

MISSISSIPPI BAR ASSOCIATION BANKRUPTCY LAW SEMINAR THE CARES ACT AND THE BANKRUPTCY CODE

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TIMELINE

March 27, 2020 – the Coronavirus Aid, Relief, and Economic Security (CARES) Act is enacted and becomes effective

March 27, 2021 – Sunset of most bankruptcy-related provisions of the CARES Act

OVERVIEW OF CONSUMER BANKRUPTCY CHANGES INCLUDED IN THE CARES ACT

Amendments to bankruptcy term definitions and COVID Stimulus payments in Chapter 7 and Chapter 13

Modifications to Confirmed Chapter 13 Plans

Modifications related to Mortgage Forbearances

Modifications related to Student Loans

CONSUMER BANKRUPTCY CARES ACT AMENDMENTS

§ 101(10A) – “current monthly income”

§ 1325 – “disposable income”

§ 1329 – Chapter 13 plan modification

STIMULUS PAYMENT EXCLUSION FROM CURRENT MONTHLY INCOME

§ 101. Definitions

The term “current monthly income” excludes --

(v) Payments made under Federal law relating to the national emergency declared by the President under the National Emergencies Act (50 U.S.C. 1601 *et seq.*) *with respect to the coronavirus disease 2019 (COVID-19)*.

STIMULUS PAYMENT EXCLUSION FROM CURRENT MONTHLY INCOME

§
1325(b)(2).
Confirmation
of Plan

[T]he term “disposable income” means currently monthly income received by the debtor (other than payments made under Federal law relating to the national emergency declared by the President under the National Emergencies Act (50 USC 1601 et seq.) with respect to the coronavirus disease 2019 (COVID-19) . . .)

STIMULUS PAYMENT EXCLUSION FROM CURRENT MONTHLY INCOME

Stimulus payments are excluded from “current monthly income”

(a) for purposes of the means test under § 707(b)

(b) for purposes of calculation of disposable income for Chapter 13 Plan confirmation purposes under § 1325(b)

However, the stimulus payment can still be property of the estate but may be subject to exemption. If not subject to exemption, will trustee’s administer those funds?

Generally, a stimulus payment is treated as a refundable tax credit.

CHAPTER 13 PLAN MODIFICATIONS

§ 1329. Modification of Plan After Confirmation.

(d)(1) Subject to paragraph (3), for a plan confirmed prior to the date of enactment of this subsection, the plan may be modified upon the request of the debtor if –

(A) the debtor is experiencing or has experienced a material financial hardship due, directly or indirectly, to the coronavirus disease (COVID-19) pandemic; and

(B) the modification is approved after notice and a hearing.

CHAPTER 13 PLAN MODIFICATIONS

§ 1329. Modification of Plan After Confirmation.

(2) A plan modified under paragraph (1) may not provide for payments over a period that expires more than 7 years after the time that the first payment under the original confirmed plan was due.

(3) Sections 1322(a), 1322(b), 1323(c), and the requirements of section 1325(a) shall apply to any modification under paragraph (1).

CHAPTER 13 PLAN MODIFICATIONS

Additional Notes:

The new provisions of § 1329(d) apply only to cases where the Plan was confirmed before the date of enactment (March 27, 2020).

These provisions sunset after March 27, 2021 and will be completely removed from the Bankruptcy Code.

COMPLICATIONS, PRACTICE POINTERS, AND OTHER ISSUES

1. After the sunset, will it be possible to further modify a plan which was modified to a seven-year plan pursuant to § 1329(d)(1)?
2. Is it possible to build-in authority to make modifications to the Chapter 13 Plan after the sunset?
3. Are there eligibility issues for Chapter 13? (Section 109(e) provides, in relevant part that only “an individual with regular income” is eligible.
4. With the modifications to the means test and exclusion of stimulus payments, is Chapter 7 the preferred bankruptcy chapter?
5. Will exclusion of stimulus payments from current monthly income and disposable income calculations lead to decreased fees to trustees?
6. Should stimulus payments be considered in conjunction with filing fee waiver requests?

