allows a court to set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *5 U.S.C. § 706(2)(A)*. As the Second Circuit has explained, "the standard for evaluating agency action under APA *§ 706(2)(A)* [is] set forth in *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Company, 463 U.S. 29, 103 S. Ct. 2856, 77 L. Ed. 2d 443 (1983)* ('State Farm')" and entails "a much stricter and more exacting review of the agency's rationale and decisionmaking process than the Chevron Step Two standard." *Catskill Mts., 846 F.3d at 521*. "*State Farm* is used to evaluate whether a rule is procedurally defective as a result of flaws in the agency's decisionmaking process" while "*Chevron*, by contrast, is generally used to evaluate whether the conclusion reached as a result of that process—an

agency's interpretation of a statutory provision **[*23]** it administers—is reasonable." *Id.*

While Plaintiffs have brought a challenge to the SBA's adoption of the bankruptcy exclusion pursuant to § 706(2)(A), the Court expressly stated in its Rule 56(f)(3) Notice that it was not considering summary judgment as to this claim. (*See* Dkt. 35). The Court has instead limited its summary judgment inquiry into whether the bankruptcy exclusion is arbitrary and capricious as that phrase is used at *Chevron* step two—that is, whether "it is not supported by a reasoned explanation." *Catskill Mts., 846 F.3d at 521*.

The SBA has offered a reasoned explanation for the bankruptcy exclusion. As set forth in its papers, under normal circumstances, the SBA fulfills is statutory mandate to ensure that *Section 7(a)* loans are of sound value by performing individual credit reviews. (Dkt. 24 at 27). However, in order to ensure that PPP loans are processed expeditiously, as the CARES Act clearly intended, the SBA decided to streamline processing by imposing a bright line exclusion of debtors in bankruptcy. (*Id.*). The SBA explained in the Fourth Interim Rule that it had adopted this bright line rule because it had determined that "providing PPP loans to debtors in bankruptcy would present an unacceptably high risk of an unauthorized **[*24]** use of funds or non-repayment of unforgiven loans." *85 Fed. Reg. at 23451*. Regardless of the Court's view of the soundness of this determination as a matter of policy, it is sufficiently reasoned that the Court must defer thereto. *See Penobscot Valley Hosp., 2020 Bankr. LEXIS 1464, 2020 WL 3032939, at *9* ("The SBA's bankruptcy exclusion was a reasonable effort to accommodate the conflicting policies committed to the SBA's care, and one that Congress might reasonably have sanctioned.").

For all these reasons, the Court finds as a matter of law that the SBA did not exceed its statutory authority in adopting the bankruptcy exclusion and grants summary judgment to Defendants as to Plaintiffs' request for a declaratory judgment to the contrary.

B. Compliance with *11 U.S.C. § 525(a)*

The Court turns next to Plaintiffs' claim that the SBA's adoption of the bankruptcy exclusion violated *11 U.S.C. § 525(a)*. Section *§ 525(a)* provides in relevant part that "a governmental unit may not deny . . . a license, permit, charter, franchise, or other similar grant to" a bankruptcy debtor. *11 U.S.C. § 525(a)*. "*Section 525(a)* evolved from *Perez v. Campbell, 402 U.S. 637, 91 S. Ct. 1704, 29 L. Ed. 2d 233 (1971)*, a seminal bankruptcy case in which the Supreme Court struck down a state statute that withheld driving privileges from debtors who failed to satisfy motor-vehicle-related tort judgments against them, even if the judgments were discharged **[*25]** under bankruptcy law." *In re Stoltz, 315 F.3d 80, 87 (2d Cir. 2002)*.

The Second Circuit has held *§ 525(a)* "does not promise protection against consideration of the prior bankruptcy in post-discharge credit arrangements" and that Congress did not intend to extend its protections "to cover loans or other forms of credit." *In re Goldrich, 771 F.2d 28, 30 (2d Cir. 1985)* (holding that *§ 525(a)* did not extend to student loans)[4]; *see also Watts v. Pa. Hous. Fin. Co., 876 F.2d 1090, 1093 (3d Cir. 1989)* (finding that *§ 525(a)* did not extend to loans made under Pennsylvania's Homeowner's Emergency Mortgage Assistance Program).

Plaintiffs argue that a PPP loan is not a true loan, but should instead be understood as a grant. The Court disagrees. While it is true that a loan issued as part of the PPP is eligible for forgiveness if certain criteria are met, "[t]he existence of favorable terms and a unique feature (namely, forgiveness under specified circumstances) does not change the character of what the [Plaintiffs] want[] to obtain: a loan that might be forgiven by the lender." *Penobscot Valley Hosp., 2020 Bankr. LEXIS 1464, 2020 WL 3032939, at *11*; *see also Schuessler, 2020 Bankr. LEXIS 1347, 2020 WL*

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[4] Subsequent to the Second Circuit's decision in *In re Goldrich*, Congress, as part of the Bankruptcy Reform Act of 1994, enacted *11 U.S.C. § 525(c)*, which states that "[a] governmental unit that operates a student grant or loan program and a person engaged in a business that includes the making of loans guaranteed or insured under a student loan program may not deny a student grant, loan, loan guarantee, or loan insurance to a person that is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, or another person with whom the debtor or bankrupt has been associated, because the debtor or bankrupt is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of a case under this title or during the pendency of the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act." Congress' decision to expressly address student loans in *§ 525(c)* confirms that loans in general do not fall within the purview of *§ 525(a)*.

2621186, at *9 ("The record is clear that Congress created the PPP as an amendment to the SBA's pre-existing *loan* program and both the statute and agency regulations refer to the funds distributed as 'loans.' The PPP loans are made through private lenders and participants sign promissory **[*26]** notes, subject to SBA guarantees. While it is certainly true that Congress created the program to make the funds readily available, even where market loans would not be, and the SBA has adopted regulations allowing the loans to be made with little-to-no underwriting, these attributes do not alter the fact that the program results in an actual loan. It is also true that Congress provided for loan forgiveness if the funds are used in certain ways, but the loan forgiveness is just that—it is a *loan* forgiveness. Moreover, forgiveness is conditioned on future events; if a recipient fails to use the funds in one of the delineated ways, the recipient must pay back the loan.").

The Court further finds that even if PPP loans were properly characterized as "grants," they are not grants that are similar to a license, permit, charter, or franchise. The Second Circuit has held that the "common qualities of the property interests protected under section 525(a) . . . are that these property interests are unobtainable from the private sector and essential to a debtor's fresh start." In re Stoltz, 315 F.3d at 90 (finding public housing lease falls within the ambit of § 525(a)). "The exclusion of persons involved in bankruptcy from the PPP does not **[*27]** conflict with the fresh start or otherwise frustrate the operation of the Bankruptcy Code" and is "not similar to denying a debtor a license to operate in his chosen field and thereby denying the debtor the opportunity to pursue economic betterment." Penobscot Valley Hosp., 2020 Bankr. LEXIS 1464, 2020 WL 3032939, at *14; *see also* Henry Anesthesia Assocs., 2020 Bankr. LEXIS 1471, 2020 WL 3002124, at *7 ("Through the PPP, the government agrees to guarantee loans for eligible borrowers, and agrees to forgive those loans if certain conditions are met. However, no legislative authority is required to contract for a loan, a loan guarantee, or even forgiveness of a loan, and all of these transactions can be obtained in the private market."). Participation in the PPP bears no resemblance to any of the property interests enumerated in § 525(a).

For the reasons set forth above, the Court finds that the SBA did not run afoul of § 525(a) in adopting the bankruptcy exclusion. Accordingly, the Court grants summary judgment to Defendants as to Plaintiffs' request for a declaratory judgment to that effect.

III. Motion for Preliminary Injunction

The Court turns next to Plaintiffs' amended motion for a preliminary injunction. As a result of the Court's conclusions as to Plaintiffs' claims that the SBA exceeded its statutory authority under the CARES Act and **[*28]** violated § 525(a) in adopting the bankruptcy exclusion, the only claim that could potentially warrant entry of a preliminary injunction is Plaintiffs' claim that the SBA's actions were arbitrary and capricious pursuant to § 706(2)(A) of the APA. The Court concludes for the reasons that follow that Plaintiffs have not demonstrated their entitlement to a preliminary injunction with respect to this claim.

A. Legal Standard

The standard for a preliminary injunction in the Second Circuit is as follows:

> In general, district courts may grant a preliminary injunction where a plaintiff demonstrates irreparable harm and meets one of two related standards: either (a) a likelihood of success on the merits, or (b) sufficiently serious questions going to the merits of its claims to make them fair ground for litigation, plus a balance of the hardships tipping decidedly in favor of the moving party.

Otoe-Missouria Tribe of Indians v. N.Y. State Dep't of Fin. Servs., 769 F.3d 105, 110 (2d Cir. 2014) (quotations omitted). However, "[a] plaintiff cannot rely on the fair-ground-for-litigation alternative to challenge governmental action taken in the public interest pursuant to a statutory or regulatory scheme." *Id.* (quotations omitted). In this context, the phrase "in the public interest" does not call upon the Court to make **[*29]** a value judgment, *see* Able v. United States, 44 F.3d 128, 131 (2d Cir. 1995) (applying higher standard in lawsuit challenging the military's "Don't Ask, Don't Tell" policy after finding "it is inappropriate for this court to substitute its own determination of the public interest for that arrived at by the political branches, whether or not there may be doubt regarding the wisdom of their conclusion"), and the higher standard applies even if the party requesting a preliminary injunction or temporary restraining order "seeks to vindicate a sovereign or public interest," Oneida Nation of N.Y. v. Cuomo, 645 F.3d 154, 164 (2d Cir. 2011). The relevant inquiry is whether the governmental policy at issue was "implemented through legislation or regulations developed through presumptively reasoned

democratic processes." *Able, 44 F.3d at 131*. Here, Plaintiffs do not contest that they must satisfy the higher likelihood-of-success-on-the-merits standard. (*See* Dkt. 18 at 22-23).

B. Sovereign Immunity

Defendants contend that this Court lacks the authority to issue a preliminary injunction against the SBA, because the sovereign immunity waiver in the Small Business Act provides that "no attachment, injunction, garnishment, or other similar process, mesne or final, shall be issued against the agency or its property." (Dkt. 24 at 16 (quoting **[*30]** *15 U.S.C. § 634(b)(1)* (emphasis and alterations omitted))). Issues of sovereign immunity implicate the Court's subject matter jurisdiction, *see Hamm v. United States, 483 F.3d 135, 137 (2d Cir. 2007)*, and subject matter jurisdiction is generally a "threshold issue," *Saleh v. Holder, 84 F. Supp. 3d 135, 138 (E.D.N.Y. 2014)*. However, in this case there is no dispute that the Court has jurisdiction over the merits of the underlying dispute—instead, the question is only whether the Court is empowered to grant a particular form of relief on a preliminary basis before that underlying dispute is resolved. Accordingly, because the Court concludes that the standard for issuance of a preliminary injunction has not been met, it need not and does not resolve this issue.

C. Likelihood of Success on the Merits

In order to succeed on their claim that the SBA acted arbitrarily and capriciously as defined in *§ 706(2)(A)* of the APA, Plaintiffs must show:

> [T]he agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.

State Farm, 463 U.S. at 43. The record before the Court is devoid of evidence **[*31]** sufficient to find that Plaintiffs are likely to succeed on such a claim. While Plaintiffs have identified purported internal inconsistencies in the SBA's interim rules (*see* Dkt. 18 at 11-12), they have not persuasively argued that these claimed inconsistencies are so significant as to warrant setting aside the agency's actions, particularly in light of the necessarily expedited manner in which SBA was operating. On the scant factual record regarding SBA's adoption of the bankruptcy exclusion, the Court cannot conclude that Plaintiffs are likely to be able to demonstrate that the SBA acted arbitrarily and capriciously.

D. Irreparable Harm

The Court further finds that Plaintiffs have not demonstrated that they will suffer irreparable harm in the absence of a preliminary injunction. "A showing of irreparable harm is the single most important prerequisite for the issuance of a preliminary injunction." *Faiveley Transp. Malmo AB v. Wabtec Corp., 559 F.3d 110, 118 (2d Cir. 2009)* (quotation omitted). "Thus, if a party fails to show irreparable harm, a court need not even address the remaining elements of the test." *Monowise Ltd. Corp. v. Ozy Media, Inc., No. 17-CV-8028 (JMF), 2018 U.S. Dist. LEXIS 75312, 2018 WL 2089342, at *1 (S.D.N.Y. May 3, 2018)*. "To establish irreparable harm, a party seeking preliminary injunctive relief must show that there is a continuing harm which cannot be adequately redressed **[*32]** by final relief on the merits and for which money damages cannot provide adequate compensation." *Kamerling v. Massanari, 295 F.3d 206, 214 (2d Cir. 2002)* (quotations omitted). Additionally, "irreparable harm must be shown to be actual and imminent, not remote or speculative." *Id.*

Here, Plaintiffs' submissions regarding the financial impact of the COVID-19 pandemic and concomitant ban on church gatherings are vague. Plaintiffs point out that offerings have dropped off precipitously, but they do not state what percentage of their funding comes from parish assessments versus other sources. Plaintiffs further have not claimed that they need PPP funds in order to make payroll—indeed, there is no indication in Plaintiffs' papers that they have not paid their employees' salaries or that failure to obtain PPP funds would somehow cause Plaintiffs to cease to operate. Instead, Plaintiffs argue that being excluded from the PPP is in and of itself irreparable harm, based on their assertions that "the demand for PPP funds greatly exceeds the available supply" and "the PPP funds are likely to become exhausted soon." (*See* Dkt. 36 at 23). However, Plaintiffs have provided no factual support for these assertions and they are contradicted by recent public **[*33]** reports indicating that there are more $120 billion dollars in PPP funds still available and that "most small businesses interested in the loan have already

applied for it." Kate Rogers, *After a Rush for More Small Business Funding, PPP Loan Money Remains Untapped*, CNBC (June 2, 2020, 6:09 PM), https://www.cnbc.com/2020/06/02/billions-in-ppp-loan-money-remains-untapped-by-small-businesses.html. In other words, there is no reason on the current record to conclude that, should they ultimately prevail in this litigation, Plaintiffs would be unable to apply for and receive PPP loans. This is particularly true in light of the narrow issues remaining in this litigation, which should require fairly minimal discovery.

CONCLUSION

For the reasons set forth above, the Court withdraws referral of this case from the Bankruptcy Court, grants summary judgment to Defendants on Plaintiffs' claims that the SBA exceeded its statutory authority under the CARES Act by excluding debtors in bankruptcy from participation in the PPP and that the SBA violated *11 U.S.C. § 525(a)* by excluding debtors in bankruptcy from participation in the PPP, and denies Plaintiffs' amended motion for a preliminary injunction (Dkt. 17).

SO ORDERED. **[*34]**

Dated: June 10, 2020

Rochester, New York

/s/ Elizabeth A. Wolford

ELIZABETH A. WOLFORD

United States District Judge

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EXHIBIT I

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

United States Court of Appeals
Fifth Circuit
FILED
June 22, 2020
Lyle W. Cayce
Clerk

No. 20-40368

In re: HIDALGO COUNTY EMERGENCY SERVICE FOUNDATION,

Debtor.

HIDALGO COUNTY EMERGENCY SERVICE FOUNDATION,

Appellee,

versus

JOVITA CARRANZA, U.S. Small Business Administration,

Appellant.

Appeal from the United States District Court
for the Southern District of Texas

Before SMITH, HIGGINSON, and ENGELHARDT, Circuit Judges.

JERRY E. SMITH, Circuit Judge:

As the reality of the coronavirus global pandemic took hold, markets plummeted and unemployment soared. Congress responded with the Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, 134 Stat.

281 (2020) ("CARES Act"). The CARES Act, *inter alia*, made $659 billion of government-guaranteed loans available to qualified small businesses through the Paycheck Protection Program ("PPP").[1] The PPP is implemented under section 7(a) of the Small Business Act, 15 U.S.C. § 636, which is administered by the Small Business Administration ("SBA").

The SBA quickly promulgated several regulations concerning PPP eligibility. At issue here is its determination that "[i]f [an] applicant . . . is the debtor in a bankruptcy proceeding, . . . th[at] applicant is ineligible to receive a PPP loan." Business Loan Program Temporary Changes; Paycheck Protection Program—Requirements—Promissory Notes, Authorizations, Affiliation, and Eligibility, 85 Fed. Reg. 23,450, 23,451 (Apr. 28, 2020).

Hidalgo County Emergency Service Foundation ("Hidalgo")—which is in Chapter 11 bankruptcy—alleges that it was denied a PPP loan based on its status as a bankruptcy debtor. It filed an adversary proceeding against the SBA in bankruptcy court, contending that the SBA's decision to preclude bankrupt parties from obtaining PPP loans (1) violates 11 U.S.C. § 525(a), which prohibits discrimination based on bankruptcy status under certain circumstances, (2) is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," 5 U.S.C. § 706(2)(A), and (3) is "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right," *id.* § 706(2)(C).

The bankruptcy court sided with Hidalgo and issued a preliminary injunction mandating that the SBA handle Hidalgo's PPP application without consideration of its ongoing bankruptcy. The district court stayed the

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[1] Congress initially funded the PPP with $349 billion, CARES Act § 1102(b)(1), 134 Stat. at 293, then increased that to $659 billion, Paycheck Protection Program and Health Care Enhancement Act, Pub. L. No. 116-139, § 101(a)(1), 134 Stat. 620, 620 (2020).

preliminary injunction and certified the case for direct appeal to the Fifth Circuit. We granted permission to take the direct appeal under 28 U.S.C. § 158(d).

As a threshold matter, the SBA Administrator contends that the Small Business Act forecloses injunctive relief by providing that "no . . . injunction . . . shall be issued against the Administrator or his property." 15 U.S.C. § 634(b)(1). Additionally—and as Hidalgo concedes—"this [c]ircuit has concluded that all injunctive relief directed at the SBA is *absolutely prohibited.*"[2] Hidalgo requests that we create "an exception" to that absolute prohibition "under the extreme facts and highly compressed time frame presented in this case" or that the doctrine "should be revisited entirely." Under our well-recognized rule of orderliness, however, a panel of this court is bound by circuit precedent. *See Teague v. City of Flower Mound*, 179 F.3d 377, 383 (5th Cir. 1999).

The issue at hand is not the validity or wisdom of the PPP regulations and related statutes, but the ability of a court to enjoin the Administrator, whether in regard to the PPP or any other circumstance. Because, under well-established Fifth Circuit law, the bankruptcy court exceeded its authority when it issued an injunction against the SBA Administrator, we VACATE its preliminary injunction.

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[2] *Enplanar, Inc. v. Marsh*, 11 F.3d 1284, 1290 n.6 (5th Cir. 1994) (emphasis added) (quotation marks omitted); *see also Valley Constr. Co. v. Marsh*, 714 F.2d 26, 29 (5th Cir. 1983) ("The Small Business Act, 15 U.S.C. § 634(b)(1), precludes injunctive relief against the SBA."); *Expedient Servs., Inc. v. Weaver*, 614 F.2d 56, 58 (5th Cir. 1980) ("Section 634(b)(1) provides, *inter alia*, that no 'injunction . . . or other similar process . . . shall be issued against the Administrator.' . . . [A] suit praying solely for injunctive relief against the Administrator is barred by the language of § 634(b)(1). Since we have determined that the sole relief prayed for in the instant case was injunctive in nature, the suit should have been dismissed.").

EXHIBIT J

By Eric J. Monzo

COVID-19 and Chapter 11

Suspension Orders and Their Impact on Creditors' Rights

Editor's Note: *ABI recently launched its Coronavirus Resources for Bankruptcy Professionals website (abi.org/covid19), which aggregates information for bankruptcy professionals to assist clients and provide guidance due to the fallout from the COVID-19 pandemic.*

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The impact of the novel coronavirus, COVID-19, on chapter 11 cases continues to develop, and courts have responded to this crisis in myriad ways. As a result, the dire tension between debtors and general unsecured creditors has and likely will continue to be affected, and it is unclear whether the pandemic's fallout will have long-term repercussions on this relationship. Stay-at-home measures have resulted in many businesses shuttering or limiting operations, and unprecedented reactions have been seen from debtors and courts in an effort to counter the ill effects on debtors in existing chapter 11 cases, which found their restructuring planning shaken because of the virus's global impact. As a result, debtors and courts are attempting to adjust to find new and creative remedies within the Bankruptcy Code to preserve the value of their businesses.

For example, some brick-and-mortar retail and other debtors that rely on consumer foot traffic for revenue, and that looked to chapter 11 to provide relief through well-laid plans of orchestrating going-out-of-business sales or systematic restructurings, have turned to requesting novel and extraordinary equitable relief under §§ 305(a) and 105(a). Debtors are looking to suspend or "mothball" their cases under § 305(a)[1] and/or 105(a)[2] as a result of the pandemic, while others have been forced into chapter 7 liquidation, unable to convince stakeholders that the company should stay in chapter 11.[3] This article explores these suspension orders and assesses the resulting treatment of the claims and rights of general unsecured creditors in the wake of this pandemic.

Suspension Orders Under the Bankruptcy Code

In recent months, professionals have seen bankruptcy courts grant extraordinary equitable relief to already financially distressed companies that have been further impacted by the COVID-19 pandemic. The harsh new reality has prompted certain debtors to request temporary suspensions of their chapter 11 cases pursuant to the courts' equity powers provided by the Bankruptcy Code, with some turning to § 305(a) while others have used § 105(a) in combination with nonbankruptcy law. Some courts have granted these "mothball" motions in cases of nonessential business, such as brick-and-mortar retail and restaurants.

The hope was to suspend the chapter 11 proceedings in order to provide additional breathing space to preserve their restructuring or liquidation efforts. These efforts included the following: (1) the debtor could preserve the value of its business and preserve jobs; (2) lenders could preserve the value of their collateral by not seeking the premature sale or liquidation in a depressed market; and (3) unsecured creditors could continue to do business with a viable reorganized entity or extract value from a liquidated entity that would be liquidating based on fair market value.

The first case to file a mothball motion resulting from the effects of COVID-19 was in *Modell's Sporting Goods Inc.*, which is pending in the U.S. Bankruptcy Court for the District of New Jersey. In this case, the debtors anticipated generating revenue through closeout sales, but because of the store closures and the lack of foot traffic, the revenue stream stalled and an immediate lack of cash to pay landlords while liquidating precipitated the need for the extraordinary requested relief. Cases in the Delaware[4] and Virginia[5] bankruptcy courts entered similar orders over the objections of landlords and other creditors in an effort to preserve value to the chapter 11 estates.

The *Modell's* motion sought relief pursuant to § 305(a), which permits the dismissal or suspension of a case if "the interests of creditors and the debtor would be better served," and § 105. Historically, § 305 has been used where state court litigation might cause a bankruptcy proceeding to be duplicative or unnecessary, or such as when minority credi-

1 *See, e.g., In re Modell's Sporting Goods Inc.*, No. 20-14179, D.E. 166, 294 (Bankr. D.N.J. March 27, 2020, further extended by order dated April 30, 2020).

