

The 90-Day Franchise Bankruptcy Solution

Featuring John Gotaskie and Craig Tractenberg of Fox Rothschild LLP

Welcome to FoxCast. We're talking today with Fox Rothschild partners John Gotaskie in Pittsburgh and Craig Tractenberg of the Fox offices in Philadelphia and New York. Our topic is really important for franchisors which may want to take advantage of the 90 day Franchise Bankruptcy Solution under the CARES Act. That's short of course for the Coronavirus Aid, Relief and Economic Security Act.

John is editor of Fox's Franchise Law Update blog. He represents clients in a variety of corporate, venture finance, franchising, licensing and distribution matters as well as in commercial litigation. Craig is Co-Chair of Fox's Franchising and Distribution Group and focuses on franchise transactions, development and disputes. Clients hire him to provide creative solutions to "bet the company" litigation and defining transactions. John, Craig, glad to have you. Good morning.

John Gotaskie/Craig Tractenberg: Thank you. Good morning.

Question: *John, can you give our listeners a quick overview of these changes to the bankruptcy code?*

John Gotaskie: The CARES Act has amended the Bankruptcy Code to provide for an expedited and easier version of a business bankruptcy proceeding. We now have "Subchapter 5" for small business and individual debtors. This process fulfills a sweet spot for small franchisors and franchisees. It anticipates a Chapter 11 style result, meaning the business may reorganize within 90 days of filing but without the normal administrative headaches and expense of Chapter 11.

Question: *What's the purpose of this new section?*

Craig Tractenberg: Its purpose is to allow business debtors and certain individuals with debts below \$7.5 million to reorganize their obligations under a much less expensive and more streamlined manner. Unlike the previous Chapter 11, the Subchapter 5 bankruptcy does not require voting on a plan of reorganization. Instead, like a Chapter 13 wage earner's plan, the debtor's disposable income is used to repay creditors. This eliminates the need for obtaining the consent of a class of "impaired" creditors as required under basic Chapter 11. It also relaxes some of the rules for administration of the Chapter 11 plan and the payment of United States Trustee quarterly fees. Certain individual debtors may also benefit from the elimination of the so-called "absolute priority rule" which prevented exemption of real or personal property in some cases.

Question: *What about the new "disposable income" requirement?*

John Gotaskie: It may mandate a minimum payment to creditors higher than what is now required under Chapter 11. Some of the normal requirements, such as monthly operating reports,

special debtor in possession bank accounts and supervision by special trustees to provide protection to creditors and parties in interest.

Question: Do you expect a lot of franchisors to move quickly on this?

Craig Tractenberg: Sure. We anticipate an uptick in filings after the CARES Act funding and its forgiveness period expires. Because it provides a needed remedy for small business debtors and individuals concerned with the administrative burdens and expense of Chapter 11 filings, franchise businesses should be prepared to use Subchapter 5 to their advantage.

Question: What are some initial first steps?

John Gotaskie: That's a great question. Franchisors should plan now to have a preset protocol for dealing with their franchisees who file Subchapter 5 cases because of the really compressed deadlines that they're looking at. Franchisors can also suggest or aid struggling franchisees with Subchapter 5 to maintain their franchise during these really uncharted pandemic times.

Craig Tractenberg: For franchisees and emerging franchisors, Subchapter 5 is a prescription to save their business from the economic consequences of the pandemic. There are also mortgage modification provisions that will help guarantors of business debt to save their homes. As these cases are filed, we'll be compiling information and helpful advice in navigating in this new bankruptcy world.

Question: Let's get a little technical for a minute. What's the definition of a "small business debtor?"

Craig Tractenberg: Although Subchapter 5 does not define that phrase, the Bankruptcy Code does. It basically defines a small business debtor as an individual partnership or corporation engaged in commerce or business with liquidated secured and unsecured debts of not more than \$7.5 million as of the date of the filing of the petition or the date of the order for relief.

Question: What can you tell us about the concept of "Chapter 11 debtor as an exclusive plan proponent?"

John Gotaskie: This is a big difference. Unlike the current version of the Bankruptcy Code, which allows any party-in-interest to file a Chapter 11 plan once the debtor's "exclusivity period" has expired – in other words the period in which the debtor has a sole right to file a plan, the SBRA only authorizes the small business debtor to file a Chapter 11 plan of reorganization.

Question: What's the process to file and confirm Chapter 11 plans?

Craig Tractenberg: The SBRA imposes a streamlined timeframe to file a Chapter 11 plan of reorganization, significantly reducing administrative expenses in bankruptcy. There are four milestones. First, no later than 60 days after the bankruptcy filing, the Bankruptcy Court will hold a status conference "to further the expeditious and economical resolution of a case under this Subchapter." Second, not later than 14 days before the status conference, the debtor's

bankruptcy counsel is required to file a report. It needs to detail the steps the company and its advisors have taken to attain a consensual plan of reorganization. Third, unless the debtor requests an extension related to circumstances outside of its control, the Chapter 11 plan must be filed no later than 90 days after the bankruptcy case is filed. Last, once the debtor completes all payments according to the plan, the reorganized debtor will receive a discharge from all of its pre-confirmation debts.

Question: John, can you address Chapter 11 plan requirements?

John Gotaskie: The Chapter 11 plan of reorganization has to provide all of the following: all projected disposable income of the debtor to be received within a three-to-five-year period. This begins on the date that the first payment is due under the plan and will be applied to make payments under the plan. Or, conversely, the value of property to be distributed under the three-to-five year plan, beginning on the date upon which the first distribution is due, and it is not less than the projected disposable income of the debtor.

Question: What about continued ownership and management?

Craig Tractenberg: Here's the really good news. The Chapter 11 plan may permit the owners of the small business debtor to retain their stake in the reorganized debtor, as long as the plan does not discriminate unfairly, and is "fair and equitable," with respect to each class of claims and interests.

Question: Well, Craig and John, unfortunately we're out of time today. There's so much more we could talk about, ranging from plan modifications, appointments of standing trustees and official committees of unsecured creditors to employment of estate professionals, U.S. trustee fees and mortgage modifications.

Listeners, to confidentially discuss whether Chapter 11 makes sense for you, please contact John Gotaskie at 412-394-5528 or at jgotaskie – that's J-G-O-T-A-S-K-I-E – at foxrothschild.com. Or you can reach Craig Tractenberg at 215.444.7161 – that's C-T-R-A-C-T-E-N-B-E-R-G – at foxrothschild.com. For more about our firm, or to subscribe to Fox's Franchise Law Update blog, please visit us on the web at www.foxrothschild.com.