OTHER ISSUES RELATED TO CHAPTER 13 PLAN MODIFICATIONS

§ 1329(d)(1)(A) authorizes modification of a Chapter 13 Plan confirmed before March 27, 2020, if “the debtor is experiencing or has experienced a material financial hardship due, directly or indirectly,” due to coronavirus.

1. How does a debtor quantify the “financial hardship?”
2. What is an indirect financial hardship?
3. If the debtor has not suffered a direct loss of income, but a spouse or roommate has stopped contributing to household expenses because of coronavirus, is that an “indirect financial hardship?”
4. Does there have to be notice and a hearing to modify the Plan? Can the notice be negative notice where a hearing is held only if there is an objection/response?
5. Is it a bad faith modification under this provisions to maintain a 5 year term but lower the percentage paid under the plan? And what about other confirmation requirements including liquidation test and feasibility?
6. If there is a modification to increase to a 7 year term, can the Chapter 13 Trustee monitor debtor’s income and require increased payments if income increases after modification of the plan?

CONDUIT MORTGAGE PLANS — SUSPENSION OF PLAN PAYMENTS

The CARES Act includes two provisions which provide homeowners with federally backed mortgages some relief with respect to those mortgages:

1. Lenders or loan servicers on federally backed mortgage loans may not foreclose for 60 days after March 18, 2020 (i.e., until May 17, 2020). Specifically, the CARES Act prohibits lenders and services from beginning a judicial or non-judicial foreclosure, or from finalizing a foreclosure judgment or sale, during the 60 day period.
2. Borrowers experiencing financial hardship due to the coronavirus pandemic have a right to request a forbearance for up to 180 days as well as a right to request an extension of that forbearance for another 180 days.

Additionally, many other lenders providing mortgages which are not federally backed are also agreeing to forbearances due to COVID-19.

CONDUIT MORTGAGE PLANS — SUSPENSION OF PLAN PAYMENTS

These potential forbearances on mortgage obligations present a number of issues for Chapter 13 debtors with confirmed conduit mortgage plans:

- 1.If there is a conduit portion and non-conduit portion related to the mortgage, can the debtor suspend the non-conduit portion?
- 2.Are the unpaid amounts during the forbearance added onto the end of the plan?
- 3.Is the debtor required to seek and obtain a forbearance before seeking modification of the plan, or can the debtor seek and provide notice of modification in anticipation of the granting of a forbearance?

CURE / NON-CONDUIT PLANS — SUSPENSION OF PLAN PAYMENTS

Plans that provide for payment of mortgage debts outside of the plan except perhaps for cure of arrearages, present issues as well:

1. In plans with post-petition mortgages outside of the plan, are post-petition arrearages created by forbearances to be paid pursuant to a modified plan? And are such forbearances requested and obtained before seeking plan modification?
2. However, mortgage arrearages to be cured within a plan can be extended in a modified plan, but such cure still has to be within a reasonable time under § 1322(b)(5).
3. What are the notice and hearing requirements in connection with suspension of plan payments and/or mortgage payments and forbearance?
4. What if loan modification is possible/preferred? Can the modification be obtained and approved by modified plan? Or is a separate motion for authority for loan forbearance or modification actually required?

STUDENT LOANS AND THE CARES ACT

Student loans held by the Department of Education (specifically Direct loans and Federal Family Education Loans) are impacted as follows by the CARES Act:

1. Interest waived through September 2020;
2. Payments automatically suspended through September 2020 (payments made during this period will be applied exclusively to principal);
3. Suspended payments will be treated as payments made for purposes of loan forgiveness programs;
4. Wage garnishment or other collection activities on defaulted student loans will be suspended through September 2020;

**What are the implications for student loans in Chapter 13 plans?*

PAYMENT PROTECTION PROGRAM ISSUES

One of the key provisions of the CARES Act was the Payment Protection Program (“PPP”) which established a fund for forgivable loans to small businesses to pay their employees during the COVID-19 crisis.

