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The editorial staff of the *Michigan Business Law Journal* welcomes suggested business law topics of general interest to the Section members, which may be the subject of future articles. Proposed business law topics may be submitted through the Publications Director, Brendan J. Cahill, *The Michigan Business Law Journal*, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, Michigan 48304, (248) 203-0721, bcahill@dykema.com, or through Max H. Matthies, ICLE, 1020 Greene Street, Ann Arbor, Michigan, 48109-1444, matthies@icle.org. General guidelines for the preparation of articles for the Michigan Business Law Journal can be found on the Section's website at http://connect.michbar.org/businesslaw/newsletter.

Each issue of the *Michigan Business Law Journal* has a different primary, legal theme focused on articles related to one of the standing committees of the Business Law Section, although we welcome articles concerning any business law related topic for any issue. The deadlines for submitting articles are as follows:

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MISSION STATEMENT

The mission of the Business Law Section is to foster the highest quality of professionalism and practice in business law and enhance the legislative and regulatory environment for conducting business in Michigan.

To fulfill this mission, the Section shall: (1) expand the resources of business lawyers by providing educational, networking, and mentoring opportunities; (2) review and promote improvements to Michigan's business legislation and regulations; and (3) provide a forum to facilitate service and commitment and to promote ethical conduct and collegiality within the practice.

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From the Desk of the Chairperson

By Julia A. Dale

More than a year has passed since the World Health Organization declared a COVID-19 Pandemic. It has been more than twelve months since I worked in the office, had lunch with a colleague, or rode in an elevator with someone other than a family member. I remember packing up my office last March, trying to decide what things were necessary and what were a matter of convenience. Cleaning house, I threw out the coffee and creamer stashed in a drawer, grabbed a favorite picture of my family, and snagged a pair of tennis shoes tucked behind my desk. Walking out of the office felt otherworldly; I was only months into a new position with the Michigan Attorney General and this was not how I anticipated spending my early days.

Like many of you, I have adjusted to the new norm. We pivot out of necessity and because there are some things we simply have no control over. The COVID-19 Pandemic is a constant reminder of this familiar life lesson.

The Business Law Section is no different. Our rhythm has changed and so have our activities. With that in mind, here is a glimpse of what you can expect in the coming months and for the remainder of 2021.

Business Law Institute

One of the most notable changes to Section activities is the cancellation of the 2021 Business Law Institute; there will be neither an in-person nor online event. This decision was made after much deliberation, in consultation with the executive committee, and out of an abundance of caution for our membership. Last year the Programming Directorship presented an online version of this classic Section event. It required a significant investment of time and energy with lower than hoped for registrations and even less actual participation. There are significant challenges in presenting one more virtual event in a season that has us weary of them already. We know that there is simply no way to replicate the draw and participation of our in-person event, and so we plan for 2022.

Annual Meeting

While we have cancelled the 2021 Busines Law Institute, we remain in a holding pattern for the Annual Meeting. This is an event that can be done on a much smaller scale, allowing us to be much more fluid in our planning. We will announce a date and plans as soon as possible.

Business Boot Camp II

Business Boot Camp II, scheduled for November 2020 and January 2021, was cancelled due to COVID-19. Discussion for later offerings of Business Boot Camp II in 2021 and 2022 are ongoing.

Other Section Events

Debtor/Creditor Rights Committee

In February of this year, the Committee presented a webinar on "Drafting and Enforcing Contracts in Light of Covid-19." The webinar was well attended with several hundred attendees. The panel addressed drafting considerations and practical implications relating to contracts in the COVID-19 era, including issues such as earn outs, force majeure provisions, material adverse change provisions, deferrals of obligations, insurance implications, and equitable doctrines such as impossibility, impracticability, frustration of purpose, and enforcement within and outside of the bankruptcy context. The Committee is planning future webinars, including one on the treatment of PPP loans by the bankruptcy court.

Small Business Forum (SBF)

Spring and Fall Forums for 2021 are in the early planning stages with further details expected soon.

Time for Change—SBM Connect

At the start of the year, we were advised that the Section listserv provider would stop providing our service, and we would no longer have access to use our lists. After some discussion, the decision was made to take advantage of SBM Connect offered by the State Bar of Michigan. In choosing this route, we were able to get assistance in migrating over our current listservs and help in creating new groups in the Connect program at no charge to the Section. Likewise, the Section will incur no cost for the ongoing service. Training for myself, our Vice-Chair John Schuring, and Section Administrator Terri Shoop, was provided at no cost via an online session. We are hoping to be able to share a similar training video for other Section leadership sometime in the coming months. If you have not yet set up your SBM Connect Profile, you can do so by logging into the State Bar of Michigan Member site. SBM Connect is a great tool for keeping track of discussions and activities across Sections.

A Bright Note

We do not have to look far to note the impact of COVID-19 on the legal system. Practitioners in all sectors are facing logistical, economic, policy, and public health challenges. Many of us are also balancing the practice of law with childcare and school from home responsibilities, while others have taken on an adult caretaker role amid this health crisis.

Practicing during a public health pandemic has provided insight and relationship with other attorneys that I might not have otherwise enjoyed. Joining colleagues for online meetings offers more than just the comfort of stretchy pants and slipper socks, working from home

provides the opportunity to see others as they are in their own environments. It offers glimpses into their personality and interests. I have learned the names of their pets, the ages of their children, and know which ones relish a good game of Scrabble based on the décor hanging on the wall.

I have also had the opportunity to be gracious, patient, and understanding and to have these same sentiments extended to me in an increasingly challenging time when everyone is seeking to do their best or simply hang on. We have all made our share of mistakes over the last year. When pivoting in such a dramatic way, it should be no surprise when we or a colleague occasionally trip over our own feet. May we respond to such moments with the same kind of dignity and grace as did Judge Roy Ferguson and Attorney Rod Ponton of "I'm not a cat" fame.

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Joseph Biden is President of the United States. The recently completed "Power Sharing" agreement reached in the United States Senate provides for democratic senators to chair the various committees and thus control committee agenda. Lastly, the Democrats have the majority in the House of Representatives. As such, we are hearing a variety of proposals for changes to the Internal Revenue Code focusing on raising the corporate tax rate, some marginal tax rates, closing the elusive "loopholes," revisiting the SALT cap on itemized deductibility, and increases in IRS funding and enforcement. Projected increases in enforcement are considered revenue raisers for government budgetary purposes.

With so many moving targets, it is difficult to do "planning;" particularly, when clients contact you to tell you what they read, saw, or heard on the Internet or a cable program. Rumors breed speculation and the sense of "missing out." As lawyers, we understand the perils of doing tax and business planning in such an unsure environment. What we intrinsically know is that the final product is usually different than the endless rumors or the musings of the myriad of talking heads. However, if there is one area that we can expect to see move forward is greater enforcement.

As readers know, I have discussed the budgetary woes at the IRS many times and the practical impact on clients and practitioners; such as, delays in correspondence, the reduction in guidance, and the frustrations in receiving PLRs, lien releases, and other ministerial matters.

Americans Overseas

The IRS recently released a report outlining its goal to improve services for Americans living abroad. Over the last several years, global awareness including the FATCA requirements have raised the general awareness that Americans living abroad have more complicated tax and informational reporting obligations. These obligations go well-beyond the FBAR filings. Finding overseas advisors competent to advise and prepare the necessary filings can be particularly burdensome and expensive. Contrary to popular belief, most Americans living abroad are not uber-wealthy, tax-dodging, globe-trotters, but everything from dual citizens, retirees, folks living an adventure or working for one of the thousands of companies that operate on a multi-national basis. Professional fees in the thousands for what would be in the United States a few hundred dollars are not uncommon.

The IRS has recognized this market dynamic (reasonable cause for penalty abatement) and is pledging to staff dedicated telephone lines and service providers to answer questions for taxpayers. The details are sketchy at this point, but I encourage you to watch for future announcements as the initiatives are rolled out. In the meantime, heightened diligence is necessary as there is a growing view within the IRS that overseas Americans have been put on notice that they have tax filing and informational filing obligations.

Round-Up

In other news, the IRS has announced that it intends to continue its coordinated examination and, in some cases, prosecution of perceived abuses of syndicated conservation easements. The efforts are to include an examination of 100 percent of the investor class. While conservation easements can lead to tax deductions under IRC 170(h)-abuses of otherwise sound tax planning and charitable giving, a skeptical eye is the best defense to potentially significant problems for clients thinking of donating conservation easements. Pay particular attention to the timing and fact-based aspects of the proposed transaction and the economic substance of the transaction.

The IRS in IR2021-20 has provided guidance on expanding the use of electronic signatures on authorization forms. In particular, IRS Form 2848, Power of Attorney and Declaration of Representative. We all know how frustrating it can be in trying to talk with an agent when you are waiting to get signatures of the power of attorney. The expanded use of electronic signature is part of the Taxpayer First Act.

Enforcement

The "J5" group of nations—the United Kingdom, Canada, Australia, the Netherlands, and the United States have begun in earnest their multi-national criminal tax enforcement. Cryptocurrency and FINTECH are front and center. However, the group has indicated that they will look beyond those two lanes for other criminal tax violations and will be paying a particular focus on enablers, facilitators, and promoters. The IRS has had a lag in guidance on cryptocurrency, but clients should understand that if they are selected for an examination, the IRS will specifically question whether the taxpayer has engaged in *any* cryptocurrency transactions. The agents will review bank and brokerage statements looking for the signs of transfers in or out of cryptocurrency brokers and dealers. Also, keep in mind that the IRS has already successfully secured information about cryptocurrency account holders via John Doe Summons. As such, the IRS agent may already be in possession of information about your client. Practice Tip: Assume that is the case and review your client's financial records carefully before submitting to the IRS.

The trend toward tougher sentences for white collar and tax offenses continues. Recently, a California woman was sentenced to five years in prison for her role in a $2 million-tax fraud against the United States. The scheme was apparently quite complex and involved false refund claims, the use of an undisclosed bank account in Cyprus, and even a "church" set up by the defendant. Such factors greatly enhance the sentencing range under the U.S. Sentencing Guidelines as evidenced by the five-year sentence. *See United States v Boone*, No 2:16-cr-00020-TLN (ED Cal Jan 21, 2021).

A tax preparer was permanently barred from preparing tax returns by

a federal judge for preparing hundreds of false tax returns. This case is the latest installment where the government has sought a permanent injunction against "bad preparers" and the disgorgement of earnings from such activities. *See United States v Cotton,* No 9:17-cv-80518 (SD Fla Jan 27, 2021).

Stay Well.

Eric M. Nemeth of Varnum LLP in Novi, Michigan practices in the areas of civil and criminal tax controversies, litigating matters in the various federal courts and administratively. Before joining Varnum, he served as a senior trial attorney for the Office of Chief Counsel of the Internal Revenue Service and as a special assistant U.S. attorney for the U.S. Department of Justice, as well as a judge advocate general for the U.S. Army Reserve.

 By Michael S. Khoury and Patrice Asimakis

Technology Tools for the Business Lawyer

This column was inspired by a discussion among the co-authors about the plethora of new technology tools, services, and applications that have been brought to market. We have all been familiar with some of the basic tools (some of us remember when electronic document comparisons of versions were considered new), but so many new options are coming on to the landscape that this review may be helpful. We are not going to talk about or recommend specific products to you, but resources are easy to find and consultants are available to assist as well.

Contract and Document Review

The underlying principles for this category are that a combination of human intelligence and computer programing or artificial intelligence can increase the quality and efficiency of our work. In substance, we are talking about algorithms and machine learning, which are instructions or rules that are carried out mechanically to produce a result. These tools can be used to analyze data and obtain information. The more the tool is used and "learns" from the user, the better it gets.

The tools that are available all essentially increase efficiency and improve results by extracting information from a set of data. This can be a single document or a set of documents. A user that wants to analyze a single contract may use such a tool to spot issues based on industry standards or an organization's knowledge base and flag concepts. Providers of these tools are using lawyers as consultants to provide industry standard practices and contract terms. The use of a standardized set of information to automate the review of confidentiality or non-disclosure agreements is one example. An organization can use industry standards or establish its own desired standards for its agreements and use the tool to generate an exception report that identifies the variations between the reviewed agreement and its preferred standard clauses. Some tools have an interface for the user to prepare redlines from this report, and other tools automatically redline the agreement.

For more complex implementations, numerous options are available. Several products are available that claim to automate the process of due diligence in a transaction by extracting specific clauses from the information provided. A buyer of a business may want to identify each time the seller has entered into agreements that have specific concepts included. If the seller has agreed to keep customer information confidential or has agreed to exclusivity or non-compete clauses in its customer agreements, the buyer will want to know that in evaluating the transaction. These tools can help to identify the relevant terms for subsequent review.