2 *See, e.g., In re Craftworks Parent LLC*, No. 20-10475, D.E. 217, 220 (Bankr. D. Del. March 30, 2020); *In re Pier 1 Imports Inc.*, No. 20-30805, D.E. 493 (Bankr. E.D. Va. April 6, 2020).

3 *See In re Art Van Furniture LLC*, No. 20-10553, D.E. 263 (Bankr. D. Del. April 7, 2020) (converting case to chapter 7). The proposed chapter 7 trustee to the Art Van estates has proposed his own form of suspension procedures. *See also In re VIP Cinema Holdings Inc.*, No. 20-10345 (Bankr. D. Del. April 7, 2020) (approving motion to pay post-petition severance). VIP Cinema was a manufacturer of movie theater seats and sought chapter 11 relief in Delaware in February 2020. It filed a consensual prepackaged plan to reduce its balance sheet. However, the pandemic saw VIP Cinema's market quickly disappear, along with the feasibility of its plan. VIP Cinema was forced to pivot from a reorganization to a liquidation as management resigned and plan supporters withdrew.

4 *See In re Craftworks Parent LLC*, No. 20-10475 (Bankr. D. Del.); *In re Forever 21 Inc.*, Case No. 19-12122 (Bankr. D. Del.).

5 *In re Pier 1 Imports Inc.*, No. 20-30805 (Bankr. E.D. Va. April 6, 2020), Order Granting (I) Relief Related to the Interim Budget, (II) Temporarily Adjourning Certain Motions and Applications for Payments, and (III) Granting Related Relief.

tors attempt to force an involuntary bankruptcy as negotiation leverage.[6] *Modell*'s mothball proposal sought to pay only critical expenses, such as wages and insurance, during the suspended period while other expenses were deferred, yet also sought to maintain the automatic stay and adjourn deadlines through 21 days past the suspended period of the cases.

Landlords objected to the debtors' request, arguing that such relief would result in their subsidizing the recovery of secured lenders. The court granted the motion with certain restrictions, including the suspension of an initial 30-day period, and allowed the parties relief from the court during the suspension "with respect to exigent and unforeseen circumstances" that could not be consensually resolved.[7]

In late April 2020, *Modell's* debtors sought to extend the initial 30-day case suspension for an additional 30 days. The debtors argued that the creditors would benefit in the long term by further extending the mothball order because the suspension would enable the debtors to recommence store closing sales at a later date for the benefit of all parties-in-interest. The *Modell's* debtors also argued that they were excused from making payments under the doctrine of frustration of purposes and intervening impossibility because they were without any other options than to suspend the store liquidation process resulting from the government-mandated shutdowns.

By order dated April 30, 2020, the court granted the requested relief over the objection of certain creditors, including landlords. The landlords objected to the continued suspension of the cases, arguing, among other things, that the suspension should be conditioned upon § 365(d)(3), which sets a 60-day limit on rental deferrals. Specifically, they argued that § 365(d)(3) provides that "[t]he court may extend, for cause, the time for performance of any [lease] obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period."[8] The landlords argued that the requested relief under §§ 305 and 105 exceeded statutory authority because § 365 requires performance of post-petition obligations no later than 61 days after the petition date. Further, the landlords noted that the request under § 105 could not be used as a basis to support the continued request because § 105 cannot be used to extend or override existing provisions of the Bankruptcy Code, pointing to Hon. **Mary F. Walrath**'s recent decision in *Forever 21*.[9] Cases that are coming into bankruptcy in more recent days and weeks, after the stay-at-home orders have been in effect for a few weeks or longer, are filing suspension motions as part of the requested first-day relief.[10] The requested relief relies primarily on § 365(d)(3) to provide the 60 days of suspension, with § 105 playing a supporting role.[11]

In a different procedural posture, in *Pier 1* the bidding deadline for its auction had passed when the debtors filed their emergency motion on March 31, 2020. The debtors argued to the U.S. Bankruptcy Court for the Eastern District of Virginia that the governmental shutdown of their stores had inhibited their opportunity for any going-concern transactions, and as a result, they were left with offers of liquidation.[12] Rather than rely on § 305(a), the debtors sought bankruptcy court approval of their suspension order under the court's equitable powers under § 105(a), with § 365(d)(3) unavailable, arguing instead that the governmental shelter-in-place order constituted a government taking that triggered abatement clauses in their leases and that they were further excused from performance under doctrines of impossibility and frustration of purpose.

The *Pier 1* debtors also sought to enforce contracts with vendors and other nonlease creditors during the suspension period and proposed alternative procedures under which creditors could seek administrative expenses. The motion was granted, and the debtors were relieved from paying rent to landlords who did not otherwise agree to a rent reduction and were permitted to not make payments to certain vendors, shippers and other suppliers during the period of the order. In *Pier 1*, like the other courts granting motions to suspend, requested monthly hearings to address material disputes.

On May 10, 2020, in a subsequent memorandum opinion, the court in *Pier 1* granted the debtors' motion seeking to temporality halt payment of rent.[13] The court permitted the debtors to skip rent payments during the pandemic (April and May) pursuant to § 365(d)(3) although "timely" payment is required.[14] The debtors were able to suspend the rent payments, but they would remain obligated to pay the rent and such obligation would be deemed an administrative expense.

The court did not require immediate payment, stating, "To compel payment by the Debtors now would elevate payment of rent to the Lessors to superpriority status, *i.e.*, a claim that would be paid before all other accrued but unpaid administrative expense claims."[15] Extending the moratorium until May 31, by an order dated May 5, 2020, the opinion explained the court's reasoning for its decision and stated that "[T]here is no feasible alternative to the relief sought" by the landlords.[16]

The Fallout of Suspension Orders

While the response from creditors to suspension orders is making its way through the court system, the impact of such orders on creditors is not as overt. The administrative burn created by mothballed landlords and other administrative-expense-holders may continue to result in debtors trying to pick and choose what post-petition expenses should be paid after the suspension order ends. The Bankruptcy Code requires that expenses incurred during the pendency of a chapter 11 case be paid in full prior to confirmation of a chapter 11 plan.[17]

6 Congress acknowledged that bankruptcy courts should decline jurisdiction over certain cases with the enactment of § 305. *See In re Bus. Info. Co. Inc.*, 81 B.R. 382 (Bankr. W.D. Pa. 1988); *see also In re DGE Corp.*, 2006 WL 4452846, *3 (Bankr. D.N.J. 2006) ("Several courts have held that abstention or dismissal is appropriate when another forum is available to determine the parties' interests and, in fact, such an action has been commenced.").

7 *See Modell's Sporting Goods* March 27, 2020, Suspension Order, at ¶ 2.b.

8 11 U.S.C. § 365(d)(3).

9 In *Forever 21*, the purchaser requested modification of the sale order in which the court denied stating that "the Supreme Court has told us in *Law v. Segal* that any relief granted under [Section] 105 must be in furtherance of a Bankruptcy Code provision and not in contravention of any specific provision." *See* Transcript, *In re Forever 21 Inc., et al.*, Case No. 19-12122 (Bankr. D. Del. April 21, 2020).

10 *See In re Chinos Holdings Inc.*, Case No. 20-32181 (Bankr. E.D. Va.), at Docket No. 23, entitled Motion of Debtors for Entry of Order (I) Extending Time for Performance of Obligations Arising Under Unexpired Non-Residential Real Property Leases, and (II) Granting Related Relief.

11 *Id. See also In re True Religion Apparel Inc.*, Case No. 20-10941 (Bankr. D. Del. May 6, 2020).

12 *In re Pier 1 Imports Inc.*, No. 20-30805 (Bankr. E.D. Va.).

13 *In re Pier 1 Imports Inc.*, No. 20-30805 (Bankr. E.D. Va. May 10, 2020).

14 *Id.* at p. 8.

15 *Id.*

16 *Id.* at p. 10.

17 11 U.S.C. § 365(d)(3), (d)(5), 4 *Collier on Bankruptcy* ¶ 503.03[4] (Richard Levin & Henry J. Sommer eds., 16th ed.) (noting that "ordinary course of business" post-petition administrative expenses "generally are paid when due").

continued on page 57

For example, in *Pier 1*, the mothball order froze expenses associated with brick-and-mortar store locations while maintaining that the e-commerce business and payments to corresponding vendors be deemed critical to the debtors' e-commerce business. Post-petition payments to landlords, vendors, shippers and suppliers were deferred after the cases had been pending for weeks or months. Ordinarily, if administrative expenses cannot be paid in full, then the debtor is deemed administratively insolvent and the case might be converted to a chapter 7 liquidation, but these are not ordinary times.

This prioritizing of administrative creditors, while possibly acceptable as a short-term fix, will likely face its own resistance as the pandemic continues. For example, in *Toys "R" Us*,[18] the debtors sought to set aside funds to compensate vendors for goods shipped after a certain date, leaving other administrative creditors out of the money. Courts might be hesitant to enforce such a long-term practice that appears to discriminate between administrative-expense-holders, but they may have no other option if they want to avoid a liquidation.

Further, vendors — facing their own challenges in the wake of COVID-19 — might, after any suspension order is lifted, have their own difficulty continuing business, and might be unable to fulfill customer orders even presuming that ongoing trade terms might be successfully negotiated. It would not be surprising to learn that even after a debtor determines that critical-vendor or other post-petition dollars are appropriate to pay a vendor, said vendor is unable to perform based on its own supply chain or other coronavirus-related disruption, whether by shipping delays, cancellation or internal concerns at factories or fulfillment centers because of the implementation of important public health policies to prevent the spread of the virus.

18 *See In re Toys "R" Us Inc.*, Case No. 17-34665 (Bankr. E.D. Va., March 25, 2018) (orders (1) authorizing wind-down of U.S. operations and postponing creditors' efforts to collect on administrative claims, and (2) establishing dates by which parties holding such administrative claims must file proofs of claim).

Conclusion

This mothballing strategy certainly departs from the accepted norm that chapter 11 requires debtors to pay administrative expenses, including landlords and current vendors, in a timely manner. However, the suspension of the cases provides a pause with the hopes that the disruption is short-lived and liquidity may be restored in time and hopefully provide a benefit to stakeholders. The courts, when granting creeping suspension such as in *Modell's*, are permitting ongoing uncertainty to stakeholders (such as landlords) as orders are extended monthly. The impact has yet to be determined.

As the pandemic shutdown of nonessential businesses in many states has been extended beyond April 30, 2020, it is unclear whether the suspension of cases will delay an inevitable liquidation or provide the anticipated useful extension of support to allow the cases to continue in chapter 11. Of those chapter 11 debtors that survive, the COVID-19 crisis may result in efforts to fast-track funds for critical administrative expenses to employees, professionals and certain vendors in order to keep certain portions of the business (such as online sales) operational, yet leave other creditors (such as landlords and other vendors) out of the money. Such a strategy to further prop up liquidity likely also further reduces or eliminates the possibility of recovery to unsecured creditors, because if such administrative expenses cannot be paid, there is little chance that general unsecured creditors will recover on their claims. abi

EXHIBIT K

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In re: MODELL'S SPORTING GOODS, INC., *et al.*, Debtors.[1]	Chapter 11 Case No. 20-14179 (VFP) Jointly Administered

DEBTORS' VERIFIED APPLICATION IN SUPPORT OF EMERGENCY MOTION FOR ENTRY OF AN ORDER TEMPORARILY SUSPENDING THEIR CHAPTER 11 CASES PURSUANT TO 11 U.S.C. §§ 105 AND 305

Modell's Sporting Goods, Inc. and its subsidiaries, as debtors and debtors in possession in the above-captioned chapter 11 cases (collectively, the "**Debtors**"), by and through their undersigned proposed counsel, submit this verified application (the "**Application**") pursuant to

[1] The Debtors in these chapter 11 cases and the last four digits of each Debtor's federal tax identification number, as applicable, are as follows: Modell's Sporting Goods, Inc. (9418), Modell's II, Inc. (9422), Modell's NY II, Inc. (9434), Modell's NJ II, Inc. (9438), Modell's PA II, Inc. (9426), Modell's Maryland II, Inc. (9437), Modell's VA II, Inc. (9428), Modell's DE II, Inc. (9423), Modell's DC II, Inc. (9417), Modell's CT II, Inc. (7556), MSG Licensing, Inc. (8971), Modell's NH, Inc. (4219), Modell's Massachusetts, Inc. (6965) and Modell's Online, Inc. (2893). The Debtors' corporate headquarters is located at 498 Seventh Avenue, 20th Floor, New York, New York 10018.

sections 105 and 305 of title 11 of the United States Code (the "**Bankruptcy Code**") and Rule 1017 of the Federal Rules of Bankruptcy Procedure (the "**Bankruptcy Rules**") file this Application to suspend their chapter 11 cases in their entireties. In support of the Application, the Debtors respectfully represent as follows:

I. JURISDICTION

1. This Court has jurisdiction to consider this matter pursuant to 28 U.S.C. §§ 157(a)-(b) and 1334(b) the *Standing Order of Reference to the Bankruptcy Court Under Title 11* of the United States District Court for the District of New Jersey, dated September 18, 2012 (Simandle, C.J.). This is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

2. The bases for the relief requested herein are sections 105 and 305 of title 11 of the United States Code, 11 U.S.C. §§ 101–1532 (the "**Bankruptcy Code**") and Rule 1017 of the Federal Rules of Bankruptcy Procedure (the "**Bankruptcy Rules**").

II. PRELIMINARY STATEMENT

3. The unprecedented, exponential spread of Coronavirus disease COVID-19 ("**COVID-19**") throughout the United States over the course of the last week, along with the resulting, state-imposed limitations and prohibitions on non-essential retail operations, has forced the Debtors to re-evaluate the short-term trajectory of their chapter 11 cases. The cornerstone of these cases is the liquidation of the Debtors' 134 stores and e-commerce site through store closing sales. Notwithstanding the Debtors' best-laid plans, COVID-19 has prevented the Debtors from conducting the robust liquidation sales that seemed possible just one week ago; it has left the Debtors with no choice but to temporarily "mothball" their operations to preserve

value, with the hope that they can recommence operations in the near future and successfully liquidate their inventory for the benefit of all parties-in-interest.

4. In order to mothball their operations and abide by their social and ethical duties to promote social distancing, the Debtors seek a temporary suspension of all deadlines and activities in their chapter 11 cases, for a period of up to sixty days, pursuant to section 305 of the Bankruptcy Code (as defined in more detail below, the "**Bankruptcy Suspension**"), without prejudice to their right to seek additional time. Critically, the Debtors seek to defer payment of all expenses other than those that are absolutely essential, as outlined in their Modified Budget (defined below). Moreover, as part of the Bankruptcy Suspension, the Debtors have instituted or intend to immediately institute an Operational Suspension (defined below), which will entail, among other things:

a. The cessation of operations, including Store Closing Sales (defined below), at all 134 of their retail stores as well as fulfillment of orders on their e-commerce site;

b. The termination of store-level and distribution center employees; and

c. The cessation of all in-person operations at their corporate headquarters and termination most corporate employees, leaving in place a skeleton crew of essential employees to effectuate critical human relations, finance, and infrastructure technology functions during the Operational Suspension.

5. The Debtors, along with their professionals, have developed a plan to reoperationalize after COVID-19 abates and believe that the breathing spell provided by the Bankruptcy Suspension is in the best interests of their estates and all creditors as it will allow the Debtors, in time, to maximize the value of their inventory and leasehold interests.

6. The Debtors recognize that all parties are suffering during these uncertain times. Nevertheless, the Debtors believe that the Bankruptcy Suspension will inure to the benefit of all parties such that it is warranted pursuant to section 305 of the Bankruptcy Code.

III. BACKGROUND

a. The Chapter 11 Cases

7. On March 11, 2020 (the "**Petition Date**"), each of the Debtors commenced with this Court voluntary cases under chapter 11 of the Bankruptcy Code. The Debtors continue to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. No trustee, examiner, or statutory committee of creditors has been appointed in these chapter 11 cases.

8. The Debtors' cases are being jointly administered under lead Case No. 20-14179 pursuant to Bankruptcy Rule 1015 [Docket No. 88].

9. Information regarding the Debtors' business, capital structure, and the circumstances leading to the commencement of these chapter 11 cases is set forth in the *Declaration of Robert J. Duffy in Support of Debtors' Chapter 11 Petitions and First Day Pleadings* [Docket No. 24] (the "**First Day Declaration**").

10. At the commencement of these cases, the Debtors operated 134 stores in ten states plus the District of Columbia. Prior to the Petition Date, the Debtors, along with their counsel, Cole Schotz P.C. ("**Cole Schotz**"), crisis managers, Berkeley Research Group, LLC, liquidation consultant, Tiger Capital Group, LLC ("**Tiger**"), and real estate consultant and advisors, A&G Realty Partners, LLC (**A&G**), modeled and analyzed the Debtors' financial performance and lease portfolio to determine how best to maximize the value of the Debtors' assets.

11. As set forth in the First Day Declaration, the Debtors filed these chapter 11 cases with the intention of liquidating their inventory through store closing sales (the "**Store Closing Sales**") conducted with the assistance of Tiger, paying off their lenders by mid-April, and using the remaining proceeds of their Store Closing Sales to wind their operations and provide a

distribution to creditors. The Debtors' intended to effectuate this plan through the consensual use of cash collateral.

12. In furtherance thereof, on the Petition Date, the Debtors filed, among other things:

a. a Motion for Entry of Interim and Final Orders (I) Authorizing the Debtors to Assume the Consulting Agreement, (II) Approving Procedures for Store Closing Sales, and (III) Approving the Implementation of Customary Store Bonus Program and Payments to Non-Insiders Thereunder [Docket No. 8] (the "**Store Closing Motion**");

b. a Motion for Entry of an Order Authorizing and Approving Procedures for Rejection of Executory Contracts and Unexpired Leases [Docket No. 9] (the "**Rejection Procedures Motion**"); and

c. a Motion for Entry of Interim and Final Orders (I) Authorizing Use of Cash Collateral and Affording Adequate Protection; (II) Modifying Automatic Stay; (III) Scheduling a Final Hearing; and (IV) Granting Related Relief [Docket No. 23] (the "**Cash Collateral Motion**").

13. On March 13, 2020 at 10:00 a.m., the Court held a hearing (the "**First Day Hearing**") at which it granted, among other things, the Store Closing Motion, the Rejection Procedures Motion, and the Cash Collateral Motion. *See* Docket Nos. 63, 68, and 66, respectively.

14. As set forth on the record at the First Day Hearing, at that time, the Debtors anticipated that the Store Closing Sales would be substantially complete by April 30, 2020 and that the Debtors would avail themselves of the rejection procedures described in the Rejection Procedures Motion to relieve themselves of certain lease obligations prior to paying May 1 rent. The Debtors intended (and intend) to assume and assign other leases with the assistance of A&G.

15. Thereafter, on March 18, 2020, the Debtors filed

a. an Application for Entry of an Order Authorizing the Employment and Retention of Cole Schotz P.C. as Bnkruptcy Counsel to the Debtors *Nunc Pro Tunc* to the Petition Date [Docket No. 99]; and

b. an Application for Entry of an Order Authorizing the Debtors to Retain A&G Realty Partners, LLC as a Real Estate Consultant and Advisor Nu*nc Pro Tunc* to the Petition Date [Docket No. 100].

16. On March 20, 2020, the Debtors filed a Motion for an Administrative Fee Order Establishing Procedures for the Allowance and Payment of Interim Compensation and Reimbursement of Expenses of Professionals Retained by Order of this Court [Docket No. 109].

b. The Impact of COVID-19 on the Store Closing Sales

17. Since the First Day Hearing, the exponential spread of COVID-19 has wreaked economic and social havoc across the country. On the afternoon of March 13, 2020, President Trump declared COVID-19 a national emergency. Pres. Proc. No. 9994, 85 F.R. 15337, 2020 WL 1272563. Separately, most of the states in which the Debtors operate have also declared states of emergency.

18. The various states in which the Debtors operate have also imposed various restrictions on retail businesses which have impacted the Debtors' ability to conduct Store Closing Sales. First, at 2:00 p.m. on March 16, 2020, the state of Pennsylvania ordered the closure of all non-essential stores, bars, and restaurants, effective at midnight that same day, thus impacting the Debtors' Store Closing projections at the Debtors' 17 Pennsylvania stores. *See* WPXI.com, TIMELINE: Pennsylvania coronavirus updates March 16, March 16, 2020, available at https://www.wpxi.com/news/top-stories/live-updates-coronavirus-pennsylvania-what-you-need-know-monday/DOARLQQXDVHSZHYF2BN77EMXIQ/. Thereafter, several of the Debtors' landlords implemented modified store hours while others forced the Debtors to close stores, further inhibiting the Store Closing Sales.

19. More recently, other states in which the Debtors operate have ordered the closure or drastic limitation of "non-essential" business functions, again restricting the Debtors' ability to conduct Store Closing Sales. *See, e.g.*, Order of the Governor of the Commonwealth of

Pennsylvania Regarding the Closure of All Businesses that Are Not Life Sustaining, signed by Gov. Tom Wolf (PA) on March 19, 2020 (closing all non-life-sustaining businesses); N.Y. Exec. Order 202.8 (Mar. 20, 2020) (directing 100% closure of all non-essential business, including retail business, state-wide); Conn. Exec. Order 7H (Mar. 20, 2020) (requiring non-essential businesses to reduce their in-person workforces at any workplace locations by 100% effective March 23, 2020 at 8:00 p.m.); N.J. Exec. Order 107 (Mar. 21, 2020) (suspending all non-essential retail businesses state-wide); Fourth Modification of the Declaration of a State of Emergency for the State of Delaware Due to a Public Health Threat (Mar. 22, 2020) (directing 100% closure of all non-essential business state-wide, effective March 24, 2020 at 8:00 a.m.); Md. Exec. Order 20-03-23-01 (March 23, 2020) (directing 100% closure of all non-essential business state-wide); Exec. Order 53 (March 23, 2020) (limiting operations at non-essential retail businesses to no more than ten patrons at a time and requiring such establishments to either "adhere to . . . proper social distancing requirements" or to close, effective March 24, 2020 at 11:59 p.m.); Mass. Order Assuring Continued Operation of Essential Services in the Commonwealth, Closing Certain Workplaces and Prohibiting Gatherings of More Than 10 People (Mar. 23, 2020) (directing 100% closure of all non-essential business state-wide, effective March 25, 2020 at 12:00 noon). At this time, nearly all of the Debtors' stores have been impacted by these restrictions, modified hours, and closures.

20. Notwithstanding the careful pre-petition planning and modeling of the Debtors and their advisors, in the past week and a half, the Debtors' situation has changed drastically as a result of COVID-19. Given the restrictions on operations at the Store Closing Sales, on March 20, 2020, the Debtors made the difficult decision to cease operations and terminate the majority of their employees.