PPP loans are capped at \$10 million and are forgivable as long as the proceeds are used to pay payroll expenses and most mortgage interest, rent, and utility costs over the 8 week period after the loan is made and employee and compensation levels are maintained.

Congress has passed subsequent amendments to the CARES Act which (1) extended the period for use of the PPP loan proceeds from 8 weeks after the loan disbursement date to the earlier of (a) 24 weeks after the loan disbursement date or (b) December 31, 2020; and (2) extended the original application deadline from June 30, 2020 to August 8, 2020.

PAYCHECK PROTECTION PROGRAM ISSUES

The CARES Act provides that all small businesses with 500 or fewer employees can apply as well as business in certain industries with more than 500 employees.

However, the PPP loan application and an interim rule issued by the Small Business Association (“SBA”) specifically exclude bankrupt debtors from the loan process because “providing PPP loans to debtors in bankruptcy would present an unacceptably high risk of an unauthorized use of funds or nonrepayment of unforgiven loans.”**

**Seriously, this is what the rule actually said.

PAYMENT PROTECTION PROGRAM ISSUES

Many debtors-in-possession have sought TROs and other relief and seeking the right to apply and obtain PPP loans.

Some of those debtors have had at least initial success:

- *Hidalgo Cnty. Emergency Serv. Found. v. Carranza (In re Hidalgo Cnty. Emergency Serv. Found.)*, No. 20-2006 (Bankr. S.D. Tex. Apr. 24, 2020) – Judge Jones entered a TRO enjoining the SBA from denying the debtor’s PPP application on the sole basis that the debtor was in bankruptcy. He noted that the SBA’s argument about the “high risk” or “unauthorized use of funds” was “so out of context that it’s a frivolous argument.”
- *Penobscot Valley Hosp. v. Carranza (In re Penobscot Valley Hosp.)*, No. 20-1005 (Bankr. D. Me. May 1, 2020) **but see subsequent decision issued June 3, 2020 discussed below
- *Calais Reg’l Hosp. v. Carranza (In re Calais Reg’l Hosp.)*, No. 20-1006 (Bankr. D. Me. May 1, 2020)
- *Roman Catholic Church of the Archdiocese of Santa Fe v. United States of Am. Small Bus. Admin. (In re Roman Catholic Church of the Archdiocese of Santa Fe)*, 2020 Bankr. LEXIS 1211, No. 18-13027 (Bankr. D. N.M. May 1, 2020) - "With only the flimsiest of justifications Defendant took one of many underwriting criteria from its “normal” loan programs (bankruptcy status of the borrower), changed it to an eligibility condition, and then applied it to an emergency grant program where it clearly had no place. Defendant’s inexplicable and highhanded decision to rewrite the PPP’s eligibility requirements in this way was arbitrary and capricious, beyond its statutory authority, and in violation of 11 U.S.C. § 525(a).
- *Springfield Hosp., Inc. v. Carranza (In re Springfield Hosp., Inc.)*, 2020 Bankr. LEXIS 1205, No. 20-01003 (Bankr. D. Vt. May 4, 2020)
- *Alpha Vision Learning Academy, Inc. v. Carranza (In re Skefos)*, 20-00071 (Bankr. W.D. Tenn. June 2, 2020 – Injunction granted barring SBA from denying PPP loan just because the owner was in Chapter 11 bankruptcy.