In the mergers and acquisitions context, there are various applications that will allow you to compare a draft agreement (such as the buyer's first draft of an asset purchase agreement) against a model agreement used by seller's counsel or against the entire EDGAR database of such agreements. These market comparison tools allow the analysis, on an automated basis, of the first-round review of the draft agreement.

Storage and Access

It is now common for practitioners to use cloud services to store and allow third-party access to documents. Some of these are simple depositories that can be set up by the user while others can organize voluminous information. In the M&A context, the data room is common for most due diligence review activities. The services vary in the scope of the offering, the organizational tools, and the data security of the services or the applications. (Note that there will be more about the issue of security later.)

Document Assembly

Document assembly tools have been available for many years, but the sophistication of the tools is now such that documents can be assembled based on the users' own templates or third-party sources. The firm or company can upload frequently used contracts to a cloud-based template bank that then organizes most frequently used concepts and prior examples—with the organization's particular magic words—to assemble almost any legal document. Among the features being touted by some of these applications are processes that "interview" the user to identify the components appropriate for an agreement. A firm's existing documents are transformed into reusable template sets that are easy-fill and signature ready.

Collaboration and Project Management

Most of us work in teams, and the need to work together has only become more difficult given the forced remote work that many have faced. Collaboration tools can be as simple as messaging or email based systems, but they can also utilize a process by which the members of the team can understand the status of the project, their role in the project, completed and upcoming tasks, and the ability to interface with other team members in a way that allows the entire team to benefit. These can be paired with project management tools that provide more than a closing checklist or Gantt chart with estimated timelines for completion. Users are able to plan, track, and manage any project from start to finish, maintaining productivity from anywhere. The tools give the team a comprehensive view of the project status and integrate seamlessly with calendars, document repositories, video conferencing application, payment services, marketing tools, and social media sites.

Closing Processes

Those of us that are of a certain age will remember when a "closing" actually took place in a large conference room with all the parties assembled and signing multiple copies of each document. It has been many years since most lawyers have had that experience, but online and electronic closings are now the norm. The processes can be as simple as each party's counsel holding the signature pages and then "releasing" them to the other party to consummate the deal. However, online closing rooms take the concept of the closing room and completely digitize the entire experience. Excessive paperwork and administrative tasks have been replaced with secure document storage, easy collaboration, and digital signature management. The closing process is automated and controlled electronically, managing all aspects of the deal, from term sheet to closing book.

Knowledge Management

Knowledge management is probably one of the most difficult activities but potentially one of the most beneficial. The concepts behind knowledge management are not new, but implementation remains elusive to many. Lawyers create thousands of documents. Although they are stored, they are not always categorized for repurposing. Common examples of prior work ripe for meaningful management include brief banks, contract review playbooks, and bodies of legal research. A knowledge management system will organize, contextualize, and assign a profile to these precedent documents, so that they will be easily searchable and filterable.

Corporate law departments can probably benefit the most from capturing the experience and knowledge of an organization in a way that allows the next user to increase efficiency and quality by accessing that experience. This will often be advertised as a way to leverage the prior work and templates for the next deal or agreement.

Costs

Some of these tools that can be seen as industry disrupters can be expensive. However, many are available on a more affordable basis, including pricing that is based on a per user-per month model, enterprise model, or even a per transaction fee. They are worth exploring, and cost should not be your primary hesitation. As with all of these tools, the upfront investment of time will yield improvements in processes and get the most out of your investment.

Ethics and Professional Responsibility

Michigan is one of the majority of states that require technology competency to comply with our professional responsibility obligations. Communication, collaboration, document management, practice management, and eDiscovery tools are so widely used that most practitioners would consider them to be reasonably necessary. Some of the tools discussed above may be the next to be essential for your practice, whether because of your ethical obligations or the demands of your clients.

A very important point that needs to be made is that the use of technology tools is not a replacement for legal judgement. A tool may highlight an issue, but it is up to the lawyer to evaluate the appropriateness of the red flag or recommended clause. A second but still very important issue is the confidentiality of client information. If you use a cloud-based system or other tools, and client information is stored external to your systems, it is incumbent on the lawyer to ensure that the data is secure and that no unauthorized access occurs. Some of the "free" tools available in the marketplace do not meet these standards. Even if the application is run within your organizations own technology infrastructure, information needs to be secure and protected. Sometimes, you get what you pay for.

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Touring the Business Courts

By Douglas L. Toering, Ian M. Williamson, Emily S. Fields

In this column, we look back and look ahead. We have the privilege of hearing from Judge James M. Alexander, who recently retired from the Oakland County Business Court; Judge Lita Masini Popke, who has just retired from the Wayne County Business Court; and Judge Michael Warren, who was appointed to the Oakland County Business Court effective January 1, 2021. We think you will find their observations enlightening.

Judge James M. Alexander

Reflecting on his career as a judge, Judge Alexander mentions that his first day in open court was September 11, 2001, and that he retired during a pandemic. Quite a set of bookends for a career! He recalls what happened on that sunny day that became known as 9/11. The judges had to decide whether to keep the courthouse open. After hearing a rumor that the Los Angeles County Courthouse had been bombed, the decision became even more difficult. Nevertheless, Judge Alexander argued to keep the courthouse open—closing would give victory to the terrorists. The judges agreed and the courthouse stayed open on 9/11.

Recalling the early days of the business courts, Judge Alexander mentioned that as of about 2011-2012, various circuits (including Kent County, Macomb County, and Oakland County) had implemented pilot programs. Oakland County's required that the amount in controversy be at least $500,000 to qualify. Judge Michael Warren was spearheading the effort at that time, and cases could be assigned to any circuit judge. Each circuit with a business court (or specialized business docket) had its own local administrative order.

In any event, the business court statute was passed in October 2012 and became effective January 1, 2013. Effective June 2013, Judge Alexander and Judge Wendy Potts were appointed as the first business court judges for the Oakland County Business Court. (Judge Alexander, who started his career doing corporate law work, felt he had now come full circle.) At that time, there was some hesitancy in the bar about specialty courts: Why did business cases deserve a special court? Despite this, the business courts were successful and now have become part of the fabric of the jurisprudence in Michigan.

Two of the goals of the business courts, according to Judge Alexander, were to increase the predictability of business court decisions and to enhance the expertise of the judges making those decisions. Both goals were accomplished. Predictability "gives a roadmap to the litigators," Judge Alexander observed. Tongue in cheek, he said "it's always fun as a judge to have a lawyer quote to you a decision that you wrote."

When he became a business judge, he expected that lawyers would be prepared, that lawyers would help resolve cases quicker (because judges would bring in the lawyers for early case management conferences), and that lawyers and judges would take a team approach to resolving business cases (which is why the advisory committee for the Oakland County Business Court was established). "We wanted to create a process to benefit the bench and the bar," Judge Alexander notes.

Were these expectations fulfilled? "Absolutely," said Judge Alexander. A side benefit of the business courts is the closeness of the business court judges throughout the state and the camaraderie that they developed.

In the business courts, the judges focus on early intervention: Can the relationship between these businesses or business owners be salvaged? If not, how can the dispute be resolved in a business-like way? Business cases are "business situations." Resolving a business case is a "business decision" for the principals, Judge Alexander notes.

Asked about his greatest satisfaction in the business courts, Judge Alexander reflects, "I feel like a proud papa watching the business courts grow." He adds that much of what the business judges in Oakland County have done has now been adopted statewide. This includes amendments to the Michigan Court Rules (effective 2020), which provide for proportional discovery, use of discovery facilitation, and great emphasis on alternative dispute resolution.

As to the attorneys who appeared in his court, Judge Alexander states that he was happy with the quality of lawyers. "It made our job as judges a lot easier."

Looking forward, Judge Alexander hopes that the Oakland County Business Court could hire a full-time business court case manager and add a third judge to the business court. This is a budgetary issue, of course. That being said, Judge Alexander enjoyed having a criminal docket with the business docket. He notes that the attorneys for indigent criminal defendants were very good, and they cared about their clients.

On the technology side, Judge Alexander believes that Zoom[1] has been an ongoing success. Attorneys can now appear for hearings in several courts on the same day without leaving their office (or their home office, as the case may be.) This saves the lawyers time and the clients money. Status conferences and court hearings by Zoom are "here to stay." For this, he gives kudos to Justice McCormack and the State Court Administrative Office, who arranged for each state court judge in Michigan to have a private Zoom room. Still, Zoom is not well suited for trials that are document intensive: "You can only have so many binders at one time."

His advice to litigators? No surprise, here: "Be prepared, know your case, be civil. Civility and preparation are two things you can never lose track of." For Zoom hearings, dress professionally and stand if you are able. In all circumstances, remember to maintain your credibility. For transactional attorneys, "Keep the worst case in mind. If a problem develops, explain how this will be handled. Be clear." As to the last, Judge Alexander observes that the less clear the document is, the harder it is to interpret. And as for mediators, he advises, "It's important in ADR that the parties have confidence in (a) your

neutrality and (b) your knowledge of strengths and weaknesses of the case and how the judge might rule."

Judge Alexander is excited about the future doing mediations for JAMS. "I'm looking forward to helping people resolve cases;" indeed, "I'm a problem solver, and that's where I get my greatest satisfaction." He's also looking forward to seeing his two grandchildren in Indianapolis, whom he has not seen in person for a year. "I've had a lot of titles in my life," Judge Alexander reflects, "but the best title is grandpa."

The end of the pandemic will mean that trials will resume. Business court cases will be behind criminal cases on the trial docket. The need for ADR will be great to process those business cases.

As to effectiveness of mediation during the pandemic, Judge Alexander observes that it appears that fewer cases were resolved. This is likely because the trial dates are likely well into the future. When parties know that they will either need to settle the case or proceed to trial, they become more serious. But courts will open up, and parties will again have to decide whether to settle today or face trial tomorrow.

Judge Lita Masini Popke

Appointed to the Wayne County Circuit Court in 2000 by then Governor John Engler, Judge Popke served on the family court bench from 2000-2012 and then in general civil until she was appointed to the business court in 2015. She retired as of March 12, 2021, to join JAMS.

Asked about her expectations when she was appointed to the business court, Judge Popke said that she wanted to be the kind of judge that she wanted when she was a practicing business attorney. In those days, she dreamed about having judges who understood business litigation at a higher level; indeed, business disputes should not follow a traditional litigation process. On the business court bench, Judge Popke asked herself and counsel: "How do we take off our litigation hats and put on our resolution hats, rather than litigate this case forever?"

For Judge Popke, phase 1 was generally geared to promoting resolution and trying to find a shorter path to narrowing the actual areas of dispute and determining what specific information was needed to reach a resolution. To answer that, she would inquire of counsel at the status conference how much discovery they really needed. This then was included in a court order that also specified a date for early ADR. If this approach did not resolve the case, then the case would proceed to phase 2. This was the more traditional litigation approach, which involved fuller discovery.

Consistent with the purpose of the business courts, Judge Popke's philosophy was to focus on "resolving business disputes efficiently and creatively." Often, this involved constructing a business solution, which resolved the case other than by direct payment of money.

As an example, Judge Popke cited non-compete cases. "These cases are great cases for the business court and for early resolution." Although she did not grant TROs in those cases, she would make sure she met with counsel within a month after the case was filed. She generally found a way to balance the employee's right to work with the employer's business interests. If non-competes can't get resolved, everyone—the employee, the employer, and third-parties (who don't want to get involved)—gets hurt.

Overall, Judge Popke is convinced that, "people in business want to get on with their business. They are in business to make money and they don't want to pay attorney fees." If counsel can "can get your hands around the case immediately, you can save your clients a lot of money." The business courts require "extensive judicial involvement to help the parties achieve a quick, efficient, and low-cost solution. To do so, the judges need to get their hands dirty."

Using an example of creative thinking, Judge Popke cited a case where she recommended that the parties retain an expert on trade secrets to opine whether something was a trade secret. The opinion from the expert helped streamline and resolve the case.

Showing her commitment to efficiency, Judge Popke observed that her job was to "be part of your team to move your case forward." So, were Judge Popke's expectations for herself fulfilled? Yes, she did exactly what she intended to do. Her keys to success appear to be early and active judicial involvement, creativity by both her as a judge and by the counsel and the litigants, and early ADR.

Reflecting on virtual court proceedings, Judge Popke raved about Zoom. "It's an incredible tool," she commented. "It's even more conducive to business cases. Business cases usually don't have jury trials and often have pro hac vice lawyers." Court proceedings done by Zoom can be a big savings of time and money. "It's never going away." That said, judges are working as hard or harder with Zoom as they did before the pandemic.

One major downside of court proceedings by Zoom is that litigants and sometimes counsel view this too casually. Thus, Judge Popke issued this reminder: "When we are on Zoom, you are still lawyers, and we are still judges. I expect you to look professional, and I expect professional backgrounds." (She suggested perhaps using a virtual background with your firm name.) Judge Popke continued: "If you are on the record, you will be on YouTube for all (including your client) to see. You are still representing your client; you have to work hard to show the utmost professionalism before the court."

