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Cullen and Dykman LLP Bankruptcy Attorneys Successfully Reverse Bankruptcy Court Decision in a Significant Small Business Reorganization Act Case

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Partner Bonnie Pollack and Of Counsel Michael Kwiatkowski recently obtained a favorable decision from the U.S. District Court for the Eastern District of New York on behalf of a secured lender in an appeal of a bankruptcy decision. The decision reversed a ruling which denied the lender's ability to continue with its own creditor plan based on a retroactive application of an amendment to the Bankruptcy Code.

The case involves an individual chapter 11 debtor who owns real property which is the debtor's residence and is also used by the debtor to operate a bed and breakfast. Prior to the chapter 11 filing, the firm's client, holder of a first mortgage on the property (the "Lender"), obtained a judgment of foreclosure and sale in state court. Over a year into the case, the parties filed competing chapter 11 plans and disclosure statements. The Lender filed a liquidating chapter 11 plan which would have sold the subject property to pay its claim. The debtor's chapter 11 plan sought to modify the mortgage by reducing the Lender's claim from approximately $1.6 million to principal amount of $1,050,000.00, which the Debtor proposed repaying over 30 years at a rate of 4.25% *per annum*. After a hearing on the parties' competing plans, the Bankruptcy Court approved the Lender's disclosure statement for its plan and held that the debtor's plan was unconfirmable on its face. Accordingly, a confirmation hearing on the client's plan was scheduled for February 26, 2020.

Shortly before the February 26, 2020 confirmation hearing, the Small Business Reorganization Act ("SBRA") came into effect on February 19, 2020. The SBRA is designed to provide a more cost-effective and streamlined option for small business to reorganize and it created a new Subchapter V within chapter 11 of the Bankruptcy Code. (We discussed the SBRA in prior posts, *see* https://www.cullenllp.com/blog/new-small-business-reorganization-act-of-2019-may-permit-small-business-debtors-to-modify-their-residential-mortgages/ https://www.cullenllp.com/blog/cares-act-expands-bankruptcy-protections-for-small-businesses/, and https://www.cullenllp.com/blog/the-small-business-reorganization-act-of-2019-and-the-individual-debtor/). At the February 26, 2020 confirmation hearing, the Bankruptcy Court informed the debtor of the SBRA and adjourned the hearing on the Lender's plan to give the debtor time to decide whether to proceed under the SBRA. Shortly thereafter, the debtor sought to amend her bankruptcy petition to designate herself as a Subchapter V debtor. Cullen and Dykman objected to the designation as it was prejudicial to the Lender. The Bankruptcy Court

overruled the objection and allowed the debtor to amend her petition and proceed as a Subchapter V debtor. *See In re Ventura*, 615 B.R. 1 (Bankr. E.D.N.Y. 2020) (Grossman, J.). Since its issuance, the Bankruptcy Court's decision has been frequently cited and much discussed as an important decision on the nascent SBRA.

On behalf of the Lender, Cullen and Dykman appealed the Bankruptcy Court's decision. On April 21, 2022, the U.S. District Court reversed the Bankruptcy Court's decision. *See Gregory Funding v. Dierdre Ventura*, 20-CV-1949 (WFK), 2022 WL 1188367 (E.D.N.Y. Apr. 21, 2022) (Kuntz, J.). The District Court held that "the Bankruptcy Court failed to consider properly the substantial prejudice [the Lender] faces due to the Debtor's belated amendment" and explained:

> Nearly sixteen months passed before the Debtor moved to amend her petition to designate herself as a Subchapter V debtor. By then, both the parties and the Bankruptcy Court spent considerable time and resources to get to a point in which [the Lender] was posed to confirm its plan. The Bankruptcy Court held numerous hearings and the parties, after significant negotiations, agreed [the Lender] could pursue its unopposed plan of reorganization if the Debtor failed to submit a plan by September 30, 2019. In reliance on this agreement and on the Debtor's representation that her petition would proceed under Chapter 11, [the Lender] filed its plan of reorganization, solicited the necessary votes, and was on the cusp of confirming it when the Debtor sought to amend her petition. Moreover, because the SBRA grants the Debtor the sole right to confirm a plan of reorganization, the Debtor's amendment had the further prejudicial effect of terminating [the Lender's] right to pass *any* plan, thereby "completely chang[ing] the rights of [the Lender] as a creditor" and resetting the "litigation posture" of the proceedings. The Debtor's amendment cannot be allowed to cause such prejudice.

2022 WL 1188367, *4 (internal citation omitted).

Additionally, the District Court found that "the prejudice to the Debtor does not outweigh the prejudice to the Lender," because "[i]f the Debtor is prevented from modifying her petition, she remains in the Chapter 11 process." The District Court continued: "While this may prevent [the debtor] from accessing some of the tools afforded by Subchapter V, the Debtor's interests are still protected by Chapter 11, which requires [the Lender's] plan to be 'fair and equitable,' proposed in good faith, deemed to be 'reasonable,' and in comportment with existing law." *Id*. Ultimately, the District Court held that that "the Bankruptcy Court abused its discretion by overruling [the Lender's] objection to the Debtor's request to amend her petition." *Id*.

This appellate decision is a significant victory for lenders involved in chapter 11 cases where a debtor chooses to belatedly elect to proceed under Subchapter V. It provides creditors with an important argument to prevent debtors from making the Subchapter V election for opportunistic or gamesmanship reasons, and can be used by analogy to other types of situations as well. Our firm always seeks to protect our client's rights and we are glad to have been able to successfully assist our client in this case.

Please note that this is a general overview of developments in the law and does not constitute legal advice. Nothing herein creates an attorney-client relationship between the sender and recipient. If you have questions regarding these provisions, or any other aspect of bankruptcy law, please contact Bonnie Pollack (bpollack@cullenllp.com) or Michael Kwiatkowski (mkwiatkowski@cullenllp.com) at (516) 357-3700.

Practices

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