21. In light of the current climate, the Debtors have worked round-the-clock with their advisors to create new models and a new go-forward plan which they believe will enable them to maximize value for all creditors. Specifically, the Debtors believe it would be in the best interests of their creditors and all parties-in-interest to suspend business operations (the "**Operational Suspension**") on the following terms:

a. To the extent they have not already done so, the Debtors shall immediately (i) cease operations, including Store Closing Sales, at all 134 of their retail stores as well as fulfillment of orders on the e-commerce site, (ii) terminate store-level and distribution center employees, without severance, and (iii) cease all in-person operations at their corporate headquarters and terminate most corporate employees, without severance. The Debtors hope to rehire certain of their terminated employees to conduct Store Closing Sales when they reoperationalize.

b. The Debtors intend to continue to employ certain critical employees responsible for human relations, finance, and infrastructure technology functions during the Operational Suspension. Without the continuation of these functions, the Debtors would be unable to reoperationalize at a later date.[2]

c. The Debtors intend to use cash collateral, with the consent of their pre-petition lenders, to pay certain critical expenses, including their remaining employees, utilities, insurance, and trust fund taxes, pursuant to a modified budget (the "**Modified Budget**"), which is a subset of the budget previously approved by the Court.[3]

22. The Modified Budget and the Operational Suspension were designed to enable the Debtors to pay essential expenses so that the Debtors can reoperationalize and complete the Store Closing Sales as economically and efficiently as possible.

23. In order to reap the benefits of the Operational Suspension, the Debtors must suspend their bankruptcy cases (the "**Bankruptcy Suspension**") on the following terms:

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[2] The Debtors' Chief Executive Officer, Mitchell Modell, has agreed to defer his compensation during the Operational Suspension.

[3] A copy of the modified budget is attached hereto as **Exhibit A**. The payments set therein have been approved of by the Debtors' pre-petition lenders.

a. The Debtors seek entry of an order authorizing them to implement the Operational Suspension, to the extent any of the terms thereof conflict with relief previously ordered by the Court or their duties as debtors in possession.

b. In order to avoid the accrual of administrative costs during the Bankruptcy Suspension, the Debtors seek entry of an Order (i) extending all deadlines that would otherwise occur during the Bankruptcy Suspension until the twenty-first day following the termination thereof and (ii) barring any party from seeking relief during the Bankruptcy Suspension.

c. The Debtors also seek entry of an Order deferring the payment of all expenses other than those essential expenses set forth in the Modified Budget.

d. In addition, the Debtors seek entry of an Order confirming that the automatic stay shall remain in full force and effect during the pendency of the Bankruptcy Suspension in order to ensure the equal treatment of creditors and the preservation of estate assets.

e. Finally, the Debtors seek entry of an Order conditionally approving the retentions of Cole Schotz and A&G. During the Bankruptcy Suspension, the Debtors' professionals shall provide only such services as are essential to effectuate the Operational Suspension and the Bankruptcy Suspension.[4]

24. The Bankruptcy Suspension was designed to streamline the Debtors' costs during the period of thereof in order to safeguard the Debtors' prospects of conducting successful Store Closing Sales after the imminent threat of COVID-19 has subsided.

IV. RELIEF REQUESTED

25. The Debtors seek entry of an Order approving the Operational Suspension and the Bankruptcy Suspension and immediately suspending these chapter 11 cases for up to sixty days,

[4] The Debtors propose that these professionals will draw on their respective retainers but not be obligated to file and serve monthly fee statements or interim compensation applications during the Bankruptcy Suspension. Notwithstanding the foregoing, (i) at least five business days prior to making any such draw, a professional shall serve a statement reflecting the number of hours worked and amount billed by such professional, broken down by timekeeper, on the Debtors' pre-petition lenders and the Office of the United States Trustee for Region 3 and (ii) any funds the professionals draw against their retainers during the Bankruptcy Suspension shall, of course, remain subject to the entry of a final order approving the award of such compensation. "[I]nterim allowances are always subject to the court's re-examination and adjustment during the course of the case as all expenses of administration must receive the court's final scrutiny and approval." *Stable Mews Assocs. v. Togut*, 778 F.2d 121, 123 n.3 (2d Cir. 1985) (quoting 2 Collier on Bankruptcy ¶ 331.03 at 331-9 (15th ed. 1985)).

pursuant to sections 105 and 305 of the Bankruptcy Code, without prejudice to the Debtors' right to seek additional time.

V. BASIS FOR RELIEF REQUESTED

A. The Bankruptcy Suspension Is Authorized Pursuant to Section 305 of the Bankruptcy Code As It Is in the Best Interests of the Debtors and Their Creditors

26. Section 305(a)(1) of the Bankruptcy Code permits the Court, "after notice and a hearing," to "suspend all proceedings in a case under this title, at any time if—(1) the interests of creditors and the debtor would be better served by such dismissal or suspension." Suspension of chapter 11 case is considered an "extraordinary remedy" and the movant bears the burden of proving that "the interests of the debtor and its creditors would benefit from . . . suspension of proceedings under § 305(a)(1)." *In re Monitor Single Lift I, Ltd.*, 381 B.R. 455, 462–63 (Bankr. S.D.N.Y. 2008) (citations omitted); *see In re Biolitec, Inc.*, 528 B.R. 261, 267, n.9 (Bankr. D.N.J. 2014) ("Although section 305(a) applies to voluntary cases, because a dismissal pursuant to this section is appealable only to the district court or a bankruptcy appellate panel, it is considered an 'extraordinary remedy' that should be granted only if it is shown that both the debtor and its creditors would be better served" by such relief) (internal marks omitted) (citing, *inter alia*, *In re Monitor Single Lift*). The decision to suspend a chapter 11 case is made on a case-by-case basis. *Monitor Single Lift*, 381 B.R. at 464.

27. The relief afforded by section 305 "is extremely broad; the court may either dismiss the case or, in the alternative, suspend all proceedings within the case . . . . As explained [by Collier on Bankruptcy]: if 'a party . . . seeks suspension of all proceedings within a case, section 305(a) should be invoked.'" *Graham v. Yoder Mach. Sales (In re Weldon F. Stump & Co.)*, 373 B.R. 823, 826 n.1 (Bankr. N.D. Ohio 2007) (citing 2 Collier on Bankruptcy P 305.01 [1] (15th ed. rev. 2005)). "Based on the case law and the purpose of § 305, . . . the

contours of suspension may be fashioned by a bankruptcy court to fit the needs of the case." *In re Picacho Hills Util. Co., Inc.*, Case No. 13-10742 TL7, 2017 WL 1067754, at *6 (Bankr. D.N.M. Mar. 21, 2017) (citing, *inter alia*, *In re Compania de Alimentos Fargo,* 376 B.R. 427, 440 (Bankr. S.D.N.Y. 2007) (implying in dicta that a section 305 suspension may not terminate section 362's automatic stay)).

28. Courts have invoked section 305's powers to suspend a case in a variety of unique circumstances.[5] For example, in *In re Milestone Educ. Inst.*, 167 B.R. 716 (Bankr. D. Mass. 1994), a bankruptcy court *sua sponte* suspended "all activity" in a chapter 11 case to allow a state court to address novel issues of receivership law. *Id.* at 724. The court noted that the suspension would "preserve the bankruptcy petition filing date for purposes of bringing preference actions" which was the stated purpose of the chapter 11 filing, with the aim of "increas[ing] the amount of money available to distribute to [the debtor's] creditors. *Id.* at 718, 724. In that case, the court noted that the harm of a delayed distribution was "outweighed by the salutary effect" of the suspension. *Id.* at 724.

29. In considering whether to suspend a case pursuant to section 305, courts consider various factors. *See, e.g.*, *In re Zais Inv. Grade Ltd. VII,* 455 B.R. 839, 846 (Bankr. D.N.J. 2011) (citing *Monitor Single Lift* factors addressing two-party disputes); *In re MicroBilt Corp.*, 484 B.R. 56, 66 (Bankr. D.N.J. 2012) (considering abstention under 28 U.S.C. § 1334(d) and 11 U.S.C. § 305(a), citing a different set of factors addressing two-party disputes, and abstaining

[5] Although the decision to suspend a case is generally made in the context of a two-party disputes and involuntary bankruptcy proceedings, "nowhere in the text of § 305(a)(1) or in its legislative history did Congress specifically limit the basis for a § 305(a)(1) motion to involuntary cases commenced by creditors to gain leverage in out-of-court negotiations." *Monitor Single Lift*, 381 B.R. at 463. In fact, the *Monitor Single Lift* court noted that "[t]he legislative history's reference to this fact-pattern only as an 'example' of a basis for abstaining under § 305(a)(1) validates this broader view of § 305(a)(1)'s application." *Id.*

from adjudicating certain claims as in the best interests of the parties and the court). Regardless of the factors courts consider, "[a]s noted in the statute, the overriding considerations are, of course, the interests of creditors and the debtor[s]." *In re Gabriel Techs. Corp.*, Case No. 13-30341, 2013 WL 5550391, at *4-*5 (Bankr. N.D. Cal. Oct. 7, 2013) (citing the *Monitor Single Lift* factors).

30. Where parties disagree as to whether suspension is in the best interests of all parties, the "court does not count votes to decide the issue but weighs the competing interests of the various creditor constituencies and the Debtor, and then appl[ies] the applicable factors to the peculiar circumstances of an[] individual case, exercise[ing] its sound discretion to make a decision for or against suspension." *Id.* at *5 (suspending a chapter 11 case in light of the fact that "the overwhelming interests of creditors generally support[ed]" suspension and in spite of the fact that a litigation counterparty was "oppose[d] any disposition under § 305")

31. The Debtors respectfully submit that, in spite of the fact that suspension is an "extraordinary remedy," approval of the Bankruptcy Suspension is appropriate as it is in the best interests of the Debtors and their creditors during these unprecedented times. *See* 11 U.S.C. § 305. Specifically, the "contours" of the Bankruptcy Suspension have been "fashioned to suit the needs of these chapter 11 cases," such that the relief requested is authorized in light of section 305's broad scope. *Picacho Hills Util. Co., Inc.*, 2017 WL 1067754, at *6; *Weldon F. Stump & Co.*, 373 B.R. at 826 n.1 (Bankr. N.D. Ohio 2007).

32. The Bankruptcy Suspension will enable the Debtors to temporarily halt both their operations and the continuation of these bankruptcy proceedings, with the continued imposition of the automatic stay, until such time as they can reinitiate the Store Closing Sales. As in *Milestone Educ. Inst.*, the Bankruptcy Suspension will preserve the Debtors estates and "increase

the amount of money available to distribute to [the debtor's] creditors," which is the stated purpose of these chapter 11 proceedings. *See id.* 167 B.R. at 718, 724 (suspending a chapter 11 case and noting that suspension would "preserve the bankruptcy petition filing date for purposes of bringing preference actions" which was the stated purpose of the chapter 11 filing).

33. During the Bankruptcy Suspension, the Debtors intend to make payments consistent with the authority granted in the Interim Order (I) Authorizing Use of Cash Collateral and Affording Adequate Protection; (II) Modifying Automatic Stay; (III) Scheduling a Final Hearing; and (IV) Granting Related Relief [Docket No 66] (the "**Cash Collateral Order**"), as modified by the Modified Budget.[6] As set forth above, the Modified Budget is a subset of the budget already approved by the Court. It has been substantially reduced to provide for the payment of only those expenses deemed critical to enable the Debtors to reoperationalize their enterprise and safeguard the success of the Store Closing Sales once COVID-19 abates. By deferring, among other things, certain rent and other non-critical obligations during the Operational Suspension, the Court will provide the Debtors with the breathing spell necessary to enable them to successfully reimplement the Store Closing Sales at a later date.[7] Indeed, the Bankruptcy Code already contemplates, in the appropriate case, that rent may be deferred for a 60-day period. *See* 11 U.S.C. § 365(d)(3) ("The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period."). In light

[6] The Cash Collateral Order contemplates the possibility of revisions to the Budget (as defined therein). Specifically, the Cash Collateral Order notes that the Budget "may be updated from time to time with the prior written consent of the Prepetition Administrative Agent and Prepetition Term Agent." *See* Cash Collateral Order at ¶ 3(a).

[7] The Debtors reserve all rights to argue that obligations allegedly accrued during the Operational Suspension are waived, abated, or otherwise not subject to payment for reasons including, but not limited to, the existence of force majeure, quiet enjoyment, or other applicable contractual provisions or legal rights.

of the fact that the Debtors will not be operating (and, indeed, cannot operate) during that time, cause exists to grant the relief requested. The Debtors believe the Modified Budget will enable them to effectuate the Operational Suspension and the Bankruptcy Suspension so as to maintain these chapter 11 cases for the benefit of all of the Debtors' creditors. Although the relief requested is unique, it is appropriate in these cases given the unprecedented impact of COVID-19 not only on the Debtors' operations but also on the United States economy in its entirety.

34. Separately, the Bankruptcy Suspension benefits the Debtors and their creditors in that (i) it will enable the Debtors to avoid incurring unnecessary administrative costs, including professionals' fees, during the Operational Suspension and (ii) the continued imposition of the automatic stay will ensure no creditor takes self-interested action to the detriment of the Debtors' estates and all other parties.

35. Although the Debtors anticipate that there will be minimal work for their professionals during the Bankruptcy Suspension, out of an abundance of caution, they seek conditional approval of the Cole Schotz and A&G retention applications, subject to the deferral of all deadlines until the twenty-first day following the termination of the Bankruptcy Suspension. As set forth in more detail above, the Debtors' professionals may draw down on their retainers during the Bankruptcy Suspension provided, however, that all funds so drawn shall remain subject to the entry of a final order approving the award of such compensation. *See* note 4, *supra*.

36. For the reasons set forth above, based on the "peculiar circumstances" COVID-19 has imposed on the United States economy, in general, and the retail industry, in particular, the Debtors submit that the Bankruptcy Suspension presents the best prospect of recovery for most, if not all, of the Debtors' creditors. *In re Gabriel Techs. Corp.*, 2013 WL 5550391, at *5. In

sum, as in, *Milestone Educ. Inst.*, any potential harm of Bankruptcy Suspension is "outweighed by the salutary effect" of the suspension. *Id.* at 724.

B. Alternatively, the Bankruptcy Suspension Is Authorized Pursuant to Section 105 of the Bankruptcy Code

37. Alternatively, the relief requested is authorized pursuant to section 105 of the Bankruptcy Code. Section 105(a) provides, in relevant part, that, "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. §105(a). This provision codifies the inherent equitable powers of the bankruptcy court. As one court articulated, section 105 is "an omnibus provision phrased in such general terms as to be the basis for a broad exercise of power in the administration of a bankruptcy case. The basic purpose of § 105 is to assure the bankruptcy courts power to take whatever action is appropriate or necessary in aid of the exercise of its jurisdiction." *Davis v. Davis (In re Davis)*, 170 F.3d 475, 492 (5th Cir. 1999) (citing 2 L. King, Collier On Bankruptcy § 105.01, at 105–3 (1996)). For the reasons set forth above, the Debtors believe that the imposition of the Bankruptcy Suspension, including the Operational Suspension, is necessary to carry out the provisions of this title as it will enable the Debtors to maximize the value of their assets, for the benefit of all creditors, through the liquidation of their inventory and sale of their valuable leasehold interests after the threat of COVID-19 subsides.

VI. WAIVER OF CERTIFICATION AND MEMORANDUM OF LAW

38. The Debtors respectfully request that the Court waive the requirement set forth in Local Rule 9013-1(a)(2) that any motion be accompanied by a certification containing the facts supporting the relief requested in compliance with Local Bankruptcy Rule 7007-1 because the facts set forth in this Application have been verified by the Debtors' Chief Restructuring Officer, Robert J. Duffy.

39. The Debtors further request that the Court waive the requirement set forth in Local Rule 9013-1(a) (3) that any motion be accompanied by a memorandum of law stating the legal basis of the relief requested because the legal basis upon which the Debtors rely is incorporated herein.

VII. NO PRIOR REQUEST

40. No prior request for the relief sought in this Application has been made to this Court or any other court.

VIII. NOTICE

41. Notice of this Application has been provided to (i) the Office of the United States Trustee for Region 3; (ii) the holders of the twenty (20) largest unsecured claims against the Debtors (on a consolidated basis); (iii) counsel for the administrative agent under the Debtors' pre-petition revolving credit facility, JPMorgan Chase Bank, N.A., c/o Daniel F. Fiorillo, Esq. and Chad B. Simon, Esq., Otterbourg P.C.; (iv) counsel for the term agent under the Debtors' pre-petition term loan, Wells Fargo Bank, National Association, c/o Steven E. Fox, Esq., Riemer & Braunstein LLP; (v) the Internal Revenue Service; (vi) the United States Attorney's Office for the District of New Jersey; and (vii) any party requesting notice pursuant to Bankruptcy Rule 2002. The Debtors submit that, in view of the facts and circumstances, such notice is sufficient and no other or further notice need be provided.

WHEREFORE, the Debtors respectfully request that the Court grant the relief requested herein and such other and further relief as the Court may deem just and proper.

Dated: March 23, 2020

Respectfully submitted,

COLE SCHOTZ P.C.
Proposed Attorneys for Debtors and Debtors in Possession

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VERIFICATION

ROBERT J. DUFFY, of full age, certifies as follows:

1. I am the Chief Restructuring Officer of Modell's Sporting Goods, Inc. and its subsidiaries, as debtors and debtors in possession in the above-captioned chapter 11 cases. As such, I have full knowledge of the facts set forth in and am duly authorized to make this verified application (the "**Application**") on the Debtors' behalf.

2. I have read the foregoing Application and certify that the statements contained therein are true based upon my personal knowledge, information, and belief.

3. I am aware that if any of the factual statements contained in the Application are willfully false, I am subject to punishment.

DATED: March 23, 2020

/s/ Robert J. Duffy

ROBERT J. DUFFY

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

Caption in Compliance with D.N.J. LBR 9004-1(b)

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In re:

MODELL'S SPORTING GOODS, INC., *et al.*,

Debtors.[1]

Chapter 11
Case No. 20-14179 (VFP)
Jointly Administered
Hearing Date and Time:
June 4, 2020, at 2:30 p.m. (ET)

ORDER FURTHER SUSPENDING THE DEBTORS' CHAPTER 11 CASES PURSUANT TO 11 U.S.C. §§ 105 AND 305 THROUGH AND INCLUDING JUNE 15, 2020 AND SETTING FINAL HEARING ON CASH COLLATERAL MOTION

The relief set forth on the following pages, numbered two (2) through five (5), is hereby **ORDERED**.

DATED: June 5, 2020

Honorable Vincent F. Papalia
United States Bankruptcy Judge

[1] The Debtors in these chapter 11 cases and the last four digits of each Debtor's federal tax identification number, as applicable, are as follows: Modell's Sporting Goods, Inc. (9418), Modell's II, Inc. (9422), Modell's NY II, Inc. (9434), Modell's NJ II, Inc. (9438), Modell's PA II, Inc. (9426), Modell's Maryland II, Inc. (9437), Modell's VA II, Inc. (9428), Modell's DE II, Inc. (9423), Modell's DC II, Inc. (9417), Modell's CT II, Inc. (7556), MSG Licensing, Inc. (8971), Modell's NH, Inc. (4219), Modell's Massachusetts, Inc. (6965) and Modell's Online, Inc. (2893). The Debtors' corporate headquarters is located at 498 Seventh Avenue, 20th Floor, New York, New York 10018.

Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the motion.

Upon the verified application [Docket No. 115] (the "**Application**")[2] of Modell's Sporting Goods, Inc. and its subsidiaries, as debtors and debtors in possession in the above-captioned chapter 11 cases (collectively, the "**Debtors**"), pursuant to sections 105 and 305 of the Bankruptcy Code and Bankruptcy Rule 1017 for entry of an order approving the Bankruptcy Suspension and, thereafter, the notice [Docket No. 234] of Debtors' intent to seek a further suspension of their chapter 11 cases through and including May 31, 2020, as more fully set forth therein and, thereafter, the notice [Docket No. 352] (the "**Second Extension Notice**") of Debtors' intent to seek a further suspension of their chapter 11 cases through and including June 15, 2020, as more fully set forth therein, and the supplement to the Second Extension Notice [Docket No. 364] which attached a copy of the Debtors proposed budget (the "**Proposed Budget**") as Exhibit A thereto; and the Court having jurisdiction to consider the Second Extension Notice and the relief requested therein in accordance with 28 U.S.C. §§ 157(a)-(b) and 1334(b); and consideration of the Second Extension Notice and the relief requested therein being a core proceeding pursuant to 28 U.S.C. § 157(b); and venue being proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409; and notice of the Second Extension Notice having been given as set forth in the Application and the order shortening time entered in connection

[2] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the Application and the Debtors' omnibus response in opposition to the landlord responses and in support of an order further suspending their chapter 11 cases through and including May 31, 2020 (the "**Omnibus Response**").

therewith, and such notice having been adequate and appropriate under the circumstances; and it appearing that no other or further notice of the Second Extension Notice need be provided; and the Court having held a hearing (the "**Hearing**") to consider the relief requested; and upon the *Declaration of Robert J. Duffy in Support of Debtors' Chapter 11 Petitions and First Day Pleadings*, the records of the Hearing, and all of the proceedings had before the Court; and the Court having previously entered an *Order Temporarily Suspending the Debtors' Chapter 11 Cases Pursuant to 11 U.S.C. §§ 105 and 305* [Docket No. 166] suspending these chapter 11 cases through and including April 30, 2020, without prejudice to the Debtors' right to seek a further extension of time and an *Order Further Suspending the Debtors' Chapter 11 Cases Pursuant to 11 U.S.C. §§ 105 and 305* [Docket No. 294] suspending these chapter 11 cases through and including May 31, 2020, without prejudice to the Debtors' right to seek a further extension of time (collectively, the "**Suspension Orders**"); and the Court having found and determined that the relief sought in the Second Extension Notice, as modified and granted herein, is in the best interests of the Debtors and their creditors, and that the legal and factual bases set forth in the Application, the Extension Notice, the Debtors' Omnibus Response, and the Court having considered the objections of certain parties and the arguments of counsel, and the Second Extension Notice, as supported by the previous submissions of the Debtor and the consent or non-objection of various significant parties in interest, including (without limitation), the Debtors' Lenders, the Creditors Committee and the Office of the United States Trustee, establish just and sufficient cause for the relief granted herein; and after due deliberation and sufficient cause appearing therefor; and for the reasons set forth on the record on June 4, 2020,

IT IS HEREBY ORDERED THAT:

1. The relief requested in the Second Extension Notice is **GRANTED** as set forth herein.

2. The Suspension Orders shall continue to govern these chapter 11 cases through and including June 15, 2020, without prejudice to the Debtors' right to seek a further extension of time for additional and sufficient cause shown.

3. The Proposed Budget is hereby approved through and including the week ending June 13, 2020.

4. A final hearing on the Debtors' *Motion for Entry of Interim and Final Orders (I) Authorizing Use of Cash Collateral and Affording Adequate Protection; (II) Modifying Automatic Stay; (III) Scheduling a Final Hearing; and (IV) Granting Related Relief* [Docket No. 23] (the "**Cash Collateral Motion**") shall be held on June 11, 2020 at 3:00 p.m. EST, with objections to the relief requested due on or before June 10, 2020 at 12:00 p.m. EST. References to the "Budget" in the Cash Collateral Motion and the proposed final cash collateral order, a copy of which was filed with this Court as Exhibit A to Docket No. 369, shall be deemed to refer to the Proposed Budget.

5. Notwithstanding any provision in the Bankruptcy Rules to the contrary, this Order shall be immediately effective and enforceable upon its entry.