Her advice to litigators? "Be prepared, be on time, be creative, know your judge." In other words, "keep doing what you're doing." Overall, Judge Popke is very pleased with the quality of counsel in the business courts. As for transactional attorneys, she recommends that they meet with the business litigators to understand how the documents the

corporate lawyers draft are used in a courtroom setting. Using an example, Judge Popke said, "Transactional lawyers need to talk with the litigators to discuss what is an enforceable non-compete."

As for the business courts, Judge Popke recommends where possible, judges in the same business court coordinate the timing of motion hearings generally and summary disposition hearings in particular. She recognizes, of course, that these are decisions that individual judges make about their own dockets. Also, although the business court statute does require that opinions be published, this doesn't always happen. (Part of this may be the heavy caseload that some business judges shoulder, and the fact that some business judges do not have research attorneys.) Judge Popke suggested that perhaps the Michigan Supreme Court could issue best-practices guidelines to the business court judges.

What does the future hold for Judge Popke? As mentioned, she joined JAMS on March 15, 2021. She will focus on mediation, arbitration, and discovery mediation. Judge Popke likes "digging into discovery issues," such as electronic discovery, privilege issues, and so forth. Noting that she will "not bring her black robe" with her, Judge Popke predicts that she will be more collaborative as a facilitator than she was able to do with the limited time she had with any individual case while she was a judge. Judge Popke enjoyed her tenure on the bench, and she is looking forward to the next chapter in her career.

Judge Michael Warren

Before taking the bench, Judge Warren clerked for Michigan Supreme Court Justice Dorothy Comstock Riley. After that, he was a litigator for Honigman Miller Schwartz Cohn. He then joined the State Board of Education for a period of time before returning to Honigman as a transactional partner. Judge Warren then joined Cornerstone Schools. In December 2002, he was appointed to the Oakland County Circuit Court by then Governor John Engler and served on the general jurisdiction bench for one year. (He succeeded Judge Alice Gilbert.) Judge Warren served on the family court bench for one year and then served on the general civil bench until January 2021, when he joined the business court. (Judge Warren still maintains his criminal docket.) This is not Judge Warren's first experience with the business court—he was the chair of the circuit court liaison for the business court formation committee.

Judge Warren's experience with the business court has been quite different from his experience in the family court and general jurisdiction docket. One important difference is that there were generally no case management conferences in the family or general jurisdiction courts. (The Michigan Court Rules were amended to permit case management conferences in those cases.) In those courts, if there were no motions filed, the judge might not see counsel until the pretrial conference.

Judge Warren finds the business court case management conferences extraordinarily helpful. They are customized to the case. Pretrial conferences in a general jurisdiction docket would only last a few minutes, whereas the case management conferences in the business court last at least 10-20 minutes, if not more. The represented parties are not required to be present at the case management conference. At those conferences, the lawyers discuss, among other things, early intervention, whether the parties are on a "peace path," and case evaluation. "I like learning about the cases and strategizing about a case management order, discussing how to manage the case, and moving the parties to a cooperative resolution if possible."

Judge Warren takes a "hands-on, active approach to business court cases; I have found that to be very rewarding and productive." He has also added a section to the case management protocol on summary disposition motions. Judge Warren takes confidence and comfort in repeatedly seeing the same lawyers in the business court. He notes that business court "issues are very interesting, very complicated; it's a joy to jump into them."

Another difference that Judge Warren notes between the business court and the general jurisdiction court is that the business court does not present the variety of disputes that the general docket does. In the business court, Judge Warren says, you "make deep dives into the limited universe" and see patterns or reformulations of the same issues. The deep dives translate into a large volume of paper—business court filings result in "a lot of trees being sacrificed."

When it comes to summary disposition motions, Judge Warren does not agree with staying the case while a motion brought pursuant to MCR 2.116(C)(8) is pending unless it presents a jurisdictional issue or a ruling that would dispose of the entire case (such as with a release). He receives more motions for summary disposition pursuant to MCR 2.116(C)(8) than he receives answers to a complaint—staying a case pending the outcome of the motion would add a significant amount of time to the case. Judge Warren tends to make a decision on motions brought under (C)(8) or (C)(10) on the briefs and recommends that attorneys "assume you will have no oral argument" on them.

Judge Warren does not take a one-size-fits-all approach to early mediation. He finds that not all cases are suitable for early mediation. If the parties are on a peace path (trying to resolve the case in good faith), Judge Warren is willing to stay the case for a period of time and order mediation. Failing that, the stay is lifted. In some cases, the parties need limited written discovery, so he will permit written discovery and maybe a few depositions for 60 days before sending the parties to mediation.

With respect to case evaluation, Judge Warren will permit the lawyers to choose whether they want to mediate, go to case evaluation, or select

another method of resolution. However, Judge Warren requires that case evaluation sanctions apply to whichever route the lawyers choose.

Judge Warren intends to do Zoom bench trials for the time being. If the parties want a jury, he asks whether they *really* want a jury because he predicts that it will be a long time before jury trials resume in the business court. He adds that he typically does not require findings of fact or conclusions of law from the parties at the end of a bench trial.

Judge Warren has found that Zoom works well and that the lawyers are becoming accustomed to it. Zoom is here to stay for status conferences, case management conferences, motion calls, evidentiary hearings, possibly settlement conferences, and most bench trials. He predicts that Zoom will be the dominant way of conducting business in the business court except for jury trials.

Advice to litigators: Judge Warren generally decides motions for summary disposition and discovery motions on the papers and without oral argument. With almost everything Judge Warren does, he is a rule follower. "Know your court rules. There is a very high standard for a TRO; if you don't meet the procedural requirements, you won't get it." Judge Warren says that motions for temporary restraining orders tend to be written in histrionics. He recommends that lawyers not defeat their chance of getting an order by not following the rules: "The hardest hurdle for most motions seeking injunctive relief is whether the harm is irreparable. The business community has a wide view of irreparable harm; the law has a narrow view of irreparable harm." An example of truly irreparable harm is a historic building that is going to be bulldozed. By contrast, a customer purloined from a business can be remedied with money and is not irreparable. Judge Warren also reminds lawyers to remember to argue the public-interest prong of a preliminary injunction or TRO. Another piece of advice: the worst thing you can do is lie. The second worst thing you can do is not be prepared. The best things you can do are to be forthright, know the case, and expect that the court rules will be enforced.

Advice to transactional attorneys, it is impossible to eliminate all ambiguity. Be as precise as possible, so if the deal goes south, the parties' intentions will be as clear as possible. Judge Warren would like to remind transactional attorneys that they do not need to use templates or forms—he encourages them to "create your own world; create the agreement you want. Make sure you know what your agreement means. Use definitions." He adds, "The more precise you can be, the less the chance of a breach" of the agreement.

NOTES

1. This article is not an endorsement of Zoom over any other digital platform.

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In-House Counsel's Role in Corporate Data Security

Not that long ago, quarantine orders by various state and local governments might well have been terminal, rather than "merely" crippling, for numerous industries. Part of the reason for this is that companies were increasingly able to offer their employees the opportunity to work from home, rather than shutting down completely—and at least some companies are not planning on returning to the office at all.[1] While the jury is still out on whether remote work will become the norm, one thing is clear: increased reliance on telework means increased vulnerability to cyberthreats. As these threats have increased over the last year—and legal liabilities for cyberattacks have correspondingly increased as well—in-house counsels should be prepared to add "cybersecurity expert" to their portfolio of responsibilities.

The Pandemic and the Cyber-Pandemic

By far the most widely reported cybersecurity incident that occurred during the pandemic is the widespread Russian hack of SolarWinds, which "affected upward of 250 federal agencies and businesses, that Russia aimed . . . [at the] United States government and many large American corporations."[2] However, politically motivated hacking is far from the norm and increased use of remote computing and cloud technologies has resulted in a "cyber-pandemic": a dramatic increase in cyberattacks that targets businesses for financial gain.[3] One cybersecurity expert explained:

> Employees are no longer sitting behind corporate networks, nor are they utilizing the best security practices while working from home. A company's data, privacy, and security are only as good as its employees' ability to utilize appropriate cyber hygiene, lock down their device security, and employ business security policies, software, and practices. Put all these factors together, and it's not hard to see how the stage is set for a possible cyber pandemic.[4]

Thus, it has been reported that during the COVID-19 shutdowns (1) there has been a two hundred and thirty-eight percent increase in cyberattacks on banks and financial institutions;[5] phishing attempts have increased by six hundred percent; most distressingly, since the start of the pandemic, a cyberattack has occurred, on average, once every thirty-nine seconds.[6]

Legal Risks from Data Breaches

A comprehensive analysis of the legal risks of cyberattacks is made somewhat more complicated by the fact that the United States does not have a single set of cybersecurity regulations in the way that the Eurozone has adopted the GDPR—a single, comprehensive set of data protection rules that are universally applicable throughout much of the Eurozone.[7] Instead, information in the United States is protected *transactionally*; that is, privacy and data security laws govern *in specific contexts*.[8]

For example, HIPAA and HITECH provide protections for "personal health information;"[9] Gramm Leach Bliley protects consumer information held by financial institutions; and the Fair Credit Reporting Act contains provisions to protect credit data.[10] As a further complication, states may well pass their own set of additional data security laws; Michigan, for example, recently enacted the Data Security Act, which requires additional cybersecurity measures on those licensed by the Michigan Department of Insurance and Financial Services.[11] Thus, it is imperative that counsel be familiar with the specific data security and privacy regulations governing its business.

Nevertheless, *direct* liability for data breaches is rare. First, many of the data security laws do not create a direct cause of action. HIPPA, for example, does not.[12] Moreover, even where a private cause of action exists, data-security litigation has proven difficult for plaintiffs. While not addressing a data breach specifically, *Spokeo Inc. v. Robins*, explains why. In that case, Thomas Robins sued Spokeo (an online "People search engine" that "allows users to search for information about other individuals by name, e-mail address, or phone number"[13]) for allegedly posting incorrect information about Robins, in violation of the Fair Credit Reporting Act (FCRA)[14] and sought statutory damages in a putative class action. The Supreme Court held that without showing the incorrect posting *actually* caused harm to Robins, he lacked Article III standing to sue.[15] In other words, Robins *might* be subjected to the risk of harm by the posting of incorrect information, but, *without more*, he had not suffered an actual redressable harm.

In a cyberbreach context, this ruling has significantly curtailed plaintiffs' ability to sue for data breaches. In *Bassett v. ABM Parking Services Inc.*, for example, the 9th Circuit, relying heavily on *Spokeo,* held that even a clear violation of the FCRA and the Fair and Accurate Credit Transactions Act (FACTA)[16] requires an actual harm to be actionable. In that case, Bassett used his credit card at an ABM garage, and the business returned to him a receipt that failed to redact his credit card number. The appellate court held, dismissively, that "[w]e need not answer whether a tree falling in the forest makes a sound when no one is there to hear it. But when this receipt fell into Bassett's hands in a parking garage and no identity thief was there to snatch it, it did not make an injury."[17] Thus, without an allegation that "his receipt was lost or stolen, that he was the victim of identity theft, or even that another person apart from his lawyers viewed the receipt" neither Bassett nor his class could sue for statutory damages. Since it is very difficult to establish that an act of identity theft is

related to any particular data breach, without a change to the law, this sort of direct data breach liability will be rare.

Data breach liability might be rare, but it does happen. In one recent Pennsylvania Supreme Court case, the court held that an employer has a "legal obligation to exercise reasonable care to safeguard its employees' sensitive personal information stored by the employer on an internet-accessible computer system."[18] In that case, the employer was alleged to have "fail[ed] to adopt, implement, and maintain adequate security measures … and [among other things] 'establish adequate firewalls to handle a server intrusion contingency.'"[19] Consequently, a result of a hack of the employer's databases, "Employees 'incurred damages relating to fraudulently filed tax returns' and are 'at an increased and imminent risk of becoming victims of identity theft crimes, fraud and abuse.'"[20] The case was remanded back to the trial court.

Moreover, even those regulations that lack a private right of action can be administratively enforced. Examples of such actions are common. The Department of Health and Human Services can levy fines for HIPAA violations that, in the most egregious cases, can exceed $1,754,698 per violation.[21] In 2019, the Federal Trade Commission (FTC) settled a case against Facebook for "unfair and deceptive business practices" related to the Cambridge Analytica data breach.[22] The FTC is also in the final stages of approving a settlement with Equifax over the 2017 data breach; a settlement which includes a payment by Equifax of $380,500,000, among other payments, costs, and actions required by the settlement. Finally, while not technically a legal risk, companies that fail to protect their customers' data may well see their customers take their business elsewhere.

