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District Judge Barred Redesignation to SBRA in a Case Pending 16 Months

> Redesignation under the SBRA might become a hot topic once again when (if) Congress raises the cap back to $7.5 million.

In a chapter 11 case that had been pending for 16 months before the Small Business Reorganization Act was enacted, District Judge William F. Kuntz, II reversed the bankruptcy court's order allowing the debtor to proceed under the Small Business Reorganization Act given "substantial prejudice" to the secured lender.

The 'Ordinary' 11 Was Facing Defeat

The debtor owned an historic mansion that she had converted to bed-and-breakfast lodging. As the local law required, she lived in the facility as her principal residence.

In a previous bankruptcy, the debtor had shed personal liability on the mortgage of some $1.7 million. The property was worth about $1 million when she filed an "ordinary" chapter 11 petition to forestall foreclosure long before the SBRA became law.

The debtor had lost "exclusivity," and the bankruptcy judge had ruled that she was prohibited from modifying the mortgage under Section 1123(a)(5). The debtor's plan was not confirmable, but the lender had filed a plan proposing to sell the property. The lender had obtained the requisite votes for its plan, which was scheduled for confirmation a few days after the SBRA came into effect.

The bankruptcy judge postponed the confirmation hearing to allow the debtor to amend her petition to elect treatment as a small business debtor.

The bankruptcy judge overruled the lender's objection to redesignation and allowed the case to proceed under the SBRA. *In re Ventura,* 615 B.R. 1 (Bankr. E.D.N.Y. 2020). To read ABI's report on the bankruptcy court's opinion in *Ventura*, **click here**.

Now under Subchapter V, the lender no longer had the right to file a plan, and the debtor had the right potentially to modify the lender's mortgage. *See* Sections 1189(a) and 1190(3).

In short, the SBRA turned the debtor's imminent defeat into possible success. The lender appealed and won in an April 21 opinion by Judge Kuntz, sitting in Brooklyn, N.Y., the Eastern District of New York.

'Substantial Prejudice' Barred Redesignation

Judge Kuntz said that the outcome turned on whether the debtor had the right under Bankruptcy Rule 1009(a) to redesignate the case for treatment under the SBRA. The rule says that a debtor "may" amend a "voluntary petition, list, schedule, or statement . . . at any time before the case is closed."

Limiting the seemingly broad language in the rule, Judge Kuntz cited a nonprecedential opinion where the Second Circuit said that an amendment under Rule 1009(a) cannot be permitted "without regard to prejudicial reliance." *Cash v. Thaler*, 319 Fed. App'x 4, 5 (2d Cir. 2009).

Judge Kuntz also cited a bankruptcy court decision from his district saying that the bankruptcy court has discretion to reject an amendment that was filed in bad faith or was fraudulent or prejudicial to creditors. He cited a Colorado bankruptcy court for saying that a pre-SBRA debtor may amend the petition to proceed under Subchapter V if the prejudice to the objecting party does not override the debtor's right to amend.

Still, the test is not whether the creditor will recover less or be adversely affected by the amendment. Rather, Judge Kuntz quoted the First Circuit Bankruptcy Appellate Panel for saying that the test is whether the creditor detrimentally relied on the debtor's initial position.

Judge Kuntz said that the bankruptcy court "failed to consider properly the substantial prejudice [the lender] faces due to the Debtor's belated amendment." Over the debtor's 16 months in chapter 11, he said that "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."

With the lender's plan on the "cusp" of confirmation, Judge Kuntz said that "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."

Reversing the bankruptcy court, Judge Kuntz said that the prejudice to the debtor did not outweigh the prejudice to the lender because the debtor would remain in chapter 11.

Observation

By its inaction, Congress allowed the debt limit for the SBRA to return to $2.725 million on March 27. If the House follows the Senate and raises the cap once again to $7.5 million, redesignation may become a live issue for cases filed after March 27.

The Senate bill has language that would seem to allow redesignation for cases filed after March 27. However, the ability to redesignate does not necessarily mean that a court is precluded from exercising equitable powers in the manner demonstrated by Judge Kuntz.

Our readers may wish to consider whether all courts would side with Judge Kuntz.

Keep two facts in mind: (1) The debtor could not be faulted for the delay in redesignation under Subchapter V; and (2) Congress typically says so in a bankruptcy statute if the amendment is to be applicable only to cases filed after the effective date.

Opinion Link

https://abi-opinions.s3.amazonaws.com/Gregory+v+Ventura.pdf

Case Details

Case Citation	Gregory Funding v. Ventura, 20-1949 (E.D.N.Y. April 21, 2022)
Case Name	Gregory Funding v. Ventura
Case Type	Business
Court	2nd Circuit New York New York Eastern District
Bankruptcy Tags	Plan Confirmation Practice and Procedure Business Reorganization Small Business

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