6. The Debtors are authorized to take all actions necessary to effectuate the relief granted pursuant to this Order, including to effectuate the intent of the Operational Suspension and the Bankruptcy Suspension, in accordance with the Application, the Extension Notice, and the Second Extension Notice.

7. This Court shall retain jurisdiction to hear and determine all matters arising from or related to the implementation, interpretation, and/or enforcement of this Order.

EXHIBIT L

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
CORPUS CHRISTI DIVISION

In re:	)	Chapter 11
J. C. PENNEY COMPANY, INC., *et al.*,[1]	)	Case No. 20-20182 (DRJ)
Debtors.	)	(Jointly Administered)

DEBTORS' EMERGENCY MOTION FOR ENTRY OF AN ORDER (I) EXTENDING TIME FOR PERFORMANCE OF OBLIGATIONS ARISING UNDER UNEXPIRED NON-RESIDENTIAL REAL PROPERTY LEASES AND (II) GRANTING RELATED RELIEF

EMERGENCY RELIEF HAS BEEN REQUESTED. A HEARING WILL BE CONDUCTED ON THIS MATTER ON JUNE 11, 2020, AT 1:30 P.M. (CENTRAL TIME) AT UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF TEXAS, 1133 N. SHORELINE BLVD, CORPUS CHRISTI, TEXAS 78401. IF YOU OBJECT TO THE RELIEF REQUESTED OR YOU BELIEVE THAT EMERGENCY CONSIDERATION IS NOT WARRANTED, YOU MUST EITHER APPEAR AT THE HEARING OR FILE A WRITTEN RESPONSE PRIOR TO THE HEARING. OTHERWISE, THE COURT MAY TREAT THE PLEADING AS UNOPPOSED AND GRANT THE RELIEF REQUESTED.

RELIEF IS REQUESTED NOT LATER THAN JUNE 11, 2020.

PLEASE NOTE THAT ON MARCH 24, 2020, THROUGH THE ENTRY OF GENERAL ORDER 2020-10, THE COURT INVOKED THE PROTOCOL FOR EMERGENCY PUBLIC HEALTH OR SAFETY CONDITIONS.

IT IS ANTICIPATED THAT ALL PERSONS WILL APPEAR TELEPHONICALLY AND ALSO MAY APPEAR VIA VIDEO AT THIS HEARING.

AUDIO COMMUNICATION WILL BE BY USE OF THE COURT'S REGULAR DIAL-IN NUMBER. THE DIAL-IN NUMBER IS +1(832) 917-1510. YOU WILL BE RESPONSIBLE FOR YOUR OWN LONG-DISTANCE CHARGES. YOU WILL BE ASKED TO KEY IN THE CONFERENCE ROOM NUMBER. JUDGE JONES' CONFERENCE ROOM NUMBER IS 205691.

PARTIES MAY PARTICIPATE IN ELECTRONIC HEARINGS BY USE OF AN INTERNET CONNECTION. THE INTERNET SITE IS WWW.JOIN.ME. PERSONS CONNECTING BY MOBILE DEVICE WILL NEED TO DOWNLOAD THE FREE JOIN.ME APPLICATION.

ONCE CONNECTED TO WWW.JOIN.ME, A PARTICIPANT MUST SELECT "JOIN A MEETING". THE CODE FOR JOINING THIS HEARING BEFORE JUDGE JONES IS "JUDGEJONES". THE NEXT SCREEN WILL HAVE A PLACE FOR THE PARTICIPANT'S NAME IN THE LOWER LEFT CORNER. PLEASE COMPLETE THE NAME AND CLICK "NOTIFY".

HEARING APPEARANCES SHOULD BE MADE ELECTRONICALLY AND IN ADVANCE OF THE HEARING. YOU MAY MAKE YOUR ELECTRONIC APPEARANCE BY:

1) GOING TO THE SOUTHERN DISTRICT OF TEXAS WEBSITE;

[1] A complete list of each of the Debtors in these chapter 11 cases may be obtained on the website of the Debtors' proposed claims and noticing agent at http://cases.primeclerk.com/JCPenney. The location of Debtor J. C. Penney Company, Inc.'s principal place of business and the Debtors' service address in these chapter 11 cases is 6501 Legacy Drive, Plano, Texas 75024.

2) SELECTING "BANKRUPTCY COURT" FROM THE TOP MENU;

3) SELECTING JUDGES' PROCEDURES AND SCHEDULES;

4) SELECTING "VIEW HOME PAGE" FOR JUDGE DAVID R. JONES;

5) UNDER "ELECTRONIC APPEARANCE" SELECT "CLICK HERE TO SUBMIT ELECTRONIC APPEARANCE;"

6) SELECT J. C. PENNEY COMPANY, INC., ET AL. FROM THE LIST OF ELECTRONIC APPEARANCE LINKS, AND

7) AFTER SELECTING J. C. PENNEY COMPANY, INC., ET AL. FROM THE LIST, COMPLETE THE REQUIRED FIELDS AND HIT THE "SUBMIT" BUTTON AT THE BOTTOM OF THE PAGE.

SUBMITTING YOUR APPEARANCE ELECTRONICALLY IN ADVANCE OF THE HEARING WILL NEGATE THE NEED TO MAKE AN APPEARANCE ON THE RECORD AT THE HEARING.

The above-captioned debtors and debtors in possession (collectively, "JCPenney" or the "Debtors") state the following in support of this motion (this "Motion"):

Preliminary Statement

1. JCPenney recently asked all of its landlords to help establish a sustainable real estate footprint as it implements its COVID-19 recovery plan. Specifically, JCPenney asked for rent abatement (*i.e.*, forgoing of rent) for June, July, and August, to be followed by four months of "percentage rent," and a waiver of any cure amount if the lease is assumed.[2] Landlord participation is critical to ensure the long-term survival of many locations as go-forward stores and to achieve the Debtors' business plan and overall restructuring goals. The Debtors are optimistic that their landlords—many of which have been partnered with the Debtors for several decades—will "contribute" to create a stronger future for the company and ensure JCPenney can remain their tenant for decades to come.

2. In connection with these efforts, JCPenney, assisted by B. Riley Real Estate, LLC, has commenced discussions with each landlord to negotiate the contours of their respective participation in the "COVID Recovery Ask." The goal is to complete these negotiations by mid-July. To facilitate these discussions, the Debtors seek an extension under section 365(d)(3) of the

[2] The Debtors are also requesting certain monetary and non-monetary lease modifications, depending on future economic performance expectations and co-tenancy, vacancy, mall and market risk.

Bankruptcy Code of the time to pay June and July lease obligations (the "Lease Obligations") through and including July 14, 2020 (the "Extension Period"). This extension will allow the Debtors to realize the benefit of the rent abatements ***now***. And that ensures the buildup of liquidity to help effectuate an exit from chapter 11.

3. The Debtors were able to weather the nadir of the pandemic by significantly stretching payment terms with all of their vendors and furloughing the vast majority of their employees for nearly two months (even as the Debtors paid April rent while all their stores were closed and their peers were skipping rent in light of the unprecedented uncertainty). Now, as the Debtors look ahead to reopening and recovery, the Debtors believe their restructuring efforts will be strengthened if they are permitted to delay approximately $34 million of rent to mid-July, pending resolution of the COVID Recovery Asks in the interim. In light of the extraordinary disruption the pandemic has wrought on the retail industry, a 6-week delay in the payment of June rent and a 2-week delay in the payment of July rent is appropriate to allow negotiations with landlords to run their course and potentially yield significant benefits to the Debtors, their estates, and all stakeholders.

Relief Requested

4. The Debtors seek entry of an order (the "Order"), substantially in the form attached hereto: (a) extending the time for the Debtors to perform obligations arising within sixty (60) days after the Petition Date under unexpired leases of nonresidential real property (the "Leases") through the Extension Period; (b) staying for the duration of the Extension Period all motions, applications, actions, or pleadings filed in these chapter 11 cases seeking to (i) lift the automatic stay as a result of the Debtors' failure to perform any obligations under any Lease, (ii) compel the Debtors' performance of any obligation including payment of rent, or (iii) compel rejection,

assumption, or assignment of any Lease, in each case unless otherwise agreed by the Debtors; and (c) granting related relief.

Jurisdiction and Venue

5. The United States Bankruptcy Court for the Southern District of Texas (the "Court") has jurisdiction over this matter pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b). The Debtors confirm their consent, pursuant to rule 7008 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), to the entry of a final order.

6. Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409.

7. The bases for the relief requested herein are sections 105(a), 362(a), 365(d)(3), 1107(a), and 1108 of chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"), Bankruptcy Rule 1015(b), and rule 9013 of the Bankruptcy Local Rules for the Southern District of Texas (the "Bankruptcy Local Rules").

8. On May 15, 2020 (the "Petition Date"), each Debtor filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. A detailed description of the facts and circumstances of these chapter 11 cases is set forth in the *Declaration of Bill Wafford, Executive Vice President, Chief Financial Officer of J. C. Penney Company, Inc., in Support of Debtors' Chapter 11 Petitions and First Day Motions* (the "First Day Declaration") [Docket No. 25].

9. The Debtors are operating their businesses and managing their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. On May 15, 2020, the Court entered an order [Docket No. 4] authorizing procedural consolidation and joint administration of these chapter 11 cases pursuant to Bankruptcy Rule 1015(b). No request for the appointment of a trustee or examiner has been made in these chapter 11 cases. On May 28, 2020,

the United States Trustee for the Southern District of Texas (the "U.S. Trustee") appointed an official committee of unsecured creditors pursuant to section 1102 of the Bankruptcy Code (the "Committee") [Docket No. 329].

Background

10. On March 18, 2020, the Debtors made the difficult decision to temporarily close all of their 846 retail stores across the United States and Puerto Rico to protect the safety of their customers and employees and in response to governmental health directives and guidelines.[3] Other than a small handful that were able to reopen at the beginning of May, the vast majority of the Debtors' stores remained closed for over two months. In April, year-over-year net sales tumbled by approximately 88 percent and store sales decreased to nearly zero, decimating the progress the Debtors had just achieved in their "Plan for Renewal" transformation strategy and ultimately necessitating the filing of these chapter 11 cases.[4]

11. During this time, the Debtors went into a protective mode, curtailing operations and reducing expenses to only those necessary to preserve the Debtors' estates and safely maintain the limited operations able to continue. All of the Debtors' stakeholders felt the pinch:

- lenders and certain bondholders did not receive approximately $30 million in interest payments that were due in April and May;
- approximately 85,000 employees (or ninety-two percent (92%) of the Debtors' workforce) were furloughed without pay for over two months;[5]
- trade vendors, including longstanding providers of essential goods and services, saw their payment terms unilaterally extended by an incremental 60 days, and the Debtors filed these

[3] First Day Declaration ¶ 7.

[4] First Day Declaration ¶ 7–8.

[5] First Day Declaration ¶ 57–58.

chapter 11 cases with approximately $650 million of prepetition accounts payable outstanding;[6] and

- the Debtors did not pay May occupancy costs for 542 of their 862 store, office, and non-retail locations (*i.e.*, $14.8 million of the total $24.7 million owed).

12. These measures, though painful, were successful in protecting the Debtors' estates. The Debtors filed their prearranged chapter 11 cases with approximately $500 million in cash and $450 million in committed new-money debtor-in-possession financing. This liquidity, when combined with prudent management of disbursements in accordance with the approved budget, will create a bridge to consummating a value-maximizing restructuring that sets JCPenney on a stronger foundation for future success.

13. As the country begins to recover from the pandemic and emerge from blanket stay-at-home orders being lifted in certain jurisdictions, the Debtors are reopening their stores in phases, consistent with health directives from federal, state, and municipal governmental units. As of this filing, approximately 305 of the Debtors' stores have been reopened in some capacity, 184 of which are leased stores. The Debtors are closely monitoring governmental directives and are optimistic the full fleet will be reopened by the end of July. As stores reopen, the Debtors will need to manage through a commensurate increase in expenditures relative to revenues as employees return to work, stores are readied for customers, and deliveries of goods are accepted to ensure shelves are adequately stocked. As part of the COVID Recovery Ask, the Debtors seek to balance these increased disbursements at this time with abatement of as much as possible of their approximately $17 million of monthly rent, approximately $34.5 million of which will become due and payable during the Extension Period.

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[6] *See Debtors' Emergency Motion for Entry of Interim and Final Orders (I) Authorizing the Debtors to Pay Certain Prepetition Claims of Trade Claimants, (II) Confirming Administrative Expense Priority of Outstanding Orders, and (III) Granting Related Relief* [Docket No. 8].

14. The Debtors recognize that JCPenney stores are integral components of the shopping centers and malls they anchor. The Debtors are therefore optimistic their landlords will participate in the COVID Recovery Ask, meaningfully reducing the June and July rent that will ultimately need to be paid, and thereby minimizing any practical burden of the requested relief.

Basis for Relief

I. Cause Exists to Grant the Extension of Time to Pay Rent.

15. Section 365(d)(3) of the Bankruptcy Code authorizes the Court to extend the time for the Debtors to perform their obligations under their unexpired real property leases arising during the first sixty (60) days of these chapter 11 cases where there is cause for such extension.[7] Although the Bankruptcy Code does not define "cause," at least one court has considered whether there is a "specific cause" articulated by a debtor or "applicable legal precedent."[8] Another bankruptcy court has held that "attempts at ***negotiating [a] settlement*** constitute 'cause' for extending the time for performance an additional sixty (60) days."[9]

16. The legislative history of section 365(d)(3) states that the "60-day grace period is intended to give the [debtor] time to ***determine what lease obligations the debtor has*** and to locate the cash to make the required payments in exceptionally large or complicated cases."[10] This Court

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7 *See* 11 U.S.C. § 365(d)(3) ("The court may extend, for cause, the time for performance of any [lease] obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period.").

8 *In re Pac-West Telecomm, Inc.*, 377 B.R. 119, 126 (Bankr. D. Del. 2007).

9 *See In re DWE Screw Prods., Inc.*, 157 B.R. 326, 329 (Bankr. N.D. Ohio 1993) (emphasis added).

10 *See* 130 Cong. Rec. S8894–95 (daily ed. June 29, 1984) (remarks of Sen. Hatch) (emphasis added); *see also Feld v. S & F Concession, INC. (In re S & F Concession, Inc.)*, 55 B.R. 689, 690 (Bankr. E.D. Pa. 1985).

has previously relied on the legislative history and Congressional intent behind section 365(d)(3) when deciding how to enforce the statute.[11]

17. Ample cause exists to grant the relief requested herein. ***First***, granting the extension to delay paying June and July rent until mid-July will materially advantage the Debtors' estates by bringing forward the time at which the Debtors can benefit from the liquidity improvement resulting from the rent concessions they hope to agree on over the coming weeks with their landlords. Without the requested relief, the Debtors would have to wait until the third quarter of 2020 to begin crediting rent abatement, and because of the anticipated four months of lower percentage rent that is part of the COVID Recovery Ask, the Debtors would likely have to apply the credits over the course of several months, dragging out the benefit to the end of the cases and potentially beyond. In contrast, granting the extension allows the Debtors to realize 100% of the achieved rent relief now, when the chapter 11 cases are still in the precarious early stages. By delaying approximately $34.5 million in Lease Obligations up to six weeks, the negotiations with landlords will be able to play out, and the Debtors will have a far better understanding of what their actual lease obligations for June and July will be—and the Debtors hope to be in a position to ultimately retain (and benefit from the resulting positive liquidity impact) a significant portion of that $34.5 million. During these uncertain times, every dollar counts. Retaining as much liquidity while responsibly re-opening their businesses may also permit the Debtors to delay the date on which the Debtors might seek to make their remaining draw from their proposed DIP

[11] *See, e.g.*, *In re Appletree Markets Inc.*, 139 B.R. 417, 419-21 (Bankr. S.D. Tex. 1992) (citing to the legislative history to determine the method of calculating and timing of postpetition rent payment); *In re Simbaki, Ltd.*, Case No. 13-36878 (MI), 2015 WL 1593888, at *5 (Bankr. S.D. Tex. Apr. 5, 2015) (same).

Financing, thus reducing interest expense on the outstanding loans and the commensurate "roll up" of certain prepetition secured debt obligations, as contemplated therein.

18. ***Second***, the pandemic has created not only industry-wide, but global exigent circumstances that have caused disruption at every part of the Debtors' operations and that of their business partners. The President of the United States declared COVID-19 to be a national emergency.[12] Similarly, nearly every state declared a state of emergency and issued orders mandating non-essential business closures or otherwise restricting the movement of people in a manner that would functionally prevent the Debtors from operating their stores.[13] Bankruptcy courts considering whether to grant extensions of time have rightfully identified COVID-19 as constituting "exceptional cause"[14] or an "extraordinary situation,"[15] and have accordingly

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[12] *See* Pres. Proc No. 9994, 85 F.R. 15337, 2020 WL 1272563 (Mar. 13, 2020)

[13] *See, e.g.*, Ala. Order of the State Health Officer (Apr. 28, 2020); Ariz. Executive Order 2020 33 (Apr. 29, 2020); Cal. Executive Order N-33-20 (Mar. 4, 2020); Colo. Executive Order D 2020 024 (Apr. 6, 2020); Conn. Executive Order No. 7H (Mar. 10, 2020); Del. Mayor's Order 2020-063 (Apr. 15, 2020); Ga. Executive Order No. 04.30.20.01 (Apr. 30, 2020); Haw. Third Supplementary Proclamation (Mar. 23, 2020); Haw. Sixth Supplementary Proclamation (Apr. 25, 2020); Idaho Order to Self-Isolate (Apr. 15, 2020); Ill. Executive Order 2020-32 (Apr. 30, 2020); Ind. Executive Order 20-22 (Apr. 20, 2020); Kan. Executive Order No. 20-16 (Mar. 28, 2020); Ky. Executive Order 2020-257 (Mar. 25, 2020); La. Proclamation Number 33 JBE 2020 (Mar. 22, 2020); La. Proclamation Number 41 JBE 2020 (Apr. 2, 2020); Me. Executive Order No. 28 FY 19/20 (Mar. 31, 2020); Md. Executive Order No. 20-03-30-01 (Mar. 30, 2020); Mass. COVID-19 Order No. 21 (Mar. 31, 2020); Mich. Executive Order No. 2020-59 (Apr. 24, 2020); Minn. Executive Order 20-33 (Apr. 8, 2020); Miss. Executive Order 1473 (Apr. 17, 2020); Mo. Dep't of Health and Human Services Order (Apr. 16, 2020); Mont. Executive Order extending 2-2020 and 3-2020 (Apr. 7, 2020); Nev. Directive 010 (Mar. 31, 2020); N.H. Executive Order 2020-04 (Mar. 26, 2020); N.J. Executive Order No. 107 (Mar. 21, 2020); N.M. Public Health Order (Apr. 30, 2020); N.Y. Executive Order No. 202.18 (Apr. 16, 2020); Ohio Department of Health Amended Stay at Home Order (Apr. 2, 2020); N.C. Executive Order No. 135 (Apr. 23, 2020); Or. Executive Order No. 20-12 (Mar. 23, 2020); Pa. Amendment to Stay at Home Order (Apr. 20, 2020); R.I. Executive Order 20-18 (Apr. 8, 2020); S.C. Executive Order No. 2020-21 (Apr. 6, 2020); Tenn. Executive Order No. 22 (Mar. 30, 2020); Tenn. Executive Order No. 27 (Apr. 13, 2020); Tex. Executive Order No. GA-14 (Mar. 31, 2020); Vt. Addendum 9 to Executive Order 01-20 (Apr. 10, 2020); Va. Executive Order No. 55 (Mar. 30, 2020); Wash. Proclamation 20-25.1 (Apr. 2, 2020); W. Va. Executive Order No. 9-20 (Mar. 23, 2020); Wis. Emergency Order #12 (Mar. 24, 2020); and Wis. Emergency Order #28 (Apr. 16, 2020). The Debtors operate stores in each of these states.

[14] Hr'g Tr. at 63:4, *In re Modell's Sporting Goods, Inc.*, No. 20-14179 (VFP) (Bankr. D.N.J. Mar. 25, 2020).

[15] *Id.* at 39:23

approved extensions.[16] Though certain states are reopening, customer traffic is expected to be depressed compared to prior periods, and the Debtors are navigating requests for tightened trade terms from vendors seeking not only greater comfort in transacting with the Debtors, but to repair the damage to their own businesses wrought by a two-month near-standstill of the retail industry. Therefore, the pandemic continues to be an ongoing crisis that, along with the imperative for the Debtors to quickly recover in the face of ongoing restrictions and fundamentally changed consumer behaviors, creates significant "cause" meriting a brief respite on rent.

19. ***Third***, the landlords will not be unduly prejudiced by the extension. Though the Debtors' acknowledge their obligation to pay rent under their leases, they note that in these unprecedented times, a significant number of commercial retailers started declining to pay rent as early as March 2020, including more than half of retailers with respect to April rent, whether by agreement or through or self-help.[17] The Debtors did not. Instead, the Debtors skipped only May rent for 542 of their 862 real properties (*i.e.*, 62%). The Debtors' landlords are in the unique position of either (a) being paid current on nearly 40% of properties or (b) holding administrative claims for May 15–31 rent, and prepetition claims for only 14 days of unpaid rent on the remaining locations. Compared to other stakeholders, the landlords entered these chapter 11 cases on

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[16] *See, e.g.*, *In re Chinos Holdings, Inc.*, Case No. 20-32181 (KLP) [Docket No. 323] (Bankr. E.D. Va. May 26, 2020) (extending time for performance of lease obligations under section 365(d)(3)); *In re Art Van Furniture, LLC*, Case No. 20-10553 (CSS) [Docket No. 373] (Bankr. D. Del. Apr. 27, 2020) (same); *In re Pier 1 Imports, Inc.*, Case No. 20-30805 [Docket No. 493] (KRH) (Bankr. E.D. Va. Apr. 6, 2020) (approving the deferment payment of rent obligations until the debtors filed a notice of intent to reopen, after which the debtors should make "reasonable best efforts" to pay deferred rent); *In re Modell's Sporting Goods, Inc.*, Case No. 20-14179 [Docket No. 166] (VFP) (Bankr. D. N.J. Mar. 27, 2020) (suspending a bankruptcy case and deferring payment of non-essential expenses, including rent obligations, due to COVID-19).

[17] Nexis Newsdesk, *Retail Rent Increases in May, Ever So Slightly*, Nexis, May 26, 2020 ("Through May 15, only 51.35% of retail rent was collected, compared to 48.9% in April. National retail collections are stronger with 53.2% of rents collected in the subcategory in May, compared to 50.65% in April."); *see* Pro Bankruptcy Briefing, *Landlords, Commercial Tenants Negotiate Rent Breaks Amid Coronavirus Disruption*, Wall St. J. Online, Apr. 20, 2020.

relatively good footing. That position would be minimally disturbed by the relief sought. Any lease obligations extended pursuant to the Order would be administrative expense claims.[18] Notably, one court has observed that:

> Section 365(d)(3) of the Bankruptcy Code requires the Debtors to *timely* perform all their obligations under their Leases. *Timely* could mean immediately, as argued by certain Lessors in this case. *Timely* could mean whatever period for timely performance is provided by the lease terms, as the Debtors' argue. *Timely* could mean that payment of these administrative claims should be made with all other administrative claims—upon the effective date of the plan.[19]

The Debtors, however, do not go so far. Pursuant to the relief requested herein, the Debtors propose to pay any rent that is not waived in relatively short order (*i.e.*, at the expiration of the Extension Period on July 14th). During the intervening weeks, the Debtors have sufficient liquidity to pay for operating costs through and after the Extension Period, including the rent obligations. The Extension Period, therefore, does not result in any significant risk to landlords for Lease Obligations arising during the Extension Period. Instead, only the timing of payment is altered, as is expressly permitted by section 365(d)(3) of the Bankruptcy Code.