(Cyber) Protecting Your Data

Given the risks of direct, indirect, reputational, and administrative liability, it is imperative that in-house counsel review the corporate data protection protocols. In this regard, HIPAA's security rule is instructive for every industry—and not just for health care companies obligated to follow it.

HIPAA's security rule provides a flexible approach, which permits covered entities to use "any security measures that allow the covered entity … to reasonably and appropriately implement the standards … and specifications as specified [under the rule]."[23] Thus, the rule creates a flexible approach to data security, which may be tailored to each individual entity. The rule requires that covered entities set up safeguards along five different parameters: administrative safeguards; physical safeguards; technical safeguards; organizational safeguards; and policies, procedures and documentation.[24]

Administrative safeguards might entail hiring a vendor to perform a cyberrisk analysis, or a long-term risk management program to reduce IT system risks and vulnerabilities.[25] Physical safeguards are the actual, real world (opposed to online or electronic) barriers put in place to protect data; these might include locked server rooms and other physical measures intended to keep physical access to servers or other data storage to a minimum.[26] Technical safeguards include firewalls, anti-malware scanning, and other electronic mechanisms designed to keep data secure.[27] Organization safeguards address the entities' relationships with its vendors and may require best practices such as indemnification for outside data breaches, warranties that vendors will use industry standard encryption protocols, and other contractual measures.[28] Policies, procedures, and documentation mean having a written data breach plan, data backup plans, and other set procedures for staff to follow in the event of a cyberattack.[29]

Addressing each of these different types of safeguards can be important for creating a robust data protection regime; doing so is likely to require the combined effort of management, along with both legal and IT departments. On the other hand, there are also simple, commonsense best practices that can be immediately implemented that may make data more secure, including:

- Install remote-wipe programs on laptop and phones that have access to sensitive data.
- Create a culture of password discipline, including regularly changing passwords, requiring strong passwords (passwords which include alphanumeric digits and special characters), and two-factor authentication.
- Ensure that your workforce is properly trained to identify phishing attempts and spam/malware attacks.

Conclusion

Cyberthreats are legal threats and are here to stay for the foreseeable future. Now, more than ever, a vigilant and strategic approach to cybersecurity must be enacted by in-house counsel as a proactive priority. Adopting a data protection policy and articulating the risk of cyberthreats across the organization will provide a platform of security. And while the threat of a cyberbreach may never go extinct, with intelligence-led measures, you may achieve herd immunity.

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3. 2020: The Year the COVID-19 Crisis Brought a Cyber Pandemic (govtech.com) https://www.govtech.com/blogs/lohrmann-on-cybersecurity/2020-the-year-the cofid-19-crisis-brought-a-cyber-pandemic.html.

4. Cyber Pandemic Survival Guide: Three Things for Future Consideration (forbes.com) https://www.forbes.com/sites/forbestechcouncil/2020/08/18/cyber-pandem-

ic-survival-guide-three-things-for-future-consideration/?sh=6f1c43282442.

5. The 2020 Cybersecurity Stats You Need to Know—Fintech News https://www.fintechnews.org/the-2020-cybersecurity-stats-you-need-to-know/.

6. *Id.*

7. The General Data Protection Regulation ("GDPR") is an international regulation on data protection and privacy for all individual citizens of the European Union (EU) and the European Economic Area (EEA). It applies to the 27 Member States in the European Union: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Italy, Ireland, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Spain, Slovakia, Slovenia, and Sweden. The GDPR also applies to several non-EU members by international agreement: the United Kingdom, Norway, Iceland, and Liechtenstein.

8. It may well be argued the American approach to data security has created a hodgepodge of conflicting security standards. Data Protection Law: An Overview (fas.org) https://fas.org/sgp/crs/misc/R45631.pdf. ("Despite the rise in interest in data protection, the legislative paradigms governing cybersecurity and data privacy are complex and technical, and lack uniformity at the federal level."). On the other hand, it may be argued that the GDPR approach creates a simplistic "one-size-fits-all" that leaves open system-wide vulnerabilities. *See, e.g.* A One Size Fits All Approach Doesn't Work for Europe and Eurasia | Morrison & Foerster (mofo.com) https://www.mofo.com/resources/insights/210112-one-size-fits-all.html. Regardless, the American approach is the system in which we find ourselves, and, absent legislation and/or regulation at the federal level, this will be the approach for the foreseeable future.

9. *Data Protection Law: An Overview,* Congressional Research Service (CRS), March 25, 2019, https://crsreports.congress.gov/product/pdf/R/R45631.

10. Id.

11. MCL 500.557 *et seq.*

12. *Thomas v University of Tennessee Health Sci Ctr at Memphis*, No 17-5708 at *2 (6th Cir Dec 6, 2017) (finding that the district court did not err in dismissing claims under HIPAA where no private right of action existed, citing, *Bradley v Pfizer, Inc*, 440 F App'x 805, 809 (11th Cir 2011); *Carpenter v Phillips*, 419 F App'x 658, 659 (7th Cir 2011); *Dodd v Jones*, 623 F3d 563, 569 (8th Cir 2010); *Wilkerson v. Shinseki*, 606 F3d 1256, 1267 n4 (10th Cir 2010); *Miller v Nichols*, 586 F3d 53, 59-60 (1st Cir 2009); *Webb v Smart Document Sols, LLC*, 499 F3d 1078, 1081 (9th Cir 2007); *Acara v Banks*, 470 F3d 569, 571 (5th Cir 2006)).

13. *Spokeo, Inc v Robins,* ___ US ___, 136 S Ct 1540 (2016), *as revised* (May 24, 2016).

14. 15 USC 1681 *et seq.*

15. *Spokeo, Inc*, 136 S Ct at 1549. ("Robins could not. . . allege a bare procedural violation, divorced from any concrete harm, and satisfy the injury-in-fact requirement.") Justice Scalia, however, did caution that "This does not mean, however, that the *risk* of real harm cannot satisfy the requirement of concreteness." *Id.* (emphasis added).

16. The FCA and FACTA require that "no person that accepts credit cards or debit cards for the transaction of business shall print more than the last 5 digits of the card number or the expiration date upon any receipt provided to the card holder at the point of sale or transaction" 15 USC 681c(g) and that "any person who willfully fails to comply with [this requirement] with respect to any consumer is liable to that consumer for statutory damages between $100 and $1000 per violations or actual damages suffered by the consumer."

17. *Bassett v. ABM Parking Servs, Inc*, 883 F3d 776, 783 (9th Cir 2018).

18. *Dittman v UPMC*, 196 A3d 1036 (PA 2018).

19. *Id.*

20. *Id.*

21. *What Are The Penalties for HIPAA Violations?,* HIPAA Journal, Jan 15, 2021, https://www.hipaajournal.com/what-are-the-penalties-for-hipaa-violations-7096/.

22. *United States v Facebook, Inc,* No 19-cv-02184-TJK (DDC July 25, 2019).

23. 42 CFR 164.306(b)(1).

24. *See generally* 42 CFR 164 *et seq.*

25. 42 CFR 164.308.

26. *Id.*

27. 42 CFR 164.310.

28. 42 CFR 164.312.

29. 42 CFR 164.314.

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The Small Business Reorganization Act: Subchapter V of Chapter 11

By Laura J. Eisele

Introduction

Congress passed the Small Business Reorganization Act (the "SBRA" or "subchapter V")[1] to streamline the chapter 11 reorganization process, making the process more affordable and accessible for small businesses.[2] The SBRA was adopted in August 2019 and became effective on February 19, 2020. The impetus for the SBRA was that despite being the backbone of the United States economy, small businesses, including family owned and entrepreneurial, were disadvantaged by the current chapter 11 construct. Many small businesses[3] were unable to obtain the benefits of chapter 11 reorganization under the United States Bankruptcy Code (the "Bankruptcy Code") due to the high cost and difficulty of confirming a chapter 11 plan. In addition, small business owners were often reluctant to file chapter 11 because unless they were able to infuse cash or other property into the business, the small business owner would lose their ownership interest. Therefore, there was little incentive for a small business owner to attempt a chapter 11 reorganization. As a result, small businesses often liquidated after failed attempts to reorganize in or out of court. The SBRA has modified the rules of reorganization for small businesses to address some of the obstacles to chapter 11.[4]

Overview

Small businesses play a key role in the United States ("U.S.") economy and job market. Small businesses in the U.S. comprise over 99 percent of all businesses in the United States. In 2018, there were 30.2 million small businesses in the U.S. representing over 99.9 percent of all U.S. businesses.[5] In addition, small businesses accounted for over 47 percent of all private sector employees, with the number of employees at 58.9 million.[6] Similarly, Michigan small businesses account for over 99.6 percent of all Michigan businesses, and employ 1.9 million employees, 49.1 percent of the workforce.[7] Unfortunately, small businesses have a high failure rate, with about 50 percent surviving for less than five years.[8]

Bankruptcy experts have advocated for decades for a mechanism for restructuring small businesses similar to chapter 12 of the Bankruptcy Code,[9] which governs reorganization of family farmers. Chapter 12 was adopted to allow family farmers with regular income to reorganize by paying off debt over three to five years, without many of the barriers of chapter 11. No committee is appointed, a trustee oversees the restructuring but does not operate the business, and owners of family farms can keep their businesses without significant infusions of new value.[10] SBRA was modeled after chapter 12 and is expected to provide similar benefits to small businesses.

By October 9, 2020, over 1000 subchapter V cases had been filed across the United States.[11] In Michigan, 18 subchapter V cases had been filed.[12] The U.S. Trustee program has appointed about 250 subchapter V trustees, including five in the Eastern District of Michigan, and three in the Western District of Michigan. More than 80 percent of small businesses have elected to file under subchapter V since its enactment. In addition, about 36 percent of chapter 11 filings have been under subchapter V. While further data is needed to assess the success of SBRA, including the percentage of plans that are confirmed, initial indicators are that the SBRA is filling a critical need.[13]

Some of the benefits of the subchapter V election that streamline chapter 11 making it less costly and more accessible include:

1. An unsecured creditors committee is only ordered by the court for cause, potentially reducing cost as the debtor will not be required to pay for the Committee's professional fees;[14]
2. Costs and expenses (administrative claims) that accrue after filing of the bankruptcy case do not need to be paid at confirmation but can be spread out over time and paid pursuant to a confirmed chapter 11 plan;[15]
3. The "absolute priority rule" does not apply and owners of small business-

es can keep equity without making substantial contributions to the plan even though senior classes of creditors are not paid in full;[16]
4. Debtor's counsel may be disinterested even if it is owed up to $10,000 in pre-petition debt, thus conserving cash for the debtor to operate in chapter 11;[17]
5. No United States Trustees fee is required;[18] and
6. Only the debtor can file a plan, which must be filed within 90 days of the petition date, avoiding drawn out cases and additional expenses.[19]

Eligibility

The SBRA has modified the rules of reorganization for small businesses to address some of the obstacles to chapter 11.

To qualify for SBRA, an individual or entity must have been engaged in commercial or business activity with non-contingent liquidated secured or unsecured debt in an amount not to exceed $7,500,000 until March 27, 2022.[20] That cap was increased in light of the COVID-19 pandemic, which caused unprecedented disruption to the economy causing financial distress to large and small businesses alike. To assist businesses affected by the pandemic, Congress enacted the CARES Act,[21] which increased the debt limit for small businesses under the SBRA to $7,500,000 to allow more small businesses to elect SBRA treatment under chapter 11.[22] This debt limit applies to debtors filing prior to March 27, 2022.[23]

At least 50 percent of the aggregate noncontingent liquidated debt must have arisen from commercial or business activities of the debtor. The definition of "small business debtor" in 11 USC 101(51D) states:

> a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owing single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than $2,725,625 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor;

The SBRA does not require that the debtor *remain engaged* in commercial or business activities post-petition, but the relevant debt must be at least 50 percent business debt. Thus, an individual guarantor of business debt could file for reorganization under the SBRA if it meets other requirements. Of note, a single asset real estate debtor, as defined in the Bankruptcy Code, is not eligible to elect subchapter V of chapter 11.[24]

Debtor in Possession

Pursuant to SBRA, the debtor remains in possession and operates its business, subject to the oversight of a subchapter V trustee and other limitations of SBRA.[25] A debtor-in-possession can be removed for cause, after notice and a hearing. "Cause" includes "fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after the commencement of the case, or for failure to perform the obligations of the debtor" under a confirmed plan.[26] If the debtor is removed for cause, the subchapter V trustee takes over the operations and duties of the debtor-in-possession.[27]

Subchapter 5 Trustee

Subchapter V provides for a trustee in all cases.[28] The principal duty of the subchapter V trustee is to "facilitate the development of a consensual plan of reorganization."[29] The United States Trustee appoints the subchapter V trustee from a list of approved trustees[30] maintained by the Bankruptcy Court. The appointed trustee does not operate the debtor's business, but rather supervises and monitors the case and participates in the development and confirmation of a plan.[31] The subchapter V trustee does not investigate the debtor, its assets, or financial condition, unless the court so orders, for cause, on request of a party in interest, the court or the subchapter V trustee, or the United States Trustee.[32]

The subchapter V trustee will appear at required status conferences and is also tasked with attending any hearings that concern the value or sale of property, or confirmation or modification of the chapter 11 plan.[33] The subchapter V trustee is not specifically tasked with attending the initial meeting of creditors with the United States Trustee but query whether inviting the subchapter V trustee to attend that meeting might facilitate resolution of the case.