PAYMENT PROTECTION PROGRAM ISSUES

Some of those debtors have not had success:

- *Cosi, Inc. v. U.S. Small Bus. Admin. (In re Cosi, Inc.)*, No. 20-50591 (Bankr. D. Del. Apr. 30, 2020) – Judge Shannon denied the debtor’s request for a TRO and said that although he disagrees with the SBA’s decision to preclude bankruptcy debtors from receiving PPP loans, he would defer to the SBA as to how loan funds are disbursed.
- *Asteria Educ., Inc. v. Carranza (In re Asteria Educ., Inc.)*, No. 20-05024 (Bankr. W.D. Tex. Apr. 30, 2020)
- *Penobscot Valley Hospital v. Carranza (In re Penobscot Valley Hospital)*, 20-1005 (Bankr. D. Me. June 3, 2020) – Although Judge Fagone initially granted the TRO, on the merits he found that § 525(a) provided the debtor with no relief because a PPP loan is a loan, even though it had extremely favorable repayment terms. And a loan is not a grant as that term is used in § 525(a), because it was not “similar to a license, permit, charter, or franchise.”

PAYMENT PROTECTION PROGRAM ISSUES

Some of those debtors have not had success:

- *Henry Anesthesia Assoc. v. Carranza (In re Henry Anesthesia Assoc.)*, 20-06084 (Bankr. N.D. Ga. June 4, 2020) – Found that a PPP loan did not fit within the statutory language of “other similar grants” under § 525(a) and denied a TRO. The court did acknowledge that the SBA was discriminating against debtors, but that the discrimination was not prohibited by § 525(a) and the denial of the PPP loan was not arbitrary and capricious.
- *Fox Valley Pro Basketball, Inc. v. U.S. Small Business Administration*, 20-793 (E.D. Wis. June 16, 2020)
- *Breda LLC v. Carranza (In re Breda LLC)*, 20-1008 (Bankr. D. Me. June 22, 2020)
- *Tradeways Ltd. v. Dept. of the Treasury*, 201324 (D. Md. June 24, 2020) – District Judge Hollander denied motion for injunction.

Some debtors have sought compensatory and other damages and the likelihood of recovery may seem slight. However, with some courts already finding the position of the SBA to be frivolous, arbitrary, and/or capricious, perhaps recovery is possible in some cases.

Regardless, it is incumbent upon debtor’s counsel to stay informed of current developments in relation to the PPP loan program to ensure that their debtor received the best advice regarding this loan program.

PAYMENT PROTECTION PROGRAM ISSUES

The U.S. Fifth Circuit in *Carranza v. Hidalgo County Emergency Service Foundation (In re Hidalgo Emergency Service Foundation)*, 20-40368 (5th Cir. June 22, 2020) reversed Judge Jones in USBC, SDTX (*Hidalgo Cnty. Emergency Serv. Found. v. Carranza (In re Hidalgo Cnty. Emergency Serv. Found.)*, No. 20- 2006 (Bankr. S.D. Tex. Apr. 24, 2020)) and found that under 15 U.S.C. § 634(b)(1) the court had no ability to enjoin the SBA Administrator and vacated the previously issued injunction barring the SBA from rejecting PPP loan applications by debtors-in-possession.

PAYMENT PROTECTION PROGRAM ISSUES

- However, it is possible to avoid the SBA prohibition against debtor's applying for PPP loans by dismissing a pending case, applying for a PPP loan, receiving the PPP loan proceeds, and then filing a new Chapter 11 case.
- *In re Eastern Niagara Hospital, Inc.*, 19-12342 and Adv. 20-1020 (Bankr. W.D.N.Y.)
– The debtor filed a Chapter 11 case on November 7, 2019. After passage of the CARES Act, the debtor commenced an adversary proceeding in May 2020 seeking a preliminary injunction permitting it to apply for a PPP loan. Prior to the hearing on the preliminary injunction motion, the debtor dismissed the case on June 24, 2020. It subsequently applied for a PPP loan for \$5.8 million which was approved on June 26, 2020. The debtor filed a new case (20-10903) on July 8, 2020.
- But consideration should be given to the treatment of the SBA as an unsecured creditor in such a case as well as the potential for litigation regarding use of the loan proceeds.