20. ***Finally***, the landlords will not be unduly burdened by the Extension Period. Because the Debtors paid all of their April rent (and 40 percent of May rent), their landlords are not coming to these chapter 11 cases under the same duress as landlords in other retail cases or other groups in these cases. Over 85,000 dedicated employees, who rely on their employment

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[18] *See CIT Commc'ns Fin. Corp. v. Midway Airlines Corp (In re Midway Airlines Corp.)*, 406 F.3d 229, 235 (4th Cir. 2005) ("A lessor is entitled to recover all payments due under the lease . . . as an administrative expense, but the lessor must still assert its administrative expense claim under § 503(b)[.]"); *see also In re Simbaki, Ltd.*, Case No. 13-36878 (MI), 2015 Bankr. LEXIS 1142, at *7–10 (Bankr. S.D. Tex. Apr. 6, 2015) ("The Court adopts the *Midway* approach and finds that [the lessor's] claim for December rent is an administrative claims under § 503(b) independent of § 503(b)(1)(A)."); 3 Collier on Bankruptcy ¶ 365.04[1][b] (Richard Levin & Henry J. Sommer, eds., 16th ed. 2020) (noting that *Midway* "seems warranted" on this point); *In re Circuit City Stores, Inc.*, 447 B.R. 475, 508 (Bankr. E.D. Va. 2009).

[19] *In re Circuit City Stores, Inc.*, 447 B.R. at 509 (emphasis in original).

with the Debtors to cover daily living costs, have been or will be furloughed for over two months or more. Trade creditors were operating under extended repayment terms, and most are being asked to agree to provide favorable trade terms despite the possibility their prepetition claims will be significantly compromised and that, for many vendors, these measures jeopardize their own ability to survive. Secured lenders did not receive May interest and a majority of those lenders are agreeing to equitize their claims and, further, invest new money into the business through the proposed DIP Financing during a time of significant capital market and financial uncertainty. Unsecured bondholders also did not receive April interest and, at present, are facing an uncertain recovery on their notes. Each of these constituencies, whether willingly or not, has already contributed significantly to the Debtors' ability to smoothly transition into chapter 11 with good prospects for a successful reorganization. In contrast, only May occupancy costs for 60% of the Debtors' locations were skipped (and part of the COVID Recovery Ask is for landlords of go-forward locations to waive those amounts in connection with assumption of their leases and agreements). Therefore, the ask made in this Motion—a brief delay in payment timing—is not being made of a constituency already feeling significant pain from the Debtors' protective measures during the pandemic.

21. The Extension Period inures to the benefit of not only the Debtors, their estates, and their stakeholders generally, but ultimately to the landlords as well. The relief would put the Debtors in a better position to negotiate mutually beneficial rent relief agreements—an exercise that helps both (a) the specific landlord counterparty by ensuring a go-forward tenant and (b) landlords on the whole, because the more rent relief the Debtors can obtain, the more likely the Debtors can achieve their optimal store footprint and not be forced to reject additional leases. Placing the long-term viability of the Debtors at risk for the short-term revenues of landlords will

likely result in significant harm to a larger group of stakeholders who themselves incurred significant hardship, and ultimately harm the landlords as well by hampering the Debtors' ability to succeed on their recovery plan. Accordingly, there is sufficient cause to grant to Extension Period under section 365(d)(3).

II. Pleadings and Motions Related to Obligations under Leases Should Be Stayed and Tolled During the Extension Period.

22. Consistent with the purpose of the Extension Period and the Bankruptcy Code, the Debtors request that any pleadings or motions seeking to enforce obligations under the Leases be stayed and tolled through the Extension Period. Section 105 of the Bankruptcy Code provides the Bankruptcy Court with "broad exercise of power in the administration of a bankruptcy case."[20] Bankruptcy Courts often rely on section 105 for the authority to protect and effectively administer estate assets.[21] The use of section 105 as the basis for "tolling" certain time periods is "consistent with the underlying philosophy of the Bankruptcy Code."[22] Indeed, courts have recognized their authority to "fashion[] whatever solutions we can possibly be coming up with in these just unforeseen, undocumented times."[23]

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[20] *See Davis v. Davis (In re Davis)*, 170 F.3d 475, 492 (5th Cir. 1999).

[21] *See* 2 Collier on Bankruptcy ¶ 105.02 (Richard Levin & Henry J. Sommer, eds., 16th ed. 2020) ("[Section 105] has also been used as the basis for staying actions by third parties against avoiding powers actions prior to the time the estate decides to pursue or abandon them."); *see also Air Line Pilots Ass'n, Int'l v. Am. Nat'l Bank and Trust Co. of Chicago (In re Ionosphere Clubs, Inc.)*, 156 B.R. 414, 436 (S.D.N.Y. 1993), ("In order to allow the Trustee to assert actions which are property of the debtor's estate for the benefit of the estate as a whole, other claimants may be prohibited by the Bankruptcy Court from pursuing such actions under 11 U.S.C. § 105(a)."), *aff'd*, 17 F.3d 600 (2d Cir. 1994).

[22] *See U.S. v. Richards (In re Richards)*, 994 F.2d 763, 765 (10th Cir. 1993).

[23] Hr'g Tr. at 61:20-22, *In re Pier 1 Imports, Inc.*, Case No. 20- 30805 (KRH) (Bankr. E.D. Va. Apr. 2, 2020); *see also In re Chinos Holdings, Inc.*, Case No. 20-32181 (KLP) [Docket No. 323] (Bankr. E.D. Va. May 26, 2020) (extending time for performance of lease obligations under section 365(d)(3)); *In re Modell's Sporting Goods, Inc.*, Case No. 20-14179 (VFP) [Docket Nos. 115, 287] (Bankr. D.N.J. Mar. 23, 2020) (suspending the bankruptcy case and debtor's operations including rent payments); *In re Pier 1 Imports, Inc.*, Case No. 20-30805 (KRH) (Bankr. E.D. Va. Apr. 6, 2020) (granting request to suspend rent payments).

23. Staying and tolling pleadings or motions seeking to enforce obligations under the Leases would be consistent with the Bankruptcy Code and the purpose of the Extension Period. Absent the stay, the Debtors could be faced with several motions to compel or similar pleadings, which would defeat the purpose of the relief provided by section 365(d)(3). Rather, the stay and tolling will permit the Debtors to focus on efficient administration of their chapter 11 cases and stabilizing their businesses during the initial transition periods of chapter 11. Accordingly, the Debtors believe that the relief requested herein is in the best interest of their estates and should be granted.

Emergency Relief is Appropriate

24. Due to the time-sensitive nature of the Lease Obligations, the Debtors seek approval of the Extension Period on an expedited basis. A hearing on the requested relief on June 11, 2020 will provide certainty for the Debtors and their landlords with respect to timing for payment, while providing adequate notice to all stakeholders.

Waiver of Bankruptcy Rules 6004(a) and 6004(h)

25. The Debtors request that the Court enter an order providing that notice of the relief requested herein satisfies Bankruptcy Rule 6004(a) and that the Debtors have established cause to exclude such relief from the 14-day stay period under Bankruptcy Rule 6004(h).

Reservation of Rights

26. Nothing contained herein or any actions taken by the Debtors pursuant to any order granting the relief requested by this Motion is intended or should be construed as: (a) an admission as to the validity, priority, or amount of any particular claim against a Debtor entity; (b) a waiver of the Debtors' right to dispute any particular claim on any grounds; (c) a promise or requirement to pay any particular claim; (d) an implication or admission that any particular claim is of a type specified or defined herein or in any order granting the relief requested by this Motion, or a finding

that any particular claim is an administrative expense claim or other priority claim; (e) a request or authorization to assume any agreement, contract, or lease pursuant to section 365 of the Bankruptcy Code; (f) an admission as to the validity, priority, enforceability, or perfection of any lien on, security interest in, or other encumbrance on property of the Debtors' estates; (g) a waiver or limitation of the Debtors' rights under the Bankruptcy Code or any other applicable law; or (h) a concession by the Debtors or any other party-in-interest that any liens (contractual, common law, statutory, or otherwise) satisfied pursuant to this Motion are valid and the Debtors and all other parties-in-interest expressly reserve their rights to contest the extent, validity, or perfection, or to seek avoidance of all such liens. If the Court grants the relief sought herein, any payment made pursuant to the Court's order is not intended and should not be construed as an admission as to the validity, priority, or amount of any particular claim or a waiver of the Debtors' or any other party-in-interest's rights to subsequently dispute such claim.

Notice

27. Notice of the hearing on the relief requested in this Motion will be provided by the Debtors in accordance and compliance with Bankruptcy Rules 4001 and 9014, as well as the Bankruptcy Local Rules, and is sufficient under the circumstances. The Debtors will provide notice to parties-in-interest, including: (a) the U.S. Trustee for the Southern District of Texas; (b) counsel to the Committee; (c) Otterbourg P.C., as counsel to Wells Fargo Bank, N.A., administrative agent under the Debtors' revolving credit facility; (d) the administrative agent under the Debtors' term loan facility; (e) Wilmington Trust, N.A., as indenture trustee under the Debtors' 5.875% first lien secured notes due 2023; (f) UMB Bank, N.A., as indenture trustee under the Debtors' 8.625% second lien secured notes due 2025; (g) BOKF, N.A., as indenture trustee under the Debtors' (i) 5.65% unsecured notes due 2020, (ii) 7.125% unsecured notes due 2023,

(iii) 6.90% unsecured notes due 2026, (iv) 6.375% unsecured notes due 2036, (v) 7.40% unsecured notes due 2037, and (vi) 7.625% unsecured notes due 2097; (h) Milbank LLP, as counsel to the ad hoc group of certain first lien creditors; (i) the United States Attorney's Office for the Southern District of Texas; (j) the Internal Revenue Service; (k) the United States Securities and Exchange Commission; (l) the Environmental Protection Agency and similar state environmental agencies for states in which the Debtors conduct business; (m) the state attorneys general for states in which the Debtors conduct business; (n) the counterparties to the Debtors' unexpired nonresidential real property leases, and (o) any party that has requested notice pursuant to Bankruptcy Rule 2002. The Debtors submit that, in light of the nature of the relief requested, no other or further notice need be given.

WHEREFORE, the Debtors request that the Court enter an order, substantially in the form attached hereto, granting the relief requested in this Motion and granting such other and further relief as is appropriate under the circumstances.

Respectfully Submitted,
May 28, 2020

/s/ *Matthew D. Cavenaugh*

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Certificate of Service

I certify that on May 28, 2020, I caused a copy of the foregoing document to be served by the Electronic Case Filing System for the United States Bankruptcy Court for the Southern District of Texas.

/s/Matthew D. Cavenaugh
Matthew D. Cavenaugh

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
CORPUS CHRISTI DIVISION

In re:	)	Chapter 11
J. C. PENNEY COMPANY, INC., *et al.*,[1]	)	Case No. 20-20182 (DRJ)
Debtors.	)	(Jointly Administered)
	)	**Re: Docket No. 338**

ORDER (I) EXTENDING TIME FOR PERFORMANCE OF OBLIGATIONS ARISING UNDER UNEXPIRED NON-RESIDENTIAL REAL PROPERTY LEASES AND (II) GRANTING RELATED RELIEF

Upon the motion (the "Motion")[2] of the above-captioned debtors and debtors in possession (collectively, the "Debtors"), for entry of an order (a) extending time for the Debtors' performance of obligations arising under unexpired non-residential real property leases for a period of sixty (60) days from May 15, 2020, and (b) granting related relief, pursuant to sections 365(d)(3) and 105(a) of title 11 of the United States Code (the "Bankruptcy Code"), all as more fully set forth in the Motion; and the Court having jurisdiction to consider the Motion and the relief requested therein pursuant to 28 U.S.C. §§ 157(a)–(b) and § 1334; and consideration of the Motion and the requested relief being a core proceeding pursuant to 28 U.S.C. § 157(b); and venue being proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409; and due and proper notice of the Motion having been provided to the Notice Parties under the circumstances, and it appearing that no other or further notice need be provided; and this Court having held a hearing to consider the relief

[1] A complete list of each of the Debtors in these chapter 11 cases may be obtained on the website of the Debtors' proposed claims and noticing agent at http://cases.primeclerk.com/JCPenney. The location of Debtor J. C. Penney Company, Inc.'s principal place of business and the Debtors' service address in these chapter 11 cases is 6501 Legacy Drive, Plano, Texas 75024.

[2] Capitalized terms used but not otherwise defined herein have the meanings given to them in the Motion.

requested in the Motion; and upon the First Day Declaration and the record of the hearing on the Motion; and all objections to the relief requested in the Motion having been withdrawn, resolved, or overruled; and the Court having determined that the legal and factual bases set forth in the Motion establish just cause for the relief granted herein; and after due deliberation and sufficient cause appearing therefor, it is HEREBY ORDERED THAT:

1. The time for the Debtors' performance of monetary obligations arising within sixty (60) days of May 15, 2020 under any unexpired lease of nonresidential real property is extended to and through July 13, 2020 at 5:00 p.m. (prevailing Central time) (the "Extension Period"); *provided* that the Debtors shall not seek to further extend the Extension Period. Promptly upon the expiration of the Extension Period, the Debtors shall pay in full all deferred June 2020 and July 2020 Lease Obligations that, as of July 13, 2020, have not been abated or deferred pursuant to an agreement between the Debtors and the applicable landlord as of July 13, 2020; *provided* that the Debtors and the applicable landlord may agree to alternative payment terms with respect to a particular Lease Obligation. The Debtors' failure to timely perform their obligations (including failure to pay lease obligations) under an unexpired nonresidential real property lease during the Extension Period will not constitute a rejection or breach of any such lease, and the rights of all parties related to any payments or obligations accruing or due but unpaid by the Debtors are reserved.

2. All motions, applications, actions, or pleadings filed in these chapter 11 cases seeking to (a) lift the automatic stay as a result of the Debtors' failure to perform any obligations under any unexpired nonresidential real property lease, (b) compel the Debtors' performance of any obligation (including payment of rent) under any unexpired nonresidential real property lease, or (c) compel rejection, assumption, or assignment of any unexpired nonresidential real property leases by the Debtors, in each case, shall be stayed and tolled during the Extension Period unless

otherwise agreed by the Debtors; *provided* that all parties shall be permitted to seek relief from this Court with respect to exigent and unforeseen circumstances not otherwise inconsistent with this Order, including but not limited to where there is a threat of loss of life, risk to public welfare, environmental hazard, violation of federal, state, local law or regulation or other similar threat, and which the Debtors and such parties are unable to resolve consensually.

3. The relief in this Order is without prejudice to the Debtors' right to seek an abatement, suspension, or deferral of obligations under an unexpired nonresidential real property lease or other agreement pursuant to (a) agreement with the applicable landlord, (b) any provision of the Bankruptcy Code except section 365(d)(3), (c) state or other applicable law, or (d) the terms of a specific lease agreement.

4. Nothing in this Order shall be deemed to affect any rights of any party related to "stub rent."

5. Notwithstanding the relief granted herein and any actions taken pursuant to such relief, nothing contained in the Motion or this Order shall constitute, nor is it intended to constitute: (a) an admission as to the validity, priority, or amount of any particular claim against a Debtor entity; (b) a waiver of the Debtors' right to dispute any particular claim on any grounds; (c) a promise or requirement to pay any particular claim or finding that any particular claim is an administrative expense claim or other priority claim; (d) an implication or admission that any particular claim is of a type specified or defined in this Order or the Motion; (e) a request or authorization to assume any agreement, contract, or lease pursuant to section 365 of the Bankruptcy Code; (f) an admission as to the validity, priority, enforceability, or perfection of any lien on, security interest in, or other encumbrance on property of the Debtors' estates (g) a waiver or limitation of the Debtors' rights under the Bankruptcy Code or any other applicable law; or

(h) a concession by the Debtors or any other party-in-interest that any liens (contractual, common law, statutory, or otherwise) satisfied pursuant to this Order are valid and the Debtors and all other parties-in-interest expressly reserve their rights to contest the extent, validity, or perfection, or to seek avoidance of all such liens. Any payment made pursuant to this Order should not be construed as an admission as to the validity, priority, or amount of any particular claim or a waiver of the Debtors' or any other party-in-interest's rights to subsequently dispute such claim.

6. Notice of the Motion as provided therein shall be deemed good and sufficient notice of such Motion and the requirements of Bankruptcy Rule 6004(a) and the Bankruptcy Local Rules are satisfied by such notice.

7. Notwithstanding Bankruptcy Rule 6004(h), the terms and conditions of this Order are immediately effective and enforceable upon its entry.

8. The Debtors are authorized to take all actions necessary to effectuate the relief granted in this Order in accordance with the Motion.

9. This Court retains exclusive jurisdiction with respect to all matters arising from or related to the implementation, interpretation, and enforcement of this Order. **

Signed: June 11, 2020.

DAVID R. JONES
UNITED STATES BANKRUPTCY JUDGE

** The Court will conduct a hearing on July 13, 2020 at 12:00 p.m. (prevailing Central time).

EXHIBIT M

Neutral
As of: June 22, 2020 1:34 PM Z

In re Ventura

United States Bankruptcy Court for the Eastern District of New York

April 10, 2020, Decided

Case No. 8-18-77193-reg, Chapter 11

Reporter
2020 Bankr. LEXIS 985 *

In re: Deirdre Ventura, Debtor.

Core Terms

Mortgage, small business, designation, consumer debt, modify, breakfast, rights, bed, proceeds, Election, proposed plan, real property, Confirmation, guests, current case, cases, business activity, reorganization, modification, retroactive, disclosure statement, principal residence, judicial estoppel, effective date, Collateral, deadline, newly, circumstances, scheduled, asserts

Case Summary

Overview

HOLDINGS: [1]-The court had discretion to reset timelines to allow the debtor to avail herself of the newly enacted Small Business Reorganization Act of 2019 (SBRA) that was not at her disposal when she filed her case; [2]-Because the debtor was merely amending her petition and availing herself of the right created by a statute that did not exist as of the petition date, judicial estoppel did not apply; [3]-This case came within the purview of *11 U.S.C.S. § 101(51D)(A)* because the primary use of the property was and remained for the operation of a bed and breakfast, rather than as a principal residence; [4]-Applying *11 U.S.C.S. § 1190(3)* to modify the mortgage would not violate the creditor's *Fifth Amendment* rights and the debtor was not barred from using *11 U.S.C.S. § 1190(3)* solely on basis that the mortgage she sought to modify was a purchase money mortgage secured by her residence.

Outcome
Objections to debtor's amended petition overruled.

LexisNexis® Headnotes

Bankruptcy
Law > ... > Reorganizations > Plans > Eligible Plan Proponents

HN1 **Plans, Eligible Plan Proponents**

Newly amended *11 U.S.C.S. § 101(51D)(A)* defines a small business debtor, in part, as a person engaged in commercial or business activities that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition in an amount not more than $2,725,625 not less than 50 percent of which arose from the commercial or business activities of the debtor. *11 U.S.C.S. § 101(51D)(A)*. The definition of small business excludes debtors whose primary business is owning single asset real estate.

Bankruptcy
Law > ... > Reorganizations > Plans > Eligible Plan Proponents

HN2 **Plans, Eligible Plan Proponents**

The Small Business Reorganization Act of 2019 (SBRA) has given small business debtors who designate

themselves as ***subchapter V*** debtors another tool to be used when proposing a plan. *11 U.S.C.S. § 1190(3)*. Furthermore, a trustee will be appointed in every ***subchapter V*** case. The ***subchapter V*** trustee will act as a fiduciary for creditors, in lieu of an appointed creditors' committee. The ***subchapter V*** trustee is also charged with facilitating the ***subchapter V*** debtor's small business reorganization and monitoring the ***subchapter V*** debtor's consummation of its plan of reorganization. *11 U.S.C.S. § 1183(a), (b)*.

Bankruptcy
Law > ... > Bankruptcy > Reorganizations > Plans

HN3 **Reorganizations, Plans**

Prior to enactment of the Small Business Reorganization Act of 2019 (SBRA), small business debtors were required to file a plan of reorganization within 120 days after the order for relief, and any party in interest could file a plan at certain times and under certain circumstances. *11 U.S.C.S. §§ 1121(b), (c)*. The newly enacted law gives ***subchapter V*** debtors the exclusive right to file a plan of reorganization, which must be filed within 90 days after entry of the order for relief. *11 U.S.C.S. § 1189(a), (b)*. This plan deadline may be extended by the Court if the need for the extension is attributable to circumstances for which the debtor should not justly be held accountable. *11 U.S.C.S. § 1189(b)*.

Bankruptcy
Law > ... > Reorganizations > Plans > Eligible Plan Proponents

HN4 **Plans, Eligible Plan Proponents**

According to *Fed. R. Bankr. P. 1020(a)*, once a small business debtor designates itself in the petition, the status of the case as a small business case shall be in accordance with the debtor's statement under this subdivision, unless and until the court enters an order finding that the debtor's statement is incorrect. *Fed. R. Bank. P. 1020(a)*. The Court's finding of incorrect designation is triggered by an objection to the designation.

Bankruptcy Law > ... > Commencement of Case > Voluntary Cases > Filing Requirements

HN5 **Voluntary Cases, Filing Requirements**

Pursuant to *Fed. R. Bankr. P. 1009(a)*, a voluntary petition, list, schedule or statement may be amended by a debtor as a matter of course at any time before the case is closed. However, such amendment by the debtor is not necessarily controlling. The designation by the debtor in the original petition still retains evidentiary effect as it is signed under penalty of perjury.

Bankruptcy
Law > ... > Reorganizations > Plans > Eligible Plan Proponents

HN6 **Plans, Eligible Plan Proponents**

The Small Business Reorganization Act of 2019 (SBRA) imposes several requirements in ***subchapter V*** cases. First, a SBRA trustee is appointed by the U.S. Trustee, who is charged with development of a consensual plan. *11 U.S.C.S. § 1183(b)(7)*. Within 60 days of entry of the order for relief, the Court must hold a status conference with the SBRA trustee. *11 U.S.C.S. § 1188(a)*. Subsection (b) provides that the court may extend the 60-day deadline if the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable. *11 U.S.C.S. § 1188(a)*. Pursuant to *11 U.S.C.S. § 1189(b)*, the ***subchapter V*** debtor shall file a plan within 90 days of entry of the order for relief, except that the court may extend the period if the need for the extension is attributable to circumstances for which the debtor should not be justly held accountable. *11 U.S.C.S. § 1189(b)*. In addition, the ***subchapter V*** debtor must submit a status report 14 days prior to the status conference detailing efforts to reach a consensual plan. *11 U.S.C.S. § 1188(c)*.

Bankruptcy
Law > ... > Reorganizations > Plans > Eligible Plan Proponents

HN7 **Plans, Eligible Plan Proponents**

There is no statutory prohibition to applying the Small Business Reorganization Act of 2019 (SBRA) to cases that were pending prior to the effective date of this legislation. While there is a presumption against retroactivity, this presumption applies to new provisions affecting contractual or property rights, matters in which

predictability and stability are of prime importance. ***Subchapter V*** incorporates many of the provisions already applicable to small business debtors. In addition, the amendment of the definition of small business debtor in *11 U.S.C.S. § 101(51D)(A)* did not appear to affect the contractual or vested property rights of parties that existed prior to the effective date of the SBRA.

Bankruptcy Law > ... > Reorganizations > Plans > Eligible Plan Proponents

Governments > Legislation > Effect & Operation > Retrospective Operation

HN8 **Plans, Eligible Plan Proponents**

The amendment in the Small Business Reorganization Act of 2019 (SBRA) to the definition of small business debtor does not amount to a taking of property. The SBRA merely amends the definition of small business debtor to ensure that certain debtors can avail themselves of a less costly and time-consuming path to reorganization that befits the family-owned businesses and other Main Street businesses that are currently in such dire need of relief.

Bankruptcy Law > ... > Reorganizations > Plans > Plan Contents

Governments > Legislation > Effect & Operation > Retrospective Operation

HN9 **Plans, Plan Contents**

The exception to the anti-modification provision permits a debtor to modify the rights of certain mortgagees by allowing the debtor to bifurcate a claim into a secured and unsecured claim based on the value of the underlying collateral. *11 U.S.C.S. § 1190(3)*. The Bankruptcy Code works to abrogate contractual rights, but does not affect the vested property rights of mortgagees. The contractual right of a secured creditor to obtain repayment of his debt may be quite different in legal contemplation from the property right of the same creditor in the collateral.

Bankruptcy Law > Claims > Types of Claims

HN10 **Claims, Types of Claims**

The fact that a debtor incurs mortgage debt to buy a residence does not automatically mean that the debt is consumer debt. The test for determining whether a debt should be classified as a business debt, rather than as a consumer debt, is whether it was incurred with an eye toward profit. Courts must look at the substance of the transaction and the borrower's purpose in obtaining the loan, rather than merely looking at the form of the transaction. A debt incurred with an eye toward profit is a business debt, rather than consumer debt.

Civil Procedure > ... > Preclusion of Judgments > Estoppel > Judicial Estoppel

HN11 **Estoppel, Judicial Estoppel**

A debtor may be judicially estopped from changing its legal position when a court has adopted and relied on it and the party claiming judicial estoppel suffers an unfair detriment as a result, unless mistake or inadvertence is an applicable defense. Inadvertence can be shown where the party in question either lacks sufficient knowledge of the undisclosed claims or would have no motive for their concealment.

Civil Procedure > ... > Preclusion of Judgments > Estoppel > Judicial Estoppel

HN12 **Estoppel, Judicial Estoppel**

The circumstances under which judicial estoppel may appropriately be invoked are probably not reducible to any general formulation of principle. However, a general test for determining when judicial estopped may be invoked has been developed, as follows: (i) a party's later position is clearly inconsistent with its earlier position, (ii) the party's former position has been accepted in some way by the court in the earlier proceeding, such that judicial acceptance of an inconsistent position in a later proceeding would create the perception that either the first or the second court was misled, and (iii) the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped.

Bankruptcy Law > ... > Commencement of Case > Voluntary Cases > Filing Requirements

Civil Procedure > ... > Preclusion of Judgments > Estoppel > Judicial Estoppel

HN13 **Voluntary Cases, Filing Requirements**

Judicial estoppel has been applied in the bankruptcy context where a debtor changes its designation on the petition.

Governments > Legislation > Interpretation

HN14 **Legislation, Interpretation**

The Court is charged with interpreting all federal and state statutes according to their plain meaning. In determining its degree of ambiguity or clarity, courts cannot examine statutory language in isolation. The Court must determine the specific context in which the language appears, and the statutory scheme's broader framework in order to preserve the coherence and consistency of the statutory scheme. In matters of statutory interpretation, the plain meaning of statutory language is often illuminated by considering not only the particular statutory language at issue, but also the structure of the section in which the key language is found, and the design of the statute as a whole and its object.

Bankruptcy Law > ... > Plans > Plan Confirmation > Prerequisites

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > Rights of Secured Creditors

HN15 **Plan Confirmation, Prerequisites**

Unlike *11 U.S.C.S. § 1123(b)(5)*, which precluded modifications of claims secured by mortgages on the debtor's principal residence, *11 U.S.C.S. § 1190(3)* specifically permits the modification of claims secured by mortgages on the debtor's principal residence. Starting with subparagraph (A), the statute reads that the mortgage proceeds cannot have been used primarily to acquire the real property. As a matter of common usage, the word "primarily" means for the most part. The phrase "real property" refers back to the real property that is the debtor's residence. Unlike *11 U.S.C.S. § 1123(b)(5)* which took an all-or-nothing approach to loans securing the debtor's residence, *11 U.S.C.S. § 1190(3)* asks the Court to determine whether the primary purpose of the mortgage was to acquire the debtor's residence. Subparagraph (B) requires the Court to determine whether the mortgage proceeds were used primarily in connection with the debtor's business. Both of these subparagraphs direct the Court to conduct a qualitative analysis to determine whether the principal purpose of the debt was not to provide the debtor with a place to live, and whether the mortgage proceeds were primarily for the benefit of the debtor's business activities.

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > Rights of Secured Creditors

HN16 **Secured Claims & Liens, Rights of Secured Creditors**

With respect to *11 U.S.C.S. § 1190(3)*, the following factors can be considered to determine whether the mortgage in question is subject to modification under this section: 1. Were the mortgage proceeds used primarily to further the debtor's business interests; 2. Is the property an integral part of the debtor's business; 3. The degree to which the specific property is necessary to run the business; 4. Do customers need to enter the property to utilize the business; and 5. Does the business utilize employees and other businesses in the area to run its operations.

Counsel: **[*1]** For Deirdre Ventura, Debtor: Sarah M Keenan, Sferrazza & Keenan, Melville, NY.

Judges: Robert E. Grossman, United States Bankruptcy Judge.

Opinion by: Robert E. Grossman

Opinion

MEMORANDUM DECISION OVERRULING OBJECTIONS TO THE DEBTOR'S ELECTION AS A *SUBCHAPTER V* DEBTOR

Introduction

The matter before the Court presents a series of legal issues that are for the most part issues of first impression. The Court is being asked to rule on questions of law resulting from amendments to the Bankruptcy Code pursuant to the Small Business Reorganization Act of 2019 which became effective on February 19, 2020. These amendments, commonly referred to as the SBRA, were instituted to broaden the opportunity for small businesses to successfully utilize the benefits of chapter 11 of the Bankruptcy Code. Congress recognized that many of the benefits afforded to large corporate debtors under chapter 11 were for all practical purposes out of the reach of smaller businesses. Chapter 11 is often an expensive and highly complicated proposition. Many small businesses have neither the money nor the time to navigate the process, even with the considerations given to small businesses prior to the enactment of the SBRA. Had Congress been given **[*2]** a crystal ball with the power to see what the world is facing today, including the severe disruption to our Nation's economy and its impact on small businesses, Congress likely could not have drafted a more effective set of mechanisms to help these businesses reorganize and hopefully survive. These amendments will be analyzed and challenged over the coming months and years, as are all new significant changes to the law. While this case may be one of the first to require a court to rule on the applicability and interpret complex issues, courts in this country have been called upon since the founding of our Republic to respond to similar challenges.

In the case of Deirdre Ventura (the "Debtor"), these issues arise in the context of objections to the Debtor's recent amendments to her petition to designate herself as a small business debtor and to proceed as a ***subchapter V*** debtor. The objections require the Court to answer the following questions:

> 1) Can the Debtor amend her petition to take advantage of the benefits of the SBRA where the Debtor's case has been pending for over fifteen months and a creditor's proposed plan of reorganization has been scheduled for a hearing on confirmation? **[*3]**
>
> 2) Assuming the SBRA applies to the Debtor's case, does the Debtor qualify as a "small business debtor" within the newly amended definition of *11 U.S.C. § 101(51D)(A)* where the majority of her debt consists of a mortgage encumbering the property where she both resides and operates a bed and breakfast?
>
> 3) Assuming the Debtor fits within the definition of a small business debtor, is the Debtor barred from utilizing provisions applicable to ***subchapter V*** debtors to modify the mortgage encumbering the property where she both resides and operates a bed and breakfast?

For the reasons set forth below, the Court answers the first two questions in the affirmative and finds that under its interpretation of *11 U.S.C. § 1190(3)*, the Debtor is not barred from utilizing this SBRA provision solely on the basis that the mortgage she seeks to modify is a purchase money mortgage secured by her residence. Based on the Court's answers to these questions, the objections to the Debtor's amended petition are overruled.

While these conclusions do not mean that the Debtor will succeed as a ***subchapter V*** debtor, the Debtor will be given a chance to proceed under this subchapter. The Debtor must still fulfill her obligations under ***subchapter V***, including **[*4]** proposing a feasible plan and coordinating with the newly appointed ***subchapter V*** trustee.

Procedural History and Facts

In 1981, the Debtor began working in the real estate brokerage business specializing in the sales and development of hotels and lodges. Ultimately, she became the sole owner of Innvest Hotel Brokers, LLC which she used to conduct a lodging property brokerage business. (Debtor's Objection to Mot. of Gregory Funding for Order Denying & Voiding Debtor's Election as a Sub-Chapter V Debtor, 1:2, Mar. 24, 2020, ECF No. 97.).

The Debtor, along with another individual, purchased the Harbor Rose Property (the "Property") in December 2007. The acquisition of the Property was financed in part by a $1 million dollar loan ("Note") secured by a mortgage ("Mortgage") on the Property from Wells Fargo Bank, N.A. ("Wells Fargo"). (Emergency Mot. to Prohibit Use of Cash Collateral. & for Relief from Auto.

Stay, Exh. A, Nov. 12, 2018, ECF No. 17.). The Note and the Mortgage were eventually assigned in 2015 to Gregory Funding, as servicer for U.S. Bank National Association, as Indentured Trustee on Behalf of and with Respect to Ajax Mortgage Loan Trust 2015-B Mortgage-Backed Notes Series **[*5]** 2015-B ("Gregory"). *Id.* Exh. B. According to the proof of claim filed in this case, Gregory is owed $1,678,664.80. (Claim No. 3-1, Dec. 21, 2018.).

The Property is not a typical Long Island residence. The original structure was built in the mid-1800's and is located in Cold Spring Harbor, a small waterfront village on Long Island's North Shore. (Ventura Aff. ¶ 7.). The Property is registered on The National Registry of Historic Places. *Id.* It is also recognized as a significant historic structure by the Town of Huntington Historic Preservation Society. *Id.* Rooms at the property from the time the Debtor acquired it were made available for rent by the Debtor as advertised on Craigslist, Facebook and Wimdu (a European version of Airbnb). (Ventura Aff. ¶ 5.). The Debtor has included as exhibits to her submission copies of emails from potential guests from 2009 through 2011. (Debtor's Objection to Mot. of Gregory Funding for Order Denying & Voiding Debtor's Election as a Sub-Chapter V Debtor, Exh. A, Mar. 24, 2020, ECF No. 97.). The documentary evidence supports a finding that paying guests were staying at the Property within the first year that the Debtor purchased the Property. At the **[*6]** time the Debtor purchased the Property, the Huntington Town Code only permitted individuals to rent two guest rooms out of their property. (Ventura Aff. ¶ 11.).

As with many local businesses, the Great Recession of 2008 had a drastic impact on the Debtor's hotel brokerage business. (Debtor's Objection to Mot. of Gregory Funding for Order Denying & Voiding Debtor's Election as a Sub-Chapter V Debtor, 3:3, Mar. 24, 2020, ECF No. 97.). Eventually, the Debtor defaulted on the Mortgage. *Id.* On January 18, 2013, Debtor filed a voluntary petition for relief from her creditors under chapter 7. (Case No. 8-13-70280-reg, ECF No. 1.) ("First Case"). The First Case was filed as a no-asset chapter 7 case, and the majority of the Debtor's debts were listed as consumer debts. *Id.* ECF 11. On May 1, 2013, the Debtor received a discharge and the case was closed shortly thereafter. *Id.* ECF No. 16. On May 3, 2013, the Debtor formed Harbor Rose LLC ("Harbor Rose") as a New York State limited liability company. (Ventura Aff. ¶ 3 n.1.).

On February 6, 2014 the Debtor filed a voluntary petition for relief under chapter 13 ("Second Case"). (Case No. 8-14-70473-reg, ECF No. 1.). The Second Case was dismissed for **[*7]** the failure to file necessary documents. *Id.* ECF No. 33. Despite the fact that the Debtor described her debts as primarily consumer debts, the Debtor included in Schedule I a breakdown of income and expenses from the operations of Harbor Rose. *Id.* ECF No. 10. From the information set forth in the Second Case, it is clear that the Debtor's sole source of income was derived from Harbor Rose, which was operating at the Property. Based on the information provided by the Debtor in the Second Case, there does not appear to be an attempt by the Debtor to mislead her creditors or to create a false impression regarding her use of the Property, notwithstanding her description of her debts as primarily consumer debts.

On February 18, 2015, the Debtor executed a loan modification with respect to the Note and Mortgage (the "Loan Modification"). (Emergency Mot. to Prohibit Use of Cash Collateral. & for Relief from Auto. Stay, 8:4, Nov. 12, 2018, ECF No. 17.). As part of the modification the co-owner of the Property transferred his interest to the Debtor. *Id.* Although the Loan Modification gave the Debtor more favorable terms, the Debtor defaulted on her obligations under the Loan Modification. *Id.* ***[*8]*** 9:4. In February of 2016, Gregory commenced a foreclosure action against the Debtor in the Supreme Court for the State of New York, Suffolk County. *Id.* 10:5.

Despite the Debtor's financial setbacks, the Debtor took steps to increase her ability to rent rooms to guests at the Property. The Debtor obtained a permit to operate as a bed and breakfast on May 4, 2016. (Ventura Aff. ¶ 11.). The Debtor urged one of the Town Councilpersons to sponsor an amendment to allow bed and breakfasts to provide up to four guest rooms and permit a maximum stay of 29 days. (Ventura Aff. ¶ 12.). The Debtor was successful in her endeavors and on November 16, 2017, the Debtor obtained a Certificate of Permitted Use for four guest rooms. (Ventura Aff. ¶ 13.). By June, 2018, the Debtor upgraded the Property to provide four guestrooms. *Id.* The Debtor also obtained the proper permits to add an additional bathroom for guests, replaced the HVAC for a portion of the Property, upgraded the electric service, and built an enclosed porch with heat for year-round use. *Id.*

It appears there is no other such bed and breakfast in the Town of Huntington, and according to the Debtor's affidavit, there is no other similar bed **[*9]** and breakfast on Long Island as of March 24, 2020. (Ventura Aff. ¶ 10.). The Town of Huntington requires as a condition to

receiving the bed and breakfast permit that the owner operator reside at the bed and breakfast premises. *Id.* In addition to its lodgings, Harbor Rose offers health and wellness package, including yoga classes, acupuncture treatments, massage treatments. (Emergency Mot. to Prohibit Use of Cash Collateral. & for Relief from Auto. Stay, 19:6, Nov. 12, 2018, ECF No. 17.).

On August 8, 2018, a judgment of foreclosure and sale was granted in favor of Gregory, with a sale date scheduled for October 25, 2018 (the "Foreclosure Sale"). *Id.* at 14-15:5-6. Pursuant to Gregory's Broker's Price Opinion dated October 02, 2018, the Property was valued at $1,200.000.00. *Id.* Exh. H. On October 24, 2018 (the Petition Date"), the Debtor filed a voluntary petition under chapter 11 (the "Current Case"). As of the Petition Date, Gregory was owed a total amount of $1,678,664.80. *Id.* at 17:6. The current value of the Property is unknown.

In the Current Case, the Debtor again described her debts as primarily consumer debts. (Case No. 8-18-77193-reg, ECF No. 1.). The Debtor also stated that she was an **[*10]** individual chapter 11 debtor and did not designate herself as a small business debtor. *Id.* The Debtor's description of the Property in the Current Case accurately set forth that it was being used as a place of business. For example, when the Debtor was asked "What is the property?" she checked the box "Other" and wrote "B&B Inn" on Schedule A/B instead of checking the box for "Single-family" home. *Id.* In Schedule C, the Debtor claimed an exemption for the Property pursuant to *11 U.S.C. § 522(b)(2)* wherein she described it as "Bed & Breakfast." *Id.* Again, on Schedule D, the Debtor described the Property as a "Bed and Breakfast." *Id.* The Debtor also lists her income and expenses from the operations of Harbor Rose in her Statement of Current Monthly Income. *Id.* ECF No. 26.

On November 12, 2018, Gregory moved this Court for an Order: (1) directing the Debtor to establish a Debtor in possession account, directing immediate turnover of cash collateral to the Debtor in possession account, and prohibiting the Debtor's use of cash collateral until the motion and request for adequate protection payments to Gregory could be heard, pursuant to *11 U.S.C. § 363(c)(2)(B)*; (2) granting Gregory relief from the automatic stay pursuant to *11 U.S.C. § 362(d)(1)*; or alternatively **[*11]** (3) adequate protection payments pursuant to *11 U.S.C. § 363(e)*. (Emergency Mot. to Prohibit Use of Cash Collateral. & for Relief from Auto. Stay, at 3, Nov. 12, 2018, ECF No. 17.). In December 2018, the Debtor agreed to pay monthly adequate protection payments to Gregory in the amount of $3,5000, to maintain proper insurance on the Property, and to timely remit taxes due subsequent to January 1, 2019. (Agreed Order Resolving Mot. for Adequate Protection Payments, at 1-2, Dec. 13, 2018, ECF No. 32.).

With the consent of the parties, the Court entered an order directing the Debtor and Gregory to participate in the Loss Mitigation Program with respect to the Property. (Order Directing the Debtor and Creditor Gregory Funding, as servicer for US Bank as Indentured Trustee to Ajax Mortgage Loan to participate in the Loss Mitigation Program, Dec. 20, 2018, ECF No. 35.). In June of 2019, the parties agreed to terminate loss mitigation, to increase the adequate protection payment to Gregory to $4,800 monthly, and to require that by September 30, 2019, the Debtor file a proposed disclosure statement and chapter 11 plan of reorganization acceptable to Gregory in its sole and absolute discretion. (Further Agreed **[*12]** Order Concerning Adequate Protection Payments, *Inter Alia*, June. 11, 2019, ECF No. 53.). In the event the Debtor's proposed disclosure statement and plan were deemed unsatisfactory to Gregory, Gregory would be permitted to file a competing plan which would provide for the sale of the Property to satisfy the Mortgage. *Id.* The Debtor failed to file a proposed disclosure statement and plan by the September 30, 2019 deadline, which effectively terminated the Debtor's exclusivity as an individual chapter 11 debtor.

At the November 19, 2019 status conference, the Court directed the Debtor and Gregory to each file a proposed plan of reorganization and disclosure statement by December 13, 2019. As expected, Gregory's proposed plan provided for an auction sale of the Property subject to higher and better offers. (Chapter 11 Plan of Liquidation, Dec. 13, 2019, ECF No. 60.). Gregory's proposed plan also provided for a carve out from the sale proceeds to pay all the other classes in full. *Id.* The Debtor's proposed plan sought to modify the Mortgage by reducing the secured portion of Gregory's claim to $1,050,00, which the Debtor represented was the value of the Property at that time, and repaying **[*13]** the secured portion of the claim over 30 years at 4.25 percent interest per annum. (Debtor's First Amended Plan of Reorganization, Dec. 20, 2019, ECF No. 67.). According to the Debtor's proposed plan, Gregory would receive no payment on account of the unsecured portion of its claim because the Debtor had previously received a discharge in the First Case. *Id.*

The viability of the Debtor's plan hinged on her ability to utilize *11 U.S.C. § 1123(b)(5)* to bifurcate the Mortgage into a secured and unsecured claim, and to pay only the secured portion in full. However, because the Debtor resided at the Property, and *11 U.S.C. § 1123(b)(5)* specifically excluded modification of claims secured by liens on a debtor's residence, the Court determined that the Debtor's proposed plan was unconfirmable on its face. So long as any portion of the Property constituted the Debtor's residence, *11 U.S.C. § 1123(b)(5)* could not be used to modify the Mortgage. This conclusion was consistent with *In re Macaluso, 254 B.R. 799 (Bankr. W.D.N.Y. 2000)*, *In re Addams, 564 B.R. 458 (Bankr. E.D.N.Y. 2017)* and *In re Wages, 508 B.R. 161 (B.A.P. 9th Cir. 2014)*. For these reasons, on January 13, 2020, the Court did not approve the Debtor's disclosure statement. (Order Approving Disclosure Statement Relating to Chapter 11 Plan of Gregory Funding as Plan Sponsor, *Inter Alia*, Jan. 13, 2020, ECF No. 79.). At the same hearing, the Court **[*14]** approved Gregory's Disclosure Statement and authorized Gregory to solicit votes. *Id.* The Court also set February 26, 2020 as the date for a hearing on the confirmation of Gregory's proposed plan (the "Confirmation Hearing"). *Id.*

In preparation for the Confirmation Hearing, Gregory solicited the necessary votes and filed the certification of ballots on February 20, 2020. (Certificate as to Balloting Accepting and Rejecting the Chapter 11 Plan, Feb. 20, 2020, ECF No. 81.). One day prior to the date the certification of ballots was filed, and seven days prior to the Confirmation Hearing, the SBRA became effective. *Pub. L. No. 116-54 § 5, 133 Stat. 1079, 1087.* Congress made clear that the changes to the Code set forth in the SBRA were intended to allow small businesses and individuals to take advantage of a chapter 11 process that would be less costly and time consuming than the current process. H.R. REP. No. 116-171, at 2 (2019).

At the Confirmation Hearing, the Court advised the parties of the SBRA and offered the Debtor the opportunity to proceed with the hearing as scheduled or the Court would adjourn the hearing for a short time to allow the Debtor to determine whether she wished to amend her petition. The Debtor opted to have **[*15]** the Confirmation Hearing adjourned. On March 3, 2020, the Debtor filed a letter with the Court advising that she intended to amend her petition. (Letter to Court regarding Debtor's Intention to Amend Her Petition, Mar. 3, 2020, ECF No. 85.).

On March 6, 2020, the Debtor amended her petition to designate herself as a small business debtor under the newly amended definition, and to elect to proceed as a ***subchapter V*** debtor. (Aff. Pursuant to *E.D.N.Y. LBR 1009-1(a)*, Mar. 6, 2020, ECF No. 87.). On March 6, 2020, the United States Trustee (the "U.S. Trustee") appointed Salvatore LaMonica, Esq., as the ***subchapter V*** trustee (the "Trustee") pursuant to *11 U.S.C. § 1183(a)*. (Notice of Appointment of ***Subchapter V*** Trustee, Mar. 6, 2020, ECF No. 88.). On March 10, 2020, the Court entered a scheduling order setting a status conference for April 1, 2020 and setting the Debtor's deadline to file a plan for June 8, 2020. (Order Scheduling Status Conference Under *11 U.S.C. § 1188*, Mar. 9, 2020, ECF No. 91.).

On March 9, 2020, Gregory filed a motion objecting to the Debtor's designation as a ***subchapter V*** debtor (the "Motion"), raising a wide range of objections to the Debtor's designation, including objections based on prejudice to Gregory's vested rights in **[*16]** this case, as the Court was at the point of holding a hearing to confirm Gregory's proposed plan. (Mot. to Object to Debtor's Designation as a Sub-Chapter V, 16:6, Mar. 10, 2020, ECF No. 92.).[1] In addition, Gregory asserts that the Debtor is not eligible for ***subchapter V*** relief because she does not fit within the definition of "small business debtor" as set forth in newly amended *11 U.S.C. § 101(51D)(A)*. *Id.* 18-19:7-8. Even if she fits within the definition, Gregory asserts that the Debtor should be judicially estopped from amending her designation based on her prior representations to Gregory as well as her prior statements in the prior bankruptcy filings and the Current Case. (Reply in Connection with Objection to Debtor's Designation as a Sub-Chapter V Debtor, 8:4, Mar. 26, 2020, ECF No. 99.). Gregory also argues that the Debtor cannot modify the Mortgage pursuant to pursuant *11 U.S.C. § 1190(3)* because the Debtor used the Mortgage proceeds to purchase a residence, not to invest in Harbor Rose. (Mot. to Object to Debtor's Designation as a Sub-Chapter V, 32:13, Mar. 10, 2020, ECF No. 92.).

On March 19, 2020 the U.S. Trustee filed an Objection ("U.S. Trustee Objection") to the Debtor's election to be treated as a ***subchapter V*** case, **[*17]** raising timing and technical issues. (United States Trustee's Objection to Debtor's Election to Be Treated as a ***Subchapter V*** Case, Mar. 19, 2020, ECF No. 96.). On March 24, 2020, the Debtor filed her opposition to the Motion (Debtor's

[1] Gregory has filed an Objection to Debtor's Designation as a Sub-Chapter V. ECF No. 89 and a motion seeking the same relief, ECF No. 92. The Court will refer to both filings as the Motion, ECF No. 92.

Objection to Mot. of Gregory Funding for Order Denying & Voiding Debtor's Election as a Sub-Chapter V Debtor, Mar. 24, 2020, ECF No. 97.), and Response to the U.S. Trustee Objection. (Resp. to United States Trustee's Objection to Debtor's Election to Be Treated as a ***Subchapter V*** Case, Mar. 24, 2020, ECF No. 98.). In her submissions, the Debtor pointed to her professional experience in the hotel business, the unique characteristics of the Property, her consistent use of the Property as a bed and breakfast, and the improvements the Debtor made to the Property as sufficient grounds for finding that the Debtor is a small business debtor within the definition of *§ 101(51D)(A)*, and that she qualified to proceed as a ***subchapter V*** debtor.

On March 30, 2020, the Debtor filed a letter indicating that since the Debtor filed her amended petition to make a retroactive election under ***subchapter V***, the Debtor has been unable to have any meaningful negotiations with Gregory. (Letter **[*18]** Pursuant to *11 U.S.C. § 1188(c)* Outlining Efforts by the Debtor to Attain Consensual Plan of Reorganization, Mar. 30, 2020, ECF No. 101.). The Debtor further notes that the Trustee has attempted to persuade Gregory to negotiate with the Debtor, to no avail. *Id.* On April 1, 2020, the Court held a telephonic hearing on the Motion and the U.S. Trustee's Objection, which was attended by the Debtor's counsel, Gregory's counsel, the U.S. Trustee and the ***subchapter V*** Trustee. Thereafter, the matter was marked submitted.

Discussion

On August 23, 2019, the President signed the SBRA into law, which became effective on February 19, 2020. *Pub. L. No. 116-54 § 5, 133 Stat. 1079, 1087*. The SBRA is codified in *11 U.S.C. §§ 1181-1195*, and certain Bankruptcy Code sections that existed prior to the SBRA have been modified as well. *Id.* By enacting this law, Congress intended to streamline the reorganization process for small business debtors because small businesses have often struggled to reorganize under chapter 11. H.R. REP. No. 116-171, at 1-2 (2019).

Of pertinence, the Report from the House Committee on the Judiciary contains, *inter alia*, the following statement:

> Small businesses--typically family-owned businesses, startups, and other entrepreneurial ventures—"form the backbone of the **[*19]** American economy." By their very nature, however, the longevity of these businesses is limited. According to the Small Business Administration Office of Advocacy, approximately 20 percent of small businesses survive the first year, but by the five-year mark only 50 percent are still in business and by the ten-year mark only one-third survive. Notwithstanding the 2005 Amendments, small business chapter 11 cases continue to encounter difficulty in successfully reorganizing...the legislation allows these debtors "to file bankruptcy in a timely, cost-effective manner, and hopefully allows them to remain in business" which "not only benefits the owners, but employees, suppliers, customers, and others who rely on that business."

Id. at 2. (Citing the Unofficial Transcript of Oversight of Bankruptcy Law and Legislative Proposals: Hearing Before the Subcomm. on Antitrust, Commercial, & Admin. Law of the H. Comm. on the Judiciary, 116th Cong. 27 (2019) (on file with H. Comm. on the Judiciary staff)).

HN1[⬆] Newly amended *11 U.S.C. § 101(51D)(A)* of the Bankruptcy Code defines a "small business debtor", in part, as "...a person engaged in commercial or business activities . . . that has aggregate noncontingent liquidated secured and unsecured debts as of the date of **[*20]** the filing of the petition . . . in an amount not more than $2,725,625. . . not less than 50 percent of which arose from the commercial or business activities of the debtor. " *11 U.S.C. § 101(51D)(A)*.[2] The definition of "small business" excludes debtors whose primary business is owning "single asset real estate." *Id.*

Prior to enactment of the SBRA, the only statutory provision the Debtor could have considered to modify the Mortgage was *11 U.S.C. § 1123(b)(5)*. This section permits chapter 11 debtors to propose a plan that modifies the rights of holders of secured claims "...other than a claim secured only by a security interest in real property that is the debtor's principal residence." *11 U.S.C. § 1123(b)(5)*.[3]

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[2] Late on the evening of March 25, 2020, the U.S. Senate unanimously passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (S.3548) to combat the U.S. spread of coronavirus, which threatens to plunge U.S. into a global recession. For one year, the Act increases the eligibility threshold to file under ***subchapter V*** of chapter 11 of the Bankruptcy Code to businesses with less than $7.5 million of debt.

[3] As set forth in the facts, the Court ruled that because the

HN2[↑] The SBRA has given small business debtors who designate themselves as ***subchapter V*** debtors another tool to be used when proposing a plan. *Section 1190(3)* provides as follows:

A plan filed under this subchapter—

(3) notwithstanding *section 1123(b)(5)* of this title, may modify the rights of the holder of a claim secured only by a security interest in real property that is the principal residence of the debtor if the new value received in connection with the granting of the security interest was—

(A) not used primarily to acquire the real property; and

(B) used primarily in connection **[*21]** with the small business of the debtor.

11 U.S.C. § 1190(3).

Furthermore, a trustee will be appointed in every ***subchapter V*** case. The ***subchapter V*** trustee will act as a fiduciary for creditors, in lieu of an appointed creditors' committee. The ***subchapter V*** trustee is also charged with facilitating the ***subchapter V*** debtor's small business reorganization and monitoring the ***subchapter V*** debtor's consummation of its plan of reorganization. *11 U.S.C § 1183 (a), (b)*.

HN3[↑] Prior to enactment of the SBRA, small business debtors were required to file a plan of reorganization within 120 days after the order for relief, and "any party in interest" could file a plan at certain times and under certain circumstances. *11 U.S.C. §§ 1121(b), (c)*. The newly enacted law gives ***subchapter V*** debtors the exclusive right to file a plan of reorganization, which must be filed within 90 days after entry of the order for relief. *11 U.S.C. § 1189(a), (b)*. This plan deadline may be extended by the Court "...if the need for the extension is attributable to circumstances for which the debtor should not justly be held accountable." *11 U.S.C. § 1189(b)*.

1. Does the SBRA apply to the Debtor's case?

a. Procedural and timing issues

The SBRA is silent as to whether it applies to pending cases, or only to cases commenced after the effective **[*22]** date. In the Current Case, the Debtor did not designate herself as a small business debtor on her petition, which was filed over fifteen months prior to the effective date of the SBRA. The Debtor has since amended the petition to reflect 1) that she is a small business debtor and 2) that she seeks to proceed as a ***subchapter V*** debtor. The sole reason for filing the amended petition is to take advantage of the changes to the Bankruptcy Code and Rules pursuant to the SBRA. While the U.S. Trustee does not specifically urge the Court to find that the SBRA should only apply to cases filed after February 19, 2020, the U.S. Trustee does argue that procedural issues prevent the Debtor from electing to proceed as a ***subchapter V*** small business debtor. In the Motion, Gregory raises a wide range of objections to the Debtor's designation, including due process objections based on prejudice to Gregory's vested rights in this case, estoppel arguments, and objections based on whether the Mortgage is subject to modification under *§ 1190(3)*.

HN4[↑] According to *Fed. R. Bankr. P. 1020(a)*, once a small business debtor designates itself in the petition, "...the status of the case as a small business case shall be in accordance with the debtor's **[*23]** statement under this subdivision, unless and until the court enters an order finding that the debtor's statement is incorrect." *Fed. R. Bank. P. 1020(a)*. The Court's finding of incorrect designation is triggered by an objection to the designation. *See In re Angel Fire Water Co., LLC, No. 13-10868 ta11, 2015 Bankr. LEXIS 170, 2015 WL 251570, at *6 (Bankr. D. N.M. Jan. 20, 2015)* (finding that because the debtor never elected to be a small business debtor and no party objected to its status, it would be inappropriate for the court to alter the debtor's statement *sua sponte*).

HN5[↑] Pursuant to *Fed. R. Bankr. P. 1009(a)*, "[a] voluntary petition, list, schedule or statement may be amended by a debtor as a matter of course at any time before the case is closed." However, such amendment by the debtor is not necessarily controlling. The designation by the debtor in the original petition still retains evidentiary effect as it is signed under penalty of perjury. *In re Roots Rents, Inc., 420 B.R. 28, 39-40 (Bankr. D. Idaho. 2009)*.

HN6[↑] As the U.S. Trustee points out, the SBRA imposes several requirements in ***subchapter V*** cases. First, a "SBRA trustee" is appointed by the U.S. Trustee, who is charged with development of a consensual plan.

Debtor resided at the Property, she could not modify the Mortgage under this provision.

11 U.S.C. § 1183(b)(7). Within 60 days of entry of the order for relief, the Court must hold a status conference with the SBRA trustee. 11 U.S.C. § 1188(a). Subsection (b) provides that the court may extend the 60-day **[*24]** deadline if "...the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable." 11 U.S.C. § 1188(a). Pursuant to 11 U.S.C. § 1189(b), the ***subchapter V*** debtor shall file a plan within 90 days of entry of the order for relief, "...except that the court may extend the period if the need for the extension is attributable to circumstances for which the debtor should not be justly held accountable." 11 U.S.C. § 1189(b). In addition, the ***subchapter V*** debtor must submit a status report 14 days prior to the status conference detailing efforts to reach a consensual plan. 11 U.S.C. § 1188(c).

According to the U.S. Trustee, there is no bar to applying the SBRA retroactively to cases commenced prior to February 19, 2020. However, because the order for relief in the Debtor's case was entered on October 24, 2018, the Debtor's 90-day deadline to file a plan has expired, and it does not appear that the SBRA trustee can effectively function as the facilitator of a consensual plan. Furthermore, many status hearings have already taken place in this case without the participation of a ***subchapter V*** trustee. First, the Court notes that both the 90 day deadline to file a plan and the 60 day deadline to hold a status conference **[*25]** may be extended if the need for an extension is attributable to circumstances for which the debtor should not be justly held accountable. Given that the Debtor's case was filed over fifteen months ago, the Court finds that to argue the Debtor should have complied with the procedural requirements of a law that did not exist is the height of absurdity. The Debtor is not required to comply with deadlines that clearly expired before the Debtor could have elected to proceed as a ***subchapter V*** debtor.

In one of the very few written decisions regarding the SBRA, the Bankruptcy Court found that any practicality and scheduling issues arising from an SBRA designation in a case commenced prior to the effective date of the SBRA, while they might result in redundant hearings or the "procedurally awkward" process of resetting deadlines, did not pose an absolute bar to retroactive application of the SBRA. *See* In re Progressive Solutions, Inc., No. 8:18-bk- 14277-SC, 2020 Bankr. LEXIS 467, 2020 WL 975464, at *4 (Bankr. C.D. Cal. February 21, 2020) (The United States Trustee raised objections on several grounds related to practicality and scheduling issues which the court overruled. The court ultimately permitted the resetting or rescheduling of these procedural matters "...in order **[*26]** to provide due process to all parties involved, unless vested rights of parties would be abridged or otherwise prejudiced.").

Armed with this case law and since there is no prohibition provided by Congress, the Court finds that it is within the Court's discretion to reset the timelines to allow the Debtor to avail herself of the newly enacted law that was not at her disposal when she filed the Current Case. Therefore, the Court overrules any objections raised by the U.S. Trustee or Gregory based on procedural or timing issues imposed by the SBRA.

b. Gregory's substantive rights

Gregory also argues that retroactive application of the SBRA to the Debtor's case is impermissible because it would be prejudicial to Gregory with respect to its "vested rights." Gregory interprets vested rights to mean prior orders issued by this Court permitting Gregory to file its own plan and approving Gregory's disclosure statement, along with the Court's finding that the Debtor's proposed disclosure statement was patently unconfirmable. However, an analysis of Gregory's argument and applicable case law leads the Court to a different conclusion.

HN7[⬆] Both Gregory and the U.S. Trustee acknowledge that there is no **[*27]** statutory prohibition to applying the SBRA to cases that were pending prior to the effective date of this legislation. The few cases that discuss this issue agree that while there is a presumption against retroactivity, this presumption applies to "'new provisions affecting contractual or property rights, matters in which predictability and stability are of prime importance.'" In re Moore Props. of Person Cty., LLC, No. 20-80081, 2020 Bankr. LEXIS 550, 2020 WL 995544, at *3 (Bankr. M.D.N.C. February 28, 2020) (citing Landgraf v. USI Film Products, 511 U.S. 244, 271, 114 S. Ct. 1483, 128 L. Ed. 2d 229 (1994) (other citations omitted)). As Judge Kahn noted, and this Court agrees, ***subchapter V*** incorporates many of the provisions already applicable to small business debtors. In re Moore Props. of Person Cty., LLC, 2020 Bankr. LEXIS 550, 2020 WL 995544, at *4, n.10. At least one other court considering this issue has drawn the same conclusion. In re Body Transit, Inc. d/b/a Rascals Fitness, No. 20-10014 (ELF), 2020 Bankr. LEXIS 740, 2020 WL 1486784, at *6 (Bankr. E.D. Pa. Mar. 24, 2020) (holding that "...in general, the new ***subchapter V*** provisions do not impair the vested

property interests of creditors and, therefore, the concerns supporting application of the canon of statutory construction disfavoring the retroactive application of new law are absent."). In addition, the amendment of the definition of "small business debtor" in *11 U.S.C. § 101(51D)(A)* of the Bankruptcy Code did not appear to affect the contractual or vested property rights of parties that existed prior to the effective date of the SBRA. *In re Moore Props. of Person Cty., LLC, 2020 Bankr. LEXIS 550, 2020 WL 995544, at *4, n.10*.

In discussing the applicability of the SBRA to a pending **[*28]** bankruptcy case, Judge Kahn in *In re Moore Props. of Person Cty., LLC* relied on guidance from the Supreme Court, which considered the issue of retroactivity in the context of a newly enacted bankruptcy statute. *2020 Bankr. LEXIS 550, [WL] at 3*. (citing *United States v. Sec. Indus. Bank, 459 U.S. 70, 103 S. Ct. 407, 74 L. Ed. 2d 235 (1982)*). The Court in *Sec. Indus. Bank* was called on to determine whether *§ 522(f)* of the 1978 Bankruptcy Act, which provided debtors with a vehicle to remove certain liens that attached to property of the debtor's estate prepetition, violated the *Fifth Amendment*. *United States v. Sec. Indus. Bank, 459 U.S. 70, 103 S. Ct. 407, 74 L. Ed. 2d 235 (1982)*. Instead of dealing with this Constitutional clash head-on, the Supreme Court held that this provision was not intended to apply to property interests created before the enactment of the 1978 Bankruptcy Act. *Id.* The Court acknowledged that the Congressional authority to enact legislation "...has been regularly construed to authorize the retrospective impairment of contractual obligations." *Id. at 74*. (citing *Hanover National Bank v. Moyses, 186 U.S. 181, 188, 22 S. Ct. 857, 46 L. Ed. 1113 (1902)*). However, the Supreme Court distinguished between using that authority to modify existing contractual obligations and using it to "defeat traditional property interests." *Id. at 75*. The Court in *Landgraf v. USI Film Products* further taught that "[t]he presumption against statutory retroactivity is founded upon elementary considerations of fairness **[*29]** dictating that individuals should have an opportunity to know what the law is and to conform their conduct accordingly," and the principle that "settled expectations should not be lightly disrupted." *Landgraf v. USI Film Products, 511 U.S. 244, 245, 265, 114 S. Ct. 1483, 128 L. Ed. 2d 229 (1994)*. After analyzing the Supreme Court's rulings, Judge Kahn concluded that in the case before him, there were no taking or retroactivity concerns which were the focus of the Supreme Court in *Landgraf* and *Security Indus. Bank. In re Moore Props. of Person Cty., LLC, 2020 Bankr. LEXIS 550, 2020 WL 995544, at *4*.

Judge Kahn did single out *11. U.S.C. § 1190(3)* as a potential area of concern if it were to be retroactively applied to affect a property right existing prior to the enactment of the SBRA, but he did not make a ruling as to whether this provision violated the *Fifth Amendment* prohibition against taking property without compensation. *2020 Bankr. LEXIS 550, [WL] at *4, n.14*.

While Gregory speaks in terms of damage to its vested rights resulting from the progress made in the Debtor's bankruptcy case, Gregory is focused on the wrong question. ***HN8***[↑] The correct question to ask is whether designation of the Debtor as a ***subchapter V*** debtor will impair Gregory's rights as they existed prior to the effective date of the SBRA. Clearly, the amendment to the definition of "small business debtor" does not amount to a taking of property. The SBRA merely amends the definition of small business **[*30]** debtor to ensure that certain debtors can avail themselves of a less costly and time-consuming path to reorganization that befits the family — owned businesses and other "Main Street" businesses that are currently in such dire need of relief. *See In re Moore Props. of Person Cty., LLC, 2020 Bankr. LEXIS 550, 2020 WL 995544, at *5 n.10 (Bankr. M.D.N.C. February 28, 2020)* ("...the SBRA [amends] the definition of 'small business debtor' under chapter 1, but that revision does not affect contractual or vested property rights any more than the general availability of ***subchapter V***.").

The more difficult question is whether *11 U.S.C. § 1190(3)* should apply to property rights which vested prior to the effective date of the SBRA, such as Gregory's rights as mortgagee. In order to answer this question, the nature of Gregory's rights must be defined. At the time Gregory became the mortgagee with respect to the Property, Gregory was granted a bundle of rights under New York State law. *Butner v. U.S., 440 U.S. 48, 55, 99 S. Ct. 914, 59 L. Ed. 2d 136 (1979)*. The Note and Mortgage afforded *in personam* rights against the Debtor including a right to proceed against the Debtor to collect the amount due and owing under the Note. In addition, Gregory was granted *in rem* rights to proceed against the Property and seek a sale of the Property. The proceeds of the sale would then be applied against the amount due and **[*31]** owing. The right to sell the Property would generate only an amount of money that reflects the value of the Property as established at a free and fair auction sale. To the extent the sale left a deficiency, Gregory would have been entitled to proceed against the Debtor for the deficiency. However, because the Debtor previously received a discharge of her personal obligations, Gregory is left with only its rights

against the Property under New York State law. In this unique case, Gregory can no longer seek entry of a judgment against the Debtor personally because of the discharge entered in the First Case. It should also be noted that Gregory may still avail itself of all rights granted to a secured creditor under the Code that have not been amended by the SBRA.

HN9[↑] The exception to the anti-modification provision permits a debtor to modify the rights of certain mortgagees by allowing the debtor to bifurcate a claim into a secured and unsecured claim based on the value of the underlying collateral. *11 U.S.C. § 1190(3)*. Since Gregory can look solely to the value of the Property to satisfy the Debtors obligation as a result of the discharge the Debtor received in the First Case, application of *11 U.S.C. § 1190(3)* will not deprive **[*32]** Gregory of any rights Gregory retained under state law. Even if the Note had not been discharged in the First Case, the Court is not convinced that *11 U.S.C. § 1190(3)* would raise sufficient Constitutional doubts to warrant only prospective application. The Bankruptcy Code works to abrogate contractual rights, but does not affect the vested property rights of mortgagees. As the Supreme Court stated in *Security Natl. Bank*, "our cases recognize, as did the common law, that the contractual right of a secured creditor to obtain repayment of his debt may be quite different in legal contemplation from the property right of the same creditor in the collateral. Compare *Hanover National Bank v. Moyses, supra*, with *Lousisville Joint Stock Land Bank v. Radford, supra*, and *Kaiser-Aetna v. United States, 444 U.S. 164, 100 S. Ct. 383, 62 L. Ed.2d 332 (1979)*." *459 U.S. 70, 75, 103 S. Ct. 407, 74 L. Ed. 2d 235*. Consequently, applying *§ 1190(3)* to the modify the Mortgage would not violate Gregory's *Fifth Amendment* rights.

This still leaves the Court to consider whether applying the SBRA to the Debtor's case is prejudicial based on the history of this case, including the fact that the Court had previously rejected the Debtor's proposed plan and was poised to rule on whether to confirm Gregory's proposed plan. To this Court, this question does not raise Constitutional issues, nor does it require the Court to treat the rulings in the Debtor's case as "vested" **[*33]** rights. Until a plan is confirmed no property rights can be said to have vested in either the Debtor or Gregory. What Gregory is alluding to is whether by permitting the Debtor to elect treatment as a ***subchapter V*** debtor would cause prejudice to Gregory. As Judge Clarkson stated in *Progressive Solutions*, he would consider whether "...other events occurring during the pendency of the present case . . . would be disturbed by the designation of the case as a ***Subchapter V*** case." *In re Progressive Solutions, Inc., 2020 Bankr. LEXIS 467, 2020 WL 975464, at *4*. Similarly, in *In re Body Transit, Inc. d/b/a Rascals Fitness*, Judge Frank took into consideration whether permitting the debtor to elect treatment as a ***subchapter V*** debtor would unduly prejudice the objecting party. *In re Body Transit, Inc. d/b/a Rascals Fitness, 2020 Bankr. LEXIS 740, 2020 WL 1486784, at *7*. Given that ***subchapter V*** was not available to the Debtor on the Petition Date and the Debtor has made very clear from the outset the nature of Property as a business, the Court will not penalize the Debtor because after careful analysis by Congress the law has been amended to address the needs of debtors that engage in the type of business she operates. These types of debtors who are willing to risk everything to start and maintain their own businesses should not be penalized, rather, they should **[*34]** be applauded. Gregory will retain many of the rights it had at the inception of the case, any delay caused by this ruling is not sufficiently prejudicial to Gregory, given the current economic conditions. For these reasons, the Court finds that the SBRA applies to the Debtor's case in its totality.

2. Does the Debtor fit within the definition of a "small business debtor"?

As previously stated, the SBRA amended the definition of "small business debtor", in part, to provide that it is "a person engaged in commercial or business activities . . . that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition . . . in an amount not more than $2,725,625. . . not less than 50 percent of which arose from the commercial or business activities of the debtor. " *11 U.S.C. § 101(51D)(A)*. The definition of "small business debtor" excludes debtors whose primary business is owning "single asset real estate." *Id.*

The Debtor listed on Schedule D filed on the Petition Date the Mortgage in the amount of $1,5000.000.00. This debt combined with the other secured and unsecured debts totals $1,562.182.00 which is within the threshold statutory threshold of *§ 101(51D)*. What remains to be **[*35]** determined is whether more than 50% of the Debtor's debts rose from her commercial or business activities, which was not part of the calculation when determining whether a debtor was a small business debtor prior to the effective date of the SBRA.

Since there is no statutory definition of what constitutes

"commercial or business activities," Gregory looks to the definition of "consumer debt" to assist in determining what types of debt fit within this new description. A consumer debt is a debt "...incurred by an individual primarily for a personal, family, or household purpose." *11 U.S.C. § 101(8)*. "Debt" means "liability on a claim," *11 U.S.C. § 101(11) (1982)*, and "claim," in turn, is broadly defined as any "right to payment, whether or not such right is ... secured, or unsecured." *11 U.S.C. § 101(4)(A)*.

Gregory correctly points out that this Court has previously held that a residential mortgage fell within the definition of "consumer debt." *In re Lemma, 393 B.R. 299 (Bankr. E.D.N.Y. 2008)*. For the parties' understanding, there was no allegation in the *Lemma* case that the debtors used their residence for anything other than their personal residence. Other courts have drawn the same conclusion. *In re Kelly, 841 F.2d 908, 912 (9th Cir. 1988)* (recognizing that "[t]he statutory scheme so clearly contemplates that consumer debt include **[*36]** debt secured by real property that there is no room left for any other conclusion."); and *In re Hall, 258 B.R. 45, 50 (Bankr. M.D. Fla. 2001)* (a purchase money mortgage on a residence is a consumer debt). The same could be true of HELOCs, depending upon the use of the mortgage proceeds. *See In re Naut, No. 07-20280 (REF), 2008 Bankr. LEXIS 175, 2008 WL 191297, at *6 (Bankr. E.D. Pa. Jan. 22, 2008)* (holding that the debt was consumer debt because virtually all the proceeds from the refinancing and second mortgage debts were used to purchase and improve the property, not for any business purpose.); *Cox v. Fokkena (In re Cox), 315 B.R. 850, 855 (B.A.P. 8th Cir. 2004)* (despite the debtor's contention that they bought their home for investment purposes, the record revealed that the debt fit squarely within the definition of a consumer debt because the proceeds were used to complete the construction of and furnish the family's home.).

HN10[↑] However, the fact that a debtor incurs mortgage debt to buy a residence does not automatically mean that the debt is consumer debt. "The test for determining whether a debt should be classified as a business debt, rather than as a consumer debt, is whether it was incurred with an eye toward profit...[c]ourts must look at the substance of the transaction and the borrower's purpose in obtaining the loan, rather than merely looking at the form of the transaction." *In re Martin, No. 12-38024, 2013 Bankr. LEXIS 4020, 2013 WL 5423954, at *6 (Bankr. S.D. Tex. Sept. 26, 2013)*. *See also In re Booth, 858 F.2d 1051, 1055 (5th Cir. 1988)* (a debt **[*37]** incurred with an eye toward profit is a business debt, rather than consumer debt.).

Gregory asserts that the form of the transaction was solely a residential loan for the purposes of purchasing a primary residence, not operating a business. Gregory points to the Mortgage whereby the Debtor declared, "I will occupy the Property and use the Property as my principal residence within 60 days after I sign this Security Instrument." (Emergency Mot. to Prohibit Use of Cash Collateral. & for Relief from Auto. Stay, Exh. A, 8:6, Nov. 12, 2018, ECF No. 17.). Gregory also directs the Court's attention to the fact that Harbor Rose was not formed until six years after the Mortgage was originally granted, and any subsequent change in the Debtor's use of the Property does not change the nature of the debt. Gregory asserts that none of the Debtor's debts, let alone 50% of the debts, are derived from the operation of Harbor Rose and none of the Mortgage proceeds were used to renovate the Property for the benefit of the business. Finally, Gregory emphasizes the Debtor's previous characterization of the Mortgage debt as consumer debt in her prior bankruptcy filings and the Current Case as grounds for **[*38]** finding that the Debtor is not a small business debtor within the definition of *11. U.S.C. § 101(51D)(A)*.

In response, the Debtor points to her long history in the hotel business, her stated need to create a business that would keep her close to her adopted daughter, and the very unique characteristics of the Property to support a finding that the Mortgage debt was indeed incurred for commercial purposes. The Debtor purchased a six-bedroom historic mansion with the intention of converting this large house into a guest house. From the outset, the Debtor asserts she rented the guest rooms by advertising on various websites. The Debtor also invested in the Property by installing a new septic system to accommodate her business. Six year after purchasing the Property, she decided to register the Property as the first legal bed and breakfast in the Town of Huntington.

While the Property is clearly the Debtor's primary residence, the primary purpose of purchasing the Property appears to have been to own and operate a bed and breakfast. The Debtor's goal was to combine her business with the needs of her life as a single parent. The fact that the Debtor resides at the Property does not control whether the Mortgage is **[*39]** in the nature of a debt which arose from the commercial or business activities of the Debtor. In fact, the Debtor's affidavit in support of her opposition to the Motion

indicates that the Town of Huntington will not grant a permit to run a bed and breakfast if the owner/ operator does not live inside the facility itself.

Case law supports this finding. *See* In re Martin, No. 12-38024, 2013 Bankr. LEXIS 4020, 2013 WL 5423954, at *6 (Bankr. S.D. Tex. Sept. 26, 2013) ("[c]ourts must look at the substance of the transaction and the borrower's purpose in obtaining the loan, rather than merely looking at the form of the transaction..."). Based on the case law and the relevant facts, the Court finds that the Debtor fits within the definition of a small business debtor under the SBRA.

3. Does judicial estoppel apply to preclude the Debtor from claiming that the Mortgage debt arose from commercial or business activities?

As an alternative argument, Gregory asserts that the Debtor is judicially estopped from asserting that the Mortgage debt arose from her commercial or business activities. Gregory points out that the Debtor's current position that her debts are not primarily consumer debts is clearly inconsistent with her earlier position that those same debts are primarily consumer debts in her prior **[*40]** bankruptcy filings and in the original schedules filed in the current case.

HN11[↑] A debtor may be judicially estopped from changing its legal position when a court has adopted and relied on it and the party claiming judicial estoppel suffers an unfair detriment as a result, unless mistake or inadvertence is an applicable defense. *See* New Hampshire v. Maine, 532 U.S. 742, 742-743, 121 S. Ct. 1808, 149 L. Ed. 2d 968 (2001) ("'[W]here a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him.'") (citing Davis v. Wakelee, 156 U.S. 680, 689, 15 S. Ct. 555, 39 L. Ed. 578 (1895)). *See also* Ahrens v. Perot Sys. Corp., 205 F.3d 831, 833 (5th Cir. 2000) ("Judicial estoppel applies to protect the integrity of the courts--preventing a litigant from contradicting its previous, inconsistent position when a court has adopted and relied on it.") (other citations omitted)). Inadvertence can be shown where the party in question either lacks sufficient knowledge of the undisclosed claims or would have no motive for their concealment. *Superior Crewboats, Inc. v. Primary P & I Underwriters (In re Superior Crewboats, Inc.), 374 F.3d 330, 335 (5th Cir. 2004)* (citing In re Coastal Plains, Inc., 179 F.3d 197, 210 (5th Cir. 1999)).

HN12[↑] The Supreme Court in *New Hampshire v. Maine* recognized that "'[t]he circumstances under which judicial estoppel may appropriately be invoked are **[*41]** probably not reducible to any general formulation of principle.'" New Hampshire v. Maine, 532 U.S. at 750. However, a general test for determining when judicial estopped may be invoked has been developed, as follows: (i) a party's later position is clearly inconsistent with its earlier position, (ii) the party's former position has been accepted in some way by the court in the earlier proceeding, such that "judicial acceptance of an inconsistent position in a later proceeding would create 'the perception that either the first or the second court was misled,'" and (iii) the "party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped." New Hampshire v. Maine, 532 U.S. at 750-51.

HN13[↑] Judicial estoppel has been applied in the bankruptcy context where a debtor changes its designation on the petition. *See* In re Save Our Springs (S.O.S.) Alliance, Inc., 393 B.R. 452 (Bankr. W.D. Tex. 2008) (judicial estoppel prevented the debtor from amending its petition to designate itself as a non-small business debtor because it was inconsistent with its original designation and the debtor had already enjoyed the benefits of expedited proceedings as a small business debtor.).

Relying on In re Jones, 556 B.R. 327 (Bankr. E.D. Mich. 2016) and In re Orlando, No. 17-41616 (CJP), 2018 Bankr. LEXIS 2235, 2018 WL 3637231 (Bankr. D. Mass. July 30, 2018), Gregory asserts that bankruptcy courts have adopted judicial **[*42]** estoppel to bar debtors from changing the description of their debts from consumer debts to non-consumer debts. In *In re Jones*, after the U.S. Trustee moved to dismiss the chapter 7 debtor's case under section 707(b) of the Bankruptcy Code, the debtor changed her response and indicated that her debts were "not primarily consumer debts, but were not primarily business debts either." In re Jones, 556 B.R. 327 at 330. The court in *In re Jones* noted that the timing of the debtor's change was indicative of "gamesmanship" on the part of the debtor in order to render section 707(b) inapplicable and escape possible dismissal of the case. Id. at 335. Similarly, in *In re Orlando*, the bankruptcy court found that the debtor's change in his position regarding the nature of his debts from consumer debts to business debts after the U.S.

Trustee filed a motion to dismiss the debtor's case under *11 U.S.C. § 707(b)* was a "late strategy change" instead of a mistake or inadvertence. *In re Orlando, 2018 Bankr. LEXIS 2235, 2018 WL 3637231, at *4*.

In applying the above factors to the Debtor's case, the Court finds that judicial estoppel does not bar the Debtor's change in description of the nature of her debts. First, it is not clear that her change of description of her Mortgage debt as a business debt is inconsistent with the Debtor's prior description of her debts. The Debtor **[*43]** referred to the Property as a bed and breakfast in the Current Case. By way of example, when the Debtor was asked "What is the property?" she checked the box "Other" and wrote "B&B Inn" on Schedule A/B instead of checking the box for "Single-family" home. (Case No. 8-18-77193-reg, ECF No. 1.). In Schedule C, the Debtor claimed an exemption for the Property pursuant to *11 U.S.C. § 522(b)(2)* wherein she described it as "Bed & Breakfast." *Id.* Again, on Schedule D, the Debtor described the Property as a "Bed and Breakfast." *Id.* The Debtor also lists her income and expenses from the operations of Harbor Rose in her Statement of Current Monthly Income. *Id.* ECF No. 26. These representations by the Debtor reflect the hybrid nature of the Property, which is rare. The Property is integral to the business operations, and the Court finds that the Debtor was attempting to be clear and forthright in her representations regarding the Property and the Mortgage.

Second, the Court took no specific action in the Current Case or in the prior bankruptcy filings based on a description of the Mortgage debt as consumer debt. This Court was not misled about the nature of the Mortgage which encumbered the Property. Third, the Debtor **[*44]** cannot be said to have taken unfair advantage over Gregory by changing the description of her debts to fit within a statute that did not exist at the time of the Petition Date. It is more akin to an innocent choice by the Debtor than gamesmanship. The Debtor's change in status was not made in response to a *11 U.S.C. § 707(b)* motion to dismiss by the U.S. Trustee, nor was it done with "the obvious motive" to make a certain law inapplicable. In fact, the law was not applicable at the time of the Petition Date because it did not exist. The SBRA was designed to protect small business debtors by affording them the right to reorganize in a timely, cost-effective manner. The Court also takes into consideration whether the Debtor's change in description of her debt, if permitted, would be unfairly detrimental to Gregory. Gregory points to the unfair burden and delay imposed, as Gregory was poised to confirm its proposed plan of liquidation that would have resulted in a sale of the Property and payment to Gregory from the sale proceeds. While the Court recognizes that there will be some prejudice to Gregory if the Debtor is permitted to recharacterize her debt, the Debtor must still satisfy the requirements **[*45]** of ***subchapter V*** in order to confirm a plan. There is no guarantee that the Debtor will be successful in this attempt, but given the current economic climate, it is doubtful that a sale of the Property could take place any time in the near future. Given the unique circumstances of this case, the prejudice to Gregory is minimized.

Finally, Gregory relies on case law where courts have judicially estopped debtors from changing their representations in petitions and schedules, made under penalties of perjury, when those changes were made because of changed circumstances in their bankruptcy cases. *See In re Osborne, 490 B.R. 75 (Bankr. S.D.N.Y. 2013)* (Court applied judicial estoppel where the debtors moved to vacate the discharge and dismiss their chapter 7 case following the discovery of a previously undisclosed asset.). Here, the Debtor is not reacting to the discovery of some wrongdoing she may have committed, nor did the Debtor make false claims in her petition. The Debtor is merely amending her petition and avail herself of the right created by a statute that did not exist as of the time of Petition Date. The cases cited by Gregory have a common denominator that is inapposite to the present case; they did not concern a newly enacted **[*46]** law that is designed to protect debtors like the Debtor in the Current Case, who are small business owners.

For all the reasons stated herein, this Court finds that the instant case comes within the purview of *11 U.S.C. § 101(51D)(A)* because the primary use of the Property was, and remains, for the operation of a bed and breakfast, rather than as a principal residence. The fact that the Harbor Rose entwines the Debtor's personal and business life does not control whether the Mortgage is a business debt or a consumer debt. In essence, the Debtor is not changing her position; the significant changes to the Bankruptcy law enable the Debtor to take advantage of a new definition of "small business debtor" in order to attempt to save her business.

4. *Is the Debtor entitled to utilize 11 U.S.C. § 1190(3)?*

Both the Debtor and Gregory agree that in order to propose a plan and successfully exit bankruptcy, the

Debtor must be permitted to modify the Mortgage. Prior to the effective date of the SBRA, the only statutory provision the Debtor could rely on to modify the Mortgage was 11 U.S.C. § 1123(b)(5). This section permits chapter 11 debtors to propose a plan that modifies the rights of holders of secured claims "...other than a claim secured only by a security **[*47]** interest in real property that is the debtor's principal residence..." 11 U.S.C. § 1123(b)(5). The Debtor's proposed plan sought to utilize this provision to modify the Mortgage, but this Court found that because the Debtor uses the Property for both business and residential purposes, the Property is the Debtor's principal residence. *See* In re Harriman, 2014 Bankr. LEXIS 1246, 2014 WL 131203 at *3 (Bankr. N.D. Cal.) (citing In re Wages, 508 B.R. 161, 168 (B.A.P. 9th Cir. 2014)). Therefore, the Debtor was prohibited from modifying the Mortgage under the law as it existed at the time.

The SBRA has given small business debtors who designate themselves as ***subchapter V*** debtors another tool to be used when proposing a plan. § 1190(3) provides as follows:

A plan filed under this subchapter—

(3) notwithstanding section 1123(b)(5) of this title, may modify the rights of the holder of a claim secured only by a security interest in real property that is the principal residence of the debtor if the new value received in connection with the granting of the security interest was—

(A) not used primarily to acquire the real property; and

(B) used primarily in connection with the small business of the debtor.

11 U.S.C. § 1190(3).

Although there are three decisions of record regarding application of the SBRA, only *In re Moore Props. of Person Cty., LLC* mentioned this particular provision. The *In re Moore* ***[*48]*** *Props. of Person Cty., LLC* court found that it did not apply in the case before it because the debtor was not an individual. In re Moore Props. of Person Cty., LLC, 2020 Bankr. LEXIS 550, 2020 WL 995544, at *4 n.14. In *dicta*, the court did state that if this section did apply, the court would consider whether the application of 11 U.S.C. § 1190(3) constituted an impermissible taking. *Id.* Therefore, the Court cannot look to prior case law to interpret this section.

HN14[↑] This Court shall commence its analysis by employing the applicable rules of statutory construction. The Court is charged with interpreting all federal and state statutes according to their plain meaning. Tyler v. Douglas, 280 F.3d 116, 123 (2d Cir. 2001), *cert. denied*, *536 U.S. 906, 122 S. Ct. 2361, 153 L. Ed. 2d 182 (2002)*. In determining its degree of ambiguity or clarity, courts cannot examine statutory language in isolation. Robinson v. Shell Oil Co., 519 U.S. 337, 341, 117 S. Ct. 843, 136 L. Ed. 2d 808 (1997). The Court must determine the specific context in which the language appears, and the statutory scheme's broader framework in order to preserve the coherence and consistency of the statutory scheme. U.S. v. Ron Pair Enters., Inc., 489 U.S. 235, 240-41, 109 S. Ct. 1026, 103 L. Ed. 2d 290 (1989) (citing Northern Pipeline Construc. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 52-53, 102 S. Ct. 2858, 73 L. Ed. 2d 598 (1982)). "[I]n matters of statutory interpretation, the plain meaning of statutory language is often illuminated by considering not only the particular statutory language at issue, but also the structure of the section in which the key language is found, and the design of the statute as a whole and its object." **[*49]** Pellegrino v. United States Transp. Sec. Admin., 896 F.3d 207, 216 n.10 (3d Cir. 2018) *reh'g en banc granted*, 904 F.3d 329 (3d Cir. 2018).

Armed with these principles, the Court will undertake its interpretation of this section. ***HN15***[↑] First, unlike 11 U.S.C. § 1123(b)(5), which precluded modifications of claims secured by mortgages on the debtor's principal residence, 11 U.S.C. § 1190(3) specifically permits the modification of claims secured by mortgages on the debtor's principal residence. Therefore, the plain language of the first paragraph of 11 U.S.C. § 1190(3) does not act as an impediment to the Debtor's attempt to modify the Mortgage. Indeed, the Property falls squarely within this paragraph.

Second, subparagraphs (A) and (B) do not bar the Debtor outright from using this provision to modify the Mortgage. Subparagraphs (A) and (B) further limit the application of this provision to mortgage proceeds that were:

(A) not used primarily to acquire the real property; and

(B) used primarily in connection with the small business of the debtor.

Starting with subparagraph (A), the statute reads that the mortgage proceeds cannot have been used "primarily to acquire the real property." As a matter of common usage, the word "primarily" means "for the most part." *Primarily*, Merriam-Webster's Law

Dictionary, (last visited Apr. 9, 2020). In the context of the 1954 Internal Revenue Code, the Supreme **[*50]** Court held that "primarily" means "of first importance" or "principally" rather than meaning "substantial." *Malat v. Riddell, 383 U.S. 569, 572, 86 S. Ct. 1030, 16 L. Ed. 2d 102 (1966)*. The phrase "real property" refers back to the real property that is the debtor's residence. In this case, the question for the Court to answer is whether the Mortgage proceeds were used primarily to purchase the Debtor's residence. Unlike *11 U.S.C. § 1123(b)(5)* which took an all-or-nothing approach to loans securing the debtor's residence, *11 U.S.C. § 1190(3)* asks the Court to determine whether the primary purpose of the mortgage was to acquire the debtor's residence.

Subparagraph (B) requires the Court to determine whether the mortgage proceeds were used primarily in connection with the debtor's business. Both of these subparagraphs direct the Court to conduct a qualitative analysis to determine whether the principal purpose of the debt was not to provide the debtor with a place to live, and whether the mortgage proceeds were primarily for the benefit of the debtor's business activities. This interpretation is consistent with the purpose and intent of the SBRA, which is to assist small business owners in whatever form they take, and to give them speedy access to relief via the bankruptcy process. As stated above, **[*51]** the Congressional intent of the SBRA was to keep small business owners in business, and to benefit the employees, suppliers, customers and others who rely on that business. A reading of this provision which takes into account the primary purpose of the mortgage debt instead of a bright-line test that would reject any business owner in the Debtor's unique position is consistent with the intent of the legislation.

Clearly, some business owners, such as business owners who took out a second mortgage and used the proceeds to buy farm equipment or a taxi medallion, easily fall into this classification. However, an inflexible reading of this statute would bar legitimate business owners such as the Debtor from obtaining relief under the SBRA. The Court does not find that this interpretation would be consistent with the goals of the SBRA.

HN16[↑] The Court proposes that the following factors be considered to determine whether the mortgage in question is subject to modification under this section:

1. Were the mortgage proceeds used primarily to further the debtor's business interests;
2. Is the property an integral part of the debtor's business;
3. The degree to which the specific property is necessary **[*52]** to run the business;
4. Do customers need to enter the property to utilize the business; and
5. Does the business utilize employees and other businesses in the area to run its operations.

In the Debtor's case, she did not purchase a residence and use one room as an office space. The Debtor bought real property and commenced using the rooms to rent and spent considerable time and resources on obtaining the proper permits to run the Property as a bed and breakfast. The primary purpose of the Property is to offer rooms for nightly fees. Harbor Rose serves a variety of guests, including guests visiting the nearby Cold Spring Harbor labs. Harbor Rose also provides holistic services to the guests staying at the Property with package services offered for additional fees. Although the Mortgage proceeds were not used to refurbish the Property or to obtain the proper zoning changes and permits, the Mortgage proceeds were used to purchase the building that houses the business run by the Debtor.

Based on its interpretation of *11 U.S.C. § 1190(3)*, the Court finds that there is sufficient evidence to hold a full evidentiary hearing to determine whether the Debtor may use this statute to modify the Mortgage. Therefore, **[*53]** if the Debtor proposes a plan which provides for bifurcation of the Mortgage, the Court shall schedule a hearing to determine whether she may take advantage of this provision using the factors listed above, along with any additional evidence produced by the parties.

Conclusion

For all the reasons stated herein, the Court finds that the Debtor is a "small business debtor" within the purview of *11 U.S.C. § 101(51D)(A)* and is eligible to proceed as a ***subchapter V*** debtor in this case. Therefore, the Court overrules the U.S. Trustee Objection and overrules the objections raised by Gregory in the Motion. An order consistent with this Memorandum Decision will be entered forthwith.

Dated: Central Islip, New York

April 10, 2020

/s/ Robert E. Grossman

Robert E. Grossman

United States Bankruptcy Judge

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PART II