The debtor and his attorney should reach out to the subchapter V trustee early in the case to develop strategy for confirmation. The subchapter V trustee can be an ally to

the debtor, assisting with negotiations with creditors and supporting the plan confirmation. The subchapter V trustee is paid by the debtor,[34] so cooperation with the subchapter V trustee and full disclosure is in the debtor's interest.

Bankruptcy Timeline

The first key event in the timeline of a subchapter V case is to elect whether to have subchapter V apply.[35] This election must be made in the petition.[36] The SBRA is silent on whether this timeline can be amended, but practically, any amendment would have to be made in time to comply with other deadlines in the SBRA.

After filing, all of the traditional chapter 11 steps must be accomplished including filing first day motions and obtaining necessary relief, filing schedules and statement of financial affairs, and 341 meeting of creditors. In subchapter V, the debtor must also meet with the subchapter V trustee. After the bankruptcy petition is filed, the U.S. trustee sends the debtor Operating Instructions and Reporting Requirements to the debtor and schedules the initial debtor interview ("IDI"). The U.S. trustee conducts the IDI, and the debtor, the debtor's counsel, and potentially the subchapter V trustee attend.

Within 60 days of the filing, the bankruptcy court shall hold a status conference "to further the expeditious and economical resolution" of the case.[37] Fourteen days prior to the conference, the debtor must file a report detailing the efforts to attain a consensual plan of reorganization.[38]

The debtor's chapter 11 plan must be filed within 90 days after the petition is filed. This deadline can only be extended under "circumstances for which the debtor should not justly be held accountable."[39] Unlike traditional chapter 11 cases, only the debtor may file a plan of reorganization, and there is no deadline by which the plan must be confirmed.[40]

The debtor will receive a discharge upon confirmation if the plan is consensual.[41] For cramdown plans, discharge occurs when the debtor completes plan payments for at least three years.[42]

The Plan

While the plan process under SBRA is similar to a plan in regular chapter 11 cases, there are significant differences.[43] First, unless the court orders otherwise, no separate disclosure statement is required.[44] That said, the plan must include certain information that is traditionally included in the disclosure statement such as a brief history of the business operations of the debtor, a liquidation analysis, and projections that show the debtor can make the payments under the plan.[45] Second, plan confirmation does not require that at least one impaired class of creditors accept the plan.[46] Thus, a chapter 11 plan under subchapter V may be "crammed down" without the consent of any creditors, provided the plan "is fair and equitable, with respect to each class of claims or interests that is impaired under … the plan."[47] Third, only a debtor may propose a plan.[48]

Finally, and perhaps most significantly, the equity holders of the debtors may retain their equity even if senior creditors are not paid in full, and even if senior creditors do not consent, provided the plan otherwise meets the standards for confirmation.[49]

The plan must provide for submission of all or such portion of the future earnings of the debtor to pay the trustee and to execute the plan.[50] The SBRA also allows a debtor's plan to modify a lien on the debtor's personal residence if the loan proceeds were used primarily to fund the debtor's business.[51]

The plan may be confirmed over the objection of creditors "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted the plan."[52] For secured creditors, the definition of fair and equitable has not changed. The secured creditor must (i) retain its lien and receive at least the value of its assets, (ii) receive the proceeds of its assets from a sale, or (iii) receive the "indubitable equivalent" of such claims.[53] For unsecured creditors, a plan is fair and equitable if the debtor's projected disposable income is contributed to the plan over a three- to five-year period, or the amount contributed to unsecured creditors is at least the amount of the debtor's projected disposable income.[54] The plan must also be "feasible" in that either (i) the debtor is able to make all payments under the plan; or (ii) there is a reasonable likelihood that the debtor can make all the payments, and there is a remedy if that is not the case.[55]

What constitutes "disposable income" is expected to be highly litigated. "Disposable income" is defined as income that is not necessary for the maintenance or support of the debtor or a dependent of the debtor, is not needed to satisfy domestic support obliga-

To qualify for SBRA, an individual or entity must have been engaged in commercial or business activity with non-contingent liquidated secured or unsecured debt in an amount not to exceed $7,500,000 million until March 27, 2022.

tions, and is not an expenditure necessary for the "continuation, preservation, or operation of the business of the debtor."[56]

Consolidated Appropriations Act of 2021

In December 2020, subsequent to the enactment of SBRA, Congress passed the Consolidated Appropriations Act of 2021 ("CAA").[57] In addition to providing billions of dollars of pandemic relief, the CAA amended the Bankruptcy Code to provide additional relief to bankruptcy debtors in light of COVID-19. The primary changes for small business owners include:

1. Payroll Protection Loans: The CAA amends the Bankruptcy Code to permit debtors to obtain loans under the Paycheck Protection Program ("PPP") created by the CARES Act. The PPP provides forgivable loans for companies negatively affected by COVID-19. While resolving the split in decisions under existing caselaw, PPP loans are still uncertain for small businesses as the CAA provides that the Small Business Administration, which administers the PPP loan program, must approve of PPP loans during bankruptcy.[58]
2. Non-residential real property leases: The CAA amends subchapter V of the Bankruptcy Code to allow small business debtors an additional 60 days to perform under an unexpired lease of non-residential real property if the debtor has experienced material financial hardship due to COVID-19.[59]
3. Preference Protection: The CAA amends section 547 of the Bankruptcy Code to prohibit preference recoveries from certain creditors who received deferred rent or vendor payments under an agreement to defer or postpone payments.[60]

Conclusion

The SBRA is a valuable tool for a small business to reorganize. Despite the benefits of the SBRA, deciding whether to file chapter 11 and take advantage of the SBRA is a complex decision driven by multiple factors, including the financial status, cash flow, and goals of the debtor, and whether the debtor wants to stay in operation, sell the business as a going concern, or liquidate assets. Other options to consider include an out-of-court restructuring, liquidation of the business pursuant to a receivership, assignment for the benefit of creditors, or dissolution. If a small business decides to reorganize, advance planning with the help of professionals is critical. The SBRA process involves tight deadlines, and failure to have a plan of action prior to filing could mean failure to the debtor's restructuring efforts. With advance planning, use of the SBRA as a tool to reorganize can benefit all parties in interest, including the small business, its owners, employees, and creditors.

NOTES

1. 11 USC 1181-1195.

2. H.R. Rep. 116-171- Small Business Reorganization Act of 2019.

3. The United States Small Business Administration ("SBA") generally defines a "small business" as a business having fewer than 500 employees.

4. Note that prior to enactment of SBRA, a debtor could elect a "small business case" under chapter 11. This option remains in effect notwithstanding the creation of subchapter V. *See* 11 USC 101(51C).

5. *See, e.g*. https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf.

6. *Id*.

7. *See, e.g*. https://cdn.advocacy.sba.gov/wp-content/uploads/2019/04/23142651/2019-Small-Business-Profiles-MI.pdf.

8. *See, e.g*. https://www.sba.gov/sites/default/files/Business-Survival.pdf.

9. Bankruptcy commentators have been recommending a chapter 12 like reorganization structure for small businesses since before the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). *See e.g*., James B. Haines, Jr. & Philip J. Hendel, No Easy Answers: Small Business Bankruptcy After BAPCPA, 47 B.C.L. Rev. 71 (2005); http://lawdigitalcommons.bc.edu/bclr/vol47/iss1/5. Unfortunately, BAPCPA did not provide any real assistance to small business debtors.

10. 11 USC 1201, *et. seq*.

11. *See a*bi.org/sbra. *See also*, Ed Flynn, "*Subchapter V's First 1000 Cases*," Ed Flynn, ABI Journal, November 2020 (Vol. XXXIX, No. 11).

12. *Id.*

13. *Id.*

14. 11 USC 1102(a)(3), 1181(b).

15. 11 USC 1191(e).

16. The requirement from 1129(b)(2)(B)(ii) that senior classes of creditors must be paid in full, was not carried over into SBRA. *See also, Czyzewski v Jevic Holding Corp*, 137 S Ct 973 (2017), affirming the absolute priority rule; *Bank of America v 203 North Lasalle*, 526 US 434 (1999)(holding that equity cannot retain ownership if unsecured creditors are not paid in full absent substantial contribution of new value).

17. 11 USC 1195.

18. 28 USC 1930(a)(6).

19. 11 USC 1189.

20. 11 USC 101(51D).

21. The Coronavirus Aid, Relief and Economic Security Act (the "CARES Act"), enacted and effective March 27, 2020. The CARES Act was amended on March 26, 2021.

22. *Id*. Note that the CARES Act provided other relief to businesses including forgivable loans and other incentives.

23. *Id*.

24. *See* definition of "single asset real estate" under 11 USC 101(51B).

25. 11 USC 1184.

26. 11 USC 1185.

27. 11 USC 1183(b)(5).

28. 11 USC 1183(a). *See also* 11 USC 322(a) which was amended in connection with SBRA to require the subchapter V trustee to file a bond in the same manner as other trustees under the Bankruptcy Code.

29. 11 USC 1183(b)(7).

30. The list of private trustees for subchapter V programs is listed at https://www.justice.gov/ust/eo/private_trustee/locator/11Vcbc.htm#MI.

31. The United States Trustee program has outlined its expectations for the Subchapter V Trustee in various materials located at: https://www.justice.gov/ust/private-trustee-handbooks-reference-materials/chapter-11-subchapter-v-handbooks-reference-materials. For example, the United States Trustee has adopted a U.S. Department of Justice Handbook for Small Business Chapter 11 Subchapter V Trustees.

32. 11 USC 1183(b)(2).

33. 11 USC 1183(b)(3).

34. *See* 11 USC 330.

35. Bankruptcy Rule 1020(a).

36. *Id*.

37. 11 USC 1188(a).

38. 11 USC 1188(a).

39. 11 USC 1189(b).

40. Interim Bankruptcy Rule 3017.2 does provide for the court to establish the time for voting on a plan and setting a date for the hearing on confirmation.

41. 11 USC 1141(d)(1)(A).

42. 11 USC 1192.

43. Note that Michigan courts have not yet adopted a model plan for subchapter V cases. Other bankruptcy courts such as Maryland have adopted such a model plan that could be used as a template. *See* https://www.mdb.uscourts.gov/content/sbra-materials.

44. 11 USC 1187(c).

45. 11 USC 1190.

46. 11 USC 1129(a)(10).

47. 11 USC 1191(b).

48. 11 USC 1189(a).

49. Footnote 12, *supra*.

50. 11 USC 1190(2).

51. 11 USC 1190(3)(B).

52. 11 USC 1191(b).

53. 11 USC 1191(c)(1). 11 USC 1129(b)(2)(A). The definition of "indubitable equivalent" is highly litigated but may include surrendering collateral to the secured creditor and allowing a deficiency claim for any unsecured portion of the secured lender's debt.

54. 11 USC 1191(c)(2).

55. 11 USC 1181-1195.

56. 11 USC 1191(d).

57. H.R.133 - Consolidated Appropriations Act, 2021, 116th Congress (2019-2020)

58. *Id*. See section 320(a), amending 11 USC 364. This provision sunsets on December 27, 2022.

59. *Id*. See section 1001, amending 11 USC 365(d)(4). This provision is applicable to Subchapter V debtors that filed prior to December 27, 2022.

60. *See* section 1001, amending 11 USC 547. This provision sunsets on December 27, 2022.

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Ten Years Later, Access to Bankruptcy Court Has Never Been More Important

By Paul R. Hage

Introduction

The Eastern District of Michigan is home to a unique access to justice program that helps provide experienced consumer bankruptcy counsel, free of charge, to low-income individuals and families who reside in the district. The Pro Se Bankruptcy Assistance Project, which does business as Access to Bankruptcy Court ("ABC"), is a 501(c)(3) organization that was founded in 2010 by the recently retired Hon. Marci B. McIvor (Bankr. E.D. Mich.) and leaders of the local bankruptcy bar. The organization is proudly celebrating its tenth anniversary this year. In the wake of the COVID-19 pandemic, the services provided by ABC have never been more necessary.

Helping Individuals and Families Obtain a Fresh Start for Over Ten Years

It is an unfortunate reality that many of the individuals in our community who are most in need of a fresh start under the country's bankruptcy laws are unable to afford such relief. Because the filing of a chapter 7 bankruptcy case generally requires an individual to pay certain legal fees and costs up front, low-income debtors will frequently have no choice but to file their bankruptcy case *pro se*. In the Eastern District of Michigan, approximately 1400 *pro se* chapter 7 cases are filed annually.

The bankruptcy process is not an easy one to navigate. A *pro se* debtor is significantly less likely to receive the benefits of bankruptcy than a debtor with counsel is. Indeed, the discharge rate in *pro se* chapter 7 cases in our district is an alarmingly low 63 percent. Moreover, *pro se* debtors are often significantly worse off after an unsuccessful bankruptcy filing, as the law imposes consequences when a bankruptcy case is dismissed. Even when such cases are not dismissed, *pro se* debtors struggling to prosecute their own cases create significant challenges for the court, trustees tasked with administering such cases, and other parties in interest. ABC's goal is to help provide experienced counsel to as many qualified applicants as possible so that such applicants can obtain a fresh start.

After her appointment to the bench in 2003, Judge McIvor became very concerned about the number of *pro se* debtors appearing in her courtroom. This concern increased with certain amendments to the Bankruptcy Code that were passed in 2005, which made navigating chapter 7 bankruptcy cases substantially more difficult and expensive. Making matters worse, most of the local legal services organizations were unable or unwilling to take on bankruptcy cases.

In an effort to address this problem, Judge McIvor organized a group of leaders in the local bankruptcy community to create ABC. "We were concerned about the number of debtors who were unable to afford legal representation," stated Judge McIvor. "It is an access to justice issue. Individuals who have money can afford a lawyer and can take advantage of the protections provided by the Bankruptcy Code, whereas those who cannot afford a lawyer, frequently, cannot. It felt like we as a legal community could do better by such individuals."

ABC provides experienced counsel to low-income individuals in need of bankruptcy relief, who otherwise might have no choice but to seek relief *pro se.* An individual whose household income is at 150 percent of the poverty level or below (based on guidelines prepared by the U.S. Department of Health and Human Services) can apply for a free bankruptcy attorney through ABC. ABC reviews the individual's application to ensure that he or she qualifies and, if so, matches him or her to a volunteer panel attorney. More than forty highly experienced members of the local consumer bankruptcy bar serve as panel attorneys for ABC and agree to handle ABC cases for a substantially reduced rate ($400), which is paid by ABC. The individual receives high-quality bankruptcy representation, free of charge, and the case generally moves through the bankrupt-

cy court process without unnecessary issues or delays.

ABC also has an educational component. It collaborates with the Wayne State University Law School to pair volunteer law students who are interested in bankruptcy law with the ABC panel attorneys and the individual applicants. Students who participate in the student program get valuable experience assisting panel attorneys with, among other things, initial consultation with applicants, preparation of filings, and attendance at creditors' examinations and hearings. Panel attorneys who participate in the student program get the opportunity to mentor eager law students and share their knowledge of bankruptcy practice. Prior to participating in the student program, law students participate in a five-hour weekend training program run by local members of the bankruptcy bar where they learn the basics of consumer bankruptcy law.

ABC has produced very good results over the past decade. In the last three years alone, the organization has referred approximately 650 applicants to panel attorneys. The discharge rate in those cases that are filed is over 90 percent. Unique to our district, ABC has become a model for other districts in the federal judicial system that are struggling to address the problem of *pro se* consumer debtors in bankruptcy.

ABC Has Never Been More Important

In the wake of the COVID-19 health and economic crisis, the need for ABC is now greater than ever. Tens of millions of people have filed for unemployment in the United States since the crisis started. While government assistance programs have helped a number of people stay afloat, it is expected that consumer bankruptcy filings will increase substantially in the coming months and years. ABC's services protect people, now more than ever, from losing their home, their vehicles, and other important assets and enables such individuals to obtain a fresh start so that they can live successful lives and make positive contributions in their communities.

ABC has traditionally raised funds by soliciting donations from local law and consulting firms at its "Hon. Marci B. McIvor Annual Fundraiser for Access to Bankruptcy Court." Over 97 percent of the funds raised by ABC go directly to providing access to justice to low-income individuals. Unfortunately, due to restrictions related to COVID-19, ABC was forced to cancel its annual fundraiser event this year.

Undeterred, ABC's all volunteer board of directors, which consists of current and former members of the bankruptcy bench, members of the bankruptcy bar, and academics, decided to commence a fundraising campaign in order to raise funds to meet the anticipated need. This campaign has involved soliciting donations from local and national charitable foundations and bar organizations. ABC is proud that several important organizations have agreed to provide financial support.

Conclusion

ABC is an important access to justice program that emanated from the commitment of Judge McIvor and others to improve the justice system and make bankruptcy accessible to individuals who need relief, but who cannot afford counsel. Reflecting on the success of ABC over the past decade, Judge McIvor stated, "One of the most satisfying aspects of serving on the bench was being in a position to help create ABC and seeing it survive for over a decade. I feel very fortunate to be a part of this program, which provides such a benefit to people who are in need of legal representation." Due to the current economic crisis, the services provided by ABC are more essential than ever before. Without proper representation, individuals and families struggling to survive during these difficult times may unnecessarily lose the opportunity to preserve their assets and obtain a badly needed fresh start.

For more information about ABC, please visit ABC's website at www.accesstobankruptcycourt.com.

It is an unfortunate reality that many of the individuals in our community who are most in need of a fresh start under the country's bankruptcy laws are unable to afford such relief.

Paul R. Hage chairs the Insolvency & Reorganization Group at Jaffe Raitt Heuer & Weiss, P.C. and serves as the President of Access to Bankruptcy Court.

Federal Tax Collections in the Pandemic

By Stephen J. Dunn

A silver lining of the pandemic may be the opportunity it creates for taxpayers to favorably resolve their federal tax balances.

The Internal Revenue Service's offer in compromise ("OIC") program has had a rocky history. The program has been oft-abused by "tax resolution" scam artists. These operators use high-pressure sales techniques and take large retainers promising to "resolve" federal tax balances. Some of them are referral operations, advertising heavily, referring responding taxpayers to practitioners in their network and taking a cut of the fees. Many of these practitioners are not attorneys.[1] Large-scale tax resolution operations have been the subject of litigation brought by aggrieved former clients,[2] the Federal Trade Commission,[3] and state administrative agencies.[4]

The IRS has traditionally rejected most OICs, discouraging taxpayers from entering the program. In the last three fiscal years, the IRS' acceptance rate of OICs was as follows:

	Fiscal Year Ended September 30		
	2017	2018	2019
Number of OICs submitted	62,243	59,127	54,225
Percentage of OICs accepted	38.1%	37.8%	35.3%[5]

This institutional hostility to OICs has swelled the IRS' inventory of uncollectible taxes, to no benefit of the U.S. Treasury or taxpayers. But the IRS' attitude toward OICs may be changing, as we shall see.

The Offer in Compromise Program Generally

Internal Revenue Code 7122(a) authorizes the Internal Revenue Service to compromise federal income tax balances. But the statute provides little by way of specifics for the OIC program.

A lump-sum offer must be accompanied by down payment of 20 percent of the offer. A lump-sum offer is any offer payable in five or fewer monthly installments upon acceptance of the offer.[6]

A periodic payment offer is any offer payable in six or more but not more than 24 monthly installments.[7] In a periodic payment offer, the taxpayer must pay the first monthly installment with submission of the offer and continue making installments during the pendency of the offer.[8] If the taxpayer misses an installment, the offer may be deemed withdrawn.[9] It is far more advantageous for a taxpayer to make a lump-sum offer than a periodic payment offer, as explained below.

The regulations authorize three grounds for OICs: doubt as to liability, doubt as to collectability, and to promote effective administration of tax.[10] But in practice, I have seen the IRS work OICs only on doubt as to collectability.

If the Internal Revenue Service does not return an OIC as non-processable, the IRS surely will take six months or more to assign the offer to an offer specialist. Once an offer is assigned to a specialist, the specialist typically takes six months or more to work the offer and to recommend acceptance or rejection of it. The offer specialist will have questions for the offeror taxpayer and may request documentation in support of the offer. The IRS typically the makes a counteroffer, and a negotiation ensues. An offer in compromise is deemed accepted if it is not rejected within 24 months after it is submitted.[11]

It the IRS will not agree with the taxpayer on an OIC, the taxpayer can seek review of the offer in the IRS Appeals Office and, failing that, petition the Tax Court to review the offer.

The statute of limitations on collection is one of the best tools available to a taxpayer in defending against a federal tax assessment. The collection statute of limitations is ten years, and it begins to run when tax is assessed—when a tax return is filed, or when tax is later assessed by audit.[12] Once the collection statute expires on an assessment, the Internal Revenue Service may no longer lawfully collect the assessment.[13] The collection statute is tolled (suspended) during the

pendency of an OIC, and for 30 days after the offer is rejected, while rejection of the offer is under review by the IRS Appeals Office.[14] The IRS is forbidden from levying (seizing) the offeror taxpayer's property while the collection statute is suspended.[15]

Filing an OIC that is ultimately not accepted is about the worst thing a taxpayer can do. The collection statute of limitations on the offeror taxpayer's tax assessments is extended by a year or more. The taxpayer is out payments made on the offer, including the 20 percent down payment made on a lump-sum offer. The taxpayer is out the professional fees incurred in making the offer—typically $5,000-$10,000. A taxpayer should make an OIC only if it is certain to be accepted.

A taxpayer who is not a candidate for an OIC has options to avoid IRS seizure of his property. These include contacting the IRS and requesting an installment agreement or that the taxpayer's accounts be posted as currently-not-collectible ("CNC"). In either case, the collection statute of limitations continues running on the taxpayer's tax assessments.

There are many strictures upon discharge of taxes in bankruptcy. Taxes are not dischargeable in bankruptcy with respect to a return, equivalent report or notice, if required—

> (i) was not filed or given; or
>
> (ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition.[16]

Taxes with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat the tax are not dischargeable in bankruptcy.[17]

> Income taxes are nondischargable—
>
> (i) for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition; [or]
>
> (ii) assessed within 240 days before the date of the filing of the petition, exclusive of—
>
> > (I) any time during which an offer in compromise with respect to that tax was pending or in effect during that 240-day period, plus 30 days; and
> >
> > (II) any time during which a stay of proceedings against collections was in effect in a prior case under this title during that 240-day period, plus 90 days.[18]

A tax required to be collected or withheld and for which the debtor is liable in whatever capacity is nondischargable.[19] These include trust fund taxes—income tax, Social Security tax, and Medicare tax withheld from employees' wages but not remitted to the taxing authority.

Employment taxes on wages earned from the debtor before the date of filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or any extension, within three years before filing of the petition, are nondischargable.[20] These would include trust fund taxes, as well as employer matching Social Security and Medicare tax.

A saving grace of taxes is that they are not "consumer debts" for purposes of 11 USC 707(b), providing for dismissal of a chapter 7 case filed by an individual debtor whose debts are primarily consumer debts, or, with the debtor's consent, for conversion of the case to chapter 13.[21]

In contrast, tax balances may be compromised, or the subject of an installment agreement or a CNC posting, notwithstanding the taxpayer's fraud. We will consider such a case below.

The Time May Be Right for an OIC

Two factors converge to make this an opportune time for many taxpayers to seek to compromise their tax balances with the IRS. First, the IRS is under increasing pressure from the National Taxpayer Advocate and Congress to accept more OICs.[22] In its 2019 Annual Report to Congress, the National Taxpayer Advocate noted that in its 2017 study of rejected OICs, the IRS had referred 82 percent of the cases for follow-up collection action. By 2019, the IRS had not been able to collect even the amount offered in 65 percent of the cases.[23] The Taxpayer Advocate noted that "[t]he IRS could be more efficient if it accepted viable offers rather than rejecting them or later assigning them to other Collection functions such as field collection, ACS [Automated Collection Service], or shelved status."[24] In view of the IRS' traditional hostility to OICs, this would be a big course correction for the IRS.

Second, the financial ravages of the pandemic have made many taxpayers better candidates for an OIC.

The Internal Revenue Service's offer in compromise ("OIC") program has had a rocky history. The program has been oft-abused by "tax resolution" scam artists.

The IRS will accept an OIC when it is unlikely that the tax liability can be collected in full and the amount offered reflects the taxpayer's reasonable collection potential ("RCP"). An OIC is a legitimate alternative to declaring a case currently not collectible or a protracted installment agreement. The goal is to collect what is potentially collectible at the earliest possible time and at the least cost to the government.[25]

RCP is the net realizable equity ("NRE") of the taxpayer's assets. NRE of the taxpayer's assets is the quick sale value ("QSV") of the assets, less amounts owed to secured lien holders with priority over the federal tax lien.[26] QSV is defined as—

> an estimate of the price a seller could get for the asset in a situation where financial pressures motivate the seller to sell in a short period of time, usually 90 calendar days or less. Generally, QSV is an amount less than fair market value (FMV).[27]

A taxpayer who is not a candidate for an OIC has options to avoid IRS seizure of his property.

QSV of a bank account is the account's current balance, except that the IRS allows an individual taxpayer to exclude the first $1,000 of cash.[28] QSV of a retirement account is the account's current balance less tax and penalties, which the taxpayer would incur on receiving distribution of the balance.[29]

QSV of a tangible asset, such as real property or a vehicle, normally equals 80 percent of the fair market value of the asset.[30]

In determining a taxpayer's RCP, the IRS adds a phantom asset for the taxpayer's future earning potential. The value of phantom asset is the excess of the taxpayer's actual monthly income over the taxpayer's *allowable* monthly expenses, multiplied by a factor.[31] For a lump sum offer (payable in not more than five monthly installments), the factor is 12.[32] In the case of a periodic payment offer (payable in more than five but not more than 24 installments), the factor is 24.[33]

IRS collection financial standards, promulgated pursuant to IRC 7122(d), determine the taxpayer's allowable monthly expenses.[34]

Recent Examples of OICs

Some recent examples will illustrate the OIC program in practice. The first example demonstrates how, sadly, financial devastation of the pandemic can position taxpayers for favorable compromise of their federal tax balances. Over the years Mr. and Mrs. Roberts have not had enough income tax withheld from their wages, nor deposited sufficient estimated taxes, so that they owe federal income tax totaling $400,000. The Roberts have two minor children. The Roberts own one car. The monthly payment on the car is $550. The balance due on the car exceeds the value of the car.

Mr. and Mrs. Roberts lease a second car. The monthly payment on the lease is $600.

The mortgage balance on the Roberts' home exceeds the house's fair market value. The monthly payment on the mortgage is $3500.

Mr. and Mrs. Roberts have $3,000 in a joint checking account. Mr. Roberts has a vested balance of $10,000 in an account with his employer's 401(k) retirement plan.

Mr. and Mrs. Roberts have monthly household gross income of $15,000.

The Roberts' monthly expenses, both actual and as limited by the IRS collection financial standards, are as follows:

	Actual	Allowed
Food, clothing, miscellaneous	$1,935	$1,740
Housing and utilities	4,100	2,267
Automobile operation	1,100	1,042
Automobile ownership	1,150	628
Out-of-pocket health care	240	224
Health insurance	900	900
Accountant/attorney fees	300	300
Retirement plan contribution	450	450
Monthly minimum payments on credit cards	600	600
Current taxes (federal and state income tax and FICA tax withheld from wages)	2,250	2,250
Total allowed		$10,401

Tuition or costs for attendance at college or private school are not expenses allowed by the IRS.

The IRS should not include a modest retirement account balance in a taxpayer's net worth for OIC purposes, but it does include them. However, the taxpayer should reduce

the retirement account balance by the federal and state tax and penalties the taxpayer would incur upon receiving distribution of the retirement account balance.

The minimum acceptable OIC from Mr. and Mrs. Roberts is $64,188, as follows:

Bank account balance, $3,000, less $1,000	$2,000
Vested balance in 401(k) account, $10,000, less estimate of tax and penalties that would be incurred on receiving distribution of same, $3,000	$7,000
Excess of monthly actual gross income, $15,000, over allowable monthly expenses, $10,401, or $4,599, multiplied by 12	55,188
Minimum acceptable offer	$64,888

At the onset of the pandemic, in March 2020, Mr. Roberts' compensation was cut in half, and Mrs. Roberts lost her employment. In view of the Roberts' sharply reduced income, in April 2020, we filed an offer to compromise the Roberts' federal tax balances for $9,000, payable in five installments. In October 2020, the IRS wrote to us saying that the case had been assigned to an offer specialist, and that we would hear from the specialist by February 2021.

The second example shows how the misfortune of a serious illness can help an offer in compromise. Michael embezzled over $400,000 from his employer before the scheme was discovered and Michael was prosecuted.

Upon being convicted of embezzlement, Michael filed an income tax return reporting all of his embezzlement income. Yes, embezzlement proceeds are gross income.[35] Filing the tax return early on reporting the embezzlement income was wise because it started the ten-year collection statute of limitations running on the assessment.

After his release from prison, Michael found a compassionate employer, and he has worked there since. But his assessed tax balance remains, albeit further down the collection statute of limitations road. His outstanding balance of tax, accrued interest, and penalties now exceeds $400,000.

In August 2019, we filed an OIC for Michael based upon the following facts:

Monthly gross compensation		$4,946
Monthly allowable expenses:		
Food, clothing, and miscellaneous	$977	
Housing and utilities	1,367	
Auto operating costs	277	
Health insurance premiums	161	
Out-of-pocket health care costs	193	
Court-ordered restitution payments	774	
Term life insurance premium	42	
Current taxes (federal, state, Social Security, Medicare)	523	
Monthly payment on delinquent state and local taxes	150	
Total monthly allowable expenses		4,464
Monthly excess of gross income over allowable expenses		482
Multiply by 12 months for lump-sum offer		x 12
Phantom asset required to be added to determine Michael's RCP		$5,784

Michael has no valuable assets. But IRS policy requires the inclusion of a non-existent asset valued at $5,784 in determining Michael's RCP. An OIC must offer at least the taxpayer's RCP, so we offered $6,000 to the IRS in complete compromise and settlement of Michael's federal tax balance owing. As required by IRS policy, Michael made a down payment of 20 percent of the offer, $1,200, and offered to pay the $4,800 balance in five monthly installments of $960 each beginning upon acceptance of the offer.

By March 2020, we had not heard from the IRS on the offer. I called Michael. He said that due to the pandemic, he was no longer receiving incentive pay, sharply curtailing his income. He also said that he had been diagnosed with stage three colon cancer. He had undergone surgery by which part of his colon had been removed, and he was receiving chemotherapy and radiation treatments. Michael is 64 years of age.

In view of the reduction in Michael's income, and the doubt now cast upon Michael's ability to continue working, we amended Michael's OIC to the $1,200 Michael had paid to the IRS initially with his offer. We en-

The IRS will accept an OIC when it is unlikely that the tax liability can be collected in full and the amount offered reflects the taxpayer's reasonable collection potential ("RCP").

closed with the amended OIC a letter from Michael's physician confirming his cancer diagnosis. An IRS offer specialist contacted me in July 2020 concerning the offer. The specialist recommended acceptance of Michael's amended offer. Indeed the amended offer has been accepted. According to the terms of the offer, Michael must remain a compliant taxpayer for the next five years. This means that Michael must timely file income tax returns, and timely pay the tax owing on them. The IRS reserves the right to revoke Michael's offer if Michael fails to remain a compliant taxpayer over the next five years.

The third example demonstrates an all-too-common abuse of the OIC program by a charlatan looking to make a quick buck on the program. Mr. and Mrs. Allen did not know it, but the tax preparer to whom they had been referred was a fraudulent operator. He took the Allens' information. The Allens assumed that he had filed their 2010-2012 income tax returns. The preparer filed a 2012 income tax return, and 2006-2009 amended income tax returns, using the Allens' names and Social Security numbers but a different address. The tax returns claimed enormous, fraudulent refunds. The IRS actually paid some of the refunds, sending the checks to the address on the returns. The preparer forged the Allens' signatures to the refund checks and cashed them. The preparer never filed income tax returns for the Allens for 2009 or 2010.

The IRS had the preparer and his cohorts civilly enjoined from continuing the scheme. The U.S. Justice Department prosecuted the preparer and his cohorts, convicted them, and had them imprisoned.

Meanwhile, the IRS assessed heavy penalties against the Allens for filing frivolous 2006-2009 amended income tax returns. In addition, the IRS examined the 2009 fraudulent income tax return filed by the preparer using the Allens' identities and assessed substantial tax and penalties against the Allens concerning it. The IRS sent these assessments to the Allens at the address used by the preparer concerning them—meaning, of course, that the Allens never received notice of the assessments.

Eventually, the IRS began sending correspondence to the Allens at their correct address demanding payment of the assessments and accrued interest. The Allens consulted their current accountant about the assessments. The accountant saw the assessments as an opportunity to get a few thousand dollars in fees from the Allens and filed an OIC for them. The IRS allowed the offer to remain extant, with the collection statute of limitations on the Allens' assessed tax balances tolled, for over a year before finally rejecting their offer.

The Allens were not candidates for an OIC. An OIC accepts the validity of assessments and seeks to compromise them to the taxpayer's NRE. The assessments against the Allens were the product of fraud. Notice of the assessments was sent to the Allens at their last known address. The Allens had neither notice of the assessments nor an opportunity to contest them. As the assessments were devoid of due process of law, they cannot stand.

The Allens needed to file actual income tax returns for 2009, 2010, and 2012. The 2009 income tax return filed by the fraudulent operator using the Allens' identities was a fraudulent document and a nullity. In the confusion, the Allens had not filed income tax returns for 2010 or 2012.

The Allens also needed to file Form 14157, Tax Preparer Complaint, and Form 14157-A, Tax Return Preparer Fraud or Misconduct Affidavit, with supporting documents, concerning the fraudulent 2006-2009 amended income tax returns filed by the preparer and the consequent frivolous return penalties.

We made the necessary filings for the Allens. The IRS has not yet responded. We will litigate for the Allens if necessary, but it should not be necessary.

The fourth example also concerns abuse of the OIC program. Mr. Collins withdrew $200,000 from his 401(k) account so that he and his wife could make a down payment on a new house in an upscale neighborhood. Mr. Collins thought he would be able to restore the funds to his 401(k) account with a bonus he was expecting from his employer, but things did not work out as he planned. By the time Mr. Collins came to me, tax, accrued interest, and penalties on the withdrawal totaled more than $350,000, and mortgage indebtedness encumbering the house far exceeded the value of the house. The Collins owe large amounts of credit card debt.

Mr. Collins had been referred to an enrolled agent ("EA") for help with the tax assessment. An EA is an individual who is—

> eighteen years of age or older who demonstrates special competence in tax matters by written examination

> administered by, or administered under the oversight of, the Internal Revenue Service, who possesses a current or otherwise valid preparer tax identification number or other prescribed identifying number, and who has not engaged in any conduct that would justify the suspension or disbarment of any practitioner … .[36]

In other words, an EA need not even have a college degree.

The EA said he could easily take care of the assessment with an OIC and pressured Mr. Collins to pay him a $5,000 retainer. Mr. Collins paid the $5,000 retainer to the EA.

The EA did not even ask Mr. Collins about his family's monthly income and allowable expenses, the starting point for determining whether they were candidates for an offer in compromise. The EA does not have an office, and he works out of his apartment.

Mr. and Mrs. Collins are not candidates for an OIC. Their income is much too high. They would have to make a lump-sum offer of at least $120,000 for the IRS to process it. They would have to make a nonrefundable down payment of 20 percent of the offer, or $24,000. They do not have available that amount of cash, especially not to pay down on an OIC, which will likely be rejected.

The EA never filed an OIC for Mr. and Mrs. Collins. We have requested a Due Process Collection hearing from the IRS for Mr. and Mrs. Collins. We have also requested an installment agreement from the IRS for Mr. and Mrs. Collins. Either request stays IRS collection action against Mr. and Mrs. Collins. I have referred Mr. and Mrs. Collins to bankruptcy counsel. But if the Collins' consumer debts preponderate, 11 USC 707(b) will preclude them from proceeding under chapter 7, leaving chapter 13 reorganization the only form of bankruptcy relief available to them.

At my urging, Mr. Collins contacted the EA and requested a refund of the $5,000 retainer that he paid to the EA. The EA did not respond.

Taxpayers tend to feel hopeless at the immense power of the IRS. Of course, I need to do everything I can to legally protect Mr. and Mrs. Collins. Beyond that, I need to continuously reassure Mr. Collins that everything will be all right. And so it will be.

The IRS could eliminate the vast majority of abuses, such as those described above, if it would allow only licensed attorneys to represent taxpayers in offers in compromise and other tax controversies.

It's About Helping People

From the above you might think that I solicit tax collection cases. I do not. Tax collection is the only area of my practice where I have trouble getting paid for my work. I handle tax collection cases for the good of the public, in gratitude for the great privilege of practicing law.

Postscript

As of April 1 2021, the IRS had rejected the Roberts' offer in compromise. We are appealing the case to the IRS Appeals Office, which has broad discretion to grant relief.

The IRS accepted Michael's amended offer of his $1,200 payment in full compromise and settlement of his federal tax balance exceeding $400,000.

The IRS still has not relieved the Collins of the consequences of the fraudulent tax returns filed making unauthorized use of their identity. We therefore filed a civil action against the United States under 26 USC 6325 seeking money damages and attorney fees suffered by the Collins from the government's failure to record a release of the unlawful Notices of Federal Tax Lien recorded against the Collins. We included a *Bivens* claim against the Commissioner of Internal Revenue alleging that he has used the color of his office to deny the Collins liberty and property without due process of law in violation the Fifth Amendment to the U.S. Constitution.

NOTES

1. *See* 31 CFR 10.3, authorizing attorneys, certified public accountants, and enrolled agents to practice before the Internal Revenue Service.

2. *E.g., DeLong v TaxMasters, Inc*, 2011 WL 3715251 (CD Cal 2011) and *JK Harris & Co v Sandlin*, 942 NE2d 875 (Ind App 2011) (class actions).

3. *E.g., Federal Trade Comm'n v American Tax Relief, LLC*, 2012 WL 12886197 (CD Cal 2012).

4. *E.g., Cox v State*, 448 SW3d 497 (Tex Ct App 2014), reconsideration en banc denied (Sept 5, 2014), review denied (Apr 1, 2016).

5. Publication 2104, National Taxpayer Advocate Annual Report to Congress 2019 (Dec 31, 2019), at p. 307, available at www.TaxpayerAdvocate.irs.gov/2019AnnualReport.

6. IRC 7122(c)(1)(A); IRM 5.8.1.15.4(3) a (Dec. 26, 2019); Form 656 Booklet, Offer in Compromise, at p.3 (Apr 2020).

7. IRC 7122(c)(1)(B); IRM 5.8.1.15.4(3) b (Dec. 26, 2019). An OIC may not be payable in more than 24

months. *Id.*; see generally Form 656 Booklet, Offer in Compromise, at p. 3 (Apr 2020).

8. IRC 7122(c)(1)(B)(i).

9. IRC 7122(c)(1)(B)(ii).

10. Treas. Reg. 301.7122-1(b).

11. IRC 7122(f).

12. IRC 6502(a)(1).

13. *Id.*

14. IRC 6501(c)(4)(A); Form 656, Offer in Compromise (Apr 2020), § 7(p).

15. Treas. Reg. (26 CFR) 301.7122-1(g)(1).

16. 11 USC 523(a)(1)(B).

17. 11 USC 523(a)(1)(C).

18. 11 USC 523(a)(1)(A), 507(a)(8)(A).

19. 11 USC 523(a)(1)(A), 507(a)(8)(C).

20. 11 USC 523(a)(1)(A), 507(a)(8)(D).

21. *E.g., In Re Jelinger*, 2014 WL 996266 at *4 (Bankr ND Ohio 2014) (income tax); *In the Matter of Burton*, 2013 WL 8351980 (Bankr SD Iowa 2013) (income tax). *See also In Re Kintzele*, 2103 WL 218856 at *1 (Bankr ED NC) (income tax); *In re Brashers*, 216 BR 59, 61 (Bankr ND Okla 1998) (income tax); *In re Traub*, 140 BR 286, 288-289 (Bankr D NM 1992) (income tax and trust fund recovery penalty).

22. Created in the Taxpayer Bill of Rights 2, Public Law 104-168, 110 Stat. 1452, the Office of Taxpayer Advocate exists to—

assist taxpayers in resolving problems with the Internal Revenue Service,

identify areas in which taxpayers have problems in dealings with the Internal Revenue Service,

to the extent possible, propose changes in the administrative practices of the Internal Revenue Service to mitigate problems identified under clause (ii), and

identify potential legislative changes which may be appropriate to mitigate such problems.

Public Law 104-168, § 101(d)(2), 110 Stat. 1454. The National Taxpayer Advocate is appointed by the Commissioner of Internal Revenue, and reports directly to the Commissioner. Public Law 104-168, § 101(d)(1), 110 Stat. 1454.

23. Publication 2104, National Taxpayer Advocate Annual Report to Congress 2019, at p. 92.

24. *Id.*, at p. 93.

25. IRM 5.8.1.2.2(1) (Dec 26, 2019).

26. IRM 5.8.5.4.1(1) (Sept 30, 2013).

27. IRM 5.8.5.4.1 (2) (Sept 30, 2013).

28. IRM 5.8.5.7(1) (Mar 23, 2018).

29. IRM 5.8.5.10 (4) (Mar 23, 2018).

30. IRM 5.8.5.4.1 (4) (Sept 30, 2013). A higher or lower percentage may be applied in determining QSV when appropriate, depending on the type of asset and current market conditions. *Id.*

31. Form 433-A (OIC), Collection Information Statement for Wage Earners and Self-Employed Individuals (Apr., 2020), at § 7.

32. *Id.* at § 8.

33. *Id.*

34. The IRS' collection financial standards are at https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards.

35. *James v United States*, 366 US 213, 219-20 (1961).

36. 31 CFR 10.4(a).

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Reclamation Is [Mostly] Dead, but Has It Been Reincarnated?

By Ronald A. Spinner and Megan R.I. Baxter-Labut

With many bankruptcy cases looming on the horizon as a result of the COVID-19 pandemic, prudent sellers are reacquainting themselves with all of their rights. Some sellers have heard of "a right of reclamation" that sometimes was helpful in bankruptcy cases, but they are not clear on what it means or entails. Others believe that there used to be such a right, but they have been told that changes to bankruptcy law gutted the right, leaving sellers without meaningful recourse to it. The common theme is that many vendors (and, to their chagrin, many of their attorneys) are uncertain as to the status and scope of the reclamation remedy, but they wish to get up to speed—and fast.

The rumors above are largely true. Reclamation is a right that used to be more helpful to sellers in a bankruptcy setting, but changes to bankruptcy law have substantially reduced its value. Those legal changes created an additional right of similar utility to the reclamation right, however. As will be noted below, there are still times when assertion of the right of reclamation and its enforcement in bankruptcy can be helpful—if done properly.[1] This article explains what reclamation used to be, what it is today and how it got there, and discusses how sellers can use the right of reclamation and the related right under section 503(b)(9) of the U.S. Bankruptcy Code today.

Reclamation Overview

To begin, reclamation is a right created by state law, not bankruptcy law. It is the right of a seller to take back goods sold on credit terms to an insolvent buyer. This right is codified in section 2-702(2) of the Uniform Commercial Code ("UCC"). Under section 2-702(2), if a seller discovers that its customer has received its goods on credit while insolvent, the seller can reclaim the goods upon demand made within ten days after the receipt of the goods. Because of this short ten-day window, the right tends to only benefit vigilant sellers who continuously monitor their buyers for indicia of insolvency. The window is eliminated, however, if the buyer made a written misrepresentation of solvency within three months before delivery. *See* UCC 2-702(2).

The seller's right to reclaim is subject to the rights of a buyer in the ordinary course of business, or other good faith purchaser, or to a lien creditor. *See* UCC 2-702(3). The UCC is silent on whether the demand for reclamation must be in writing, or can be made orally.

What happens when a reclamation seller and a secured creditor seek to satisfy debts from the same goods? Usually, the secured creditor wins. The application of UCC section 2-702(2) is limited by section 2-702(3), which states, "[t]he seller's right to reclaim under subsection (2) is subject to the rights of a buyer in the ordinary course or other good faith purchaser under this Article (section 2-403)." This means that a seller's right of reclamation is subject to the rights of certain third parties, such as "ordinary course or good faith purchasers." Because section 2-702(3) refers to section 2-403, which governs the power of a party to transfer good title, lien holders are included in the list of third parties with superior rights.

Section 2-403 states that a buyer with voidable title can transfer good title to a good faith purchaser for value. *See* UCC 2-403(1). Several courts have decided that a secured creditor with a floating blanket lien on inventory is a good faith purchaser. *In re Circuit City Stores, Inc*, 441 BR 496, 509 (Bankr ED Va 2010) (citing *U.S. Billiards Co, Inc v Greenberger (In re Bensar Co)*, 36 BR 699, 703 (Bankr SD Ohio 1984) (holding that secured creditor qualifies as purchaser); *Harris Tr & Sav Bank v Wathen's Elevators, Inc (In re Wathen's Elevators, Inc)*, 32 BR 912, 919–20 (Bankr WD Ky 1983) (same); *RJ Reynolds Tobacco Co v Friedwald (In re Bowman)*, 25 UCC Rep. Serv. 738, 742–44, *available at* 1978 WL 23499 (Bankr ND Ga 1978) (same); *In re American Food Purveyors, Inc*, 17 UCC Rep. Serv. 436, 441, *available at* 1974 WL 21665 (ND Ga 1974) (conceding that Code definition of "purchaser" is broad enough to include Article 9 secured creditor).

In practice, many (perhaps most) of a seller's customers will have granted floating liens on their assets (for example, their inventory) to lenders to secure debts. Absent any indication that it acted other than in good faith, a secured creditor is a purchaser, and the seller's reclamation right is subject to the secured creditor's interest in the goods, vastly limiting (or eliminating) the seller's reclamation right. This means, there are two possible outcomes when the shipped goods are subject to a lender's lien.

If the secured creditor is undersecured, the seller cannot reclaim the goods because of the priority afforded to the secured creditor. *See e.g. In re Dana Corp*, 367 BR 409, 419 (Bankr SDNY 2007) (applying post-BACPA law, "if the value of any given reclaiming supplier's goods does not exceed the amount of debt secured by the prior lien, that reclamation claim is valueless"). But, if the secured creditor is oversecured, the seller may be able to reclaim the goods that remain after the secured creditor's lien is satisfied. *See e.g. Galey & Lord, Inc v Arley Corp (In re Arlo Inc)*, 239 BR 261, 272 (Bankr SDNY 1999) (applying pre-BACPA law, "it is only when the reclaiming seller's goods or traceable proceeds from those goods are in excess of the value of the superior claimants' claim that the reclaiming seller will be allowed either to reclaim the goods or receive an administrative claim or lien in an amount equal to the goods or receive an administrative claim or lien in an amount equal to the goods that remain after the superior claim has been paid").

To begin, reclamation is a right created by state law, not bankruptcy law. It is the right of a seller to take back goods sold on credit terms to an insolvent buyer.

There is split in authority as to whether the presence of a superior lien merely subordinates the seller's right of reclamation, or if the superior lien outright terminates the seller's right of reclamation. *See, e.g., Toyota Indus Trucks USA, Inc v Citizens Nat'l Bank of Evans City*, 611 F2d 465, 473 & n 6 (3d Cir 1979) (holding reclamation seller's right to reclaim is subordinate to secured creditor's perfected security interest); *Pester Refining Co v Ethyl Corp (In re Pester Refining Co)*, 964 F2d 842, 846 (8th Cir 1992); *Bindley W Indus v Reliable Drug Stores, Inc*, 181 BR 374 (SD Ind 1995), *aff'd sub nom. In re Reliable Drug Stores, Inc*, 70 F3d 948 (7th Cir 1995) (holding that, although seller's reclamation rights were subject to the bank's prior perfected security interest, bank's interest subordinated and did not extinguish the seller's reclamation right); *c.f. United States v Westside Bank*, 732 F2d 1258 (5th Cir 1984) (non-bankruptcy case holding that seller's right of reclamation was extinguished by secured creditor's foreclosure); *In re Roberts Hardware Co*, 103 BR 396, 398 (Bankr NDNY 1988) (holding that secured creditor's superior status precludes the seller's ability to exercise its right of reclamation). Before 2005, a seller was largely indifferent on the court's decision to determine its right was subordinated or extinguished because under the old version of section 546(c)(2), if a seller was denied its reclamation right, the court had to award the seller an alternative remedy.

Reclamation in Bankruptcy Pre-BAPCPA

Prior to amendment in 2005, the Bankruptcy Code did not limit reclamation rights. At that time, section 546(c) ("Prior § 546(c)") stated

> Except as provided in subsection (d) of this section, the rights and powers of a trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, but
>
> (1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods
>
> (A) before 10 days after receipt of such goods by the debtor; or
>
> (B) if such 10-day period expires after the commencement of the case, before 20 days after receipt of such goods by the debtor; and
>
> (2) *the court may deny reclamation to a seller* with such a right of reclamation that has made such a demand *only if the court*
>
> (A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or
>
> (B) secures such claim by a lien. (emphasis added).

With the exception of requiring the seller to make its demand in writing, the UCC and Prior § 546(c) were largely harmonious. Even the ten-day window for making the reclamation demand was mirrored in the Bankruptcy Code.

As previously discussed, under the UCC and Prior § 546(c), a seller's reclamation right was subject to a secured creditor's lien on the goods, which could subordinate or termi-

nate the right. In either case, when a seller's reclamation right was denied, Prior §546(c)(2) provided that a reclaiming seller was to be granted an administrative expense priority claim or a lien. *See e.g. Isaly Klondike Co v Sunstate Dairy & Food Prods Co (In re Sunstate Dairy & Food Prods Co)*, 145 BR 341 (Bankr MD Fla 1992) (awarding an administrative expense to a seller under § 546(c)(2) when denied reclamation).

Caselaw was divergent on the *amount* of the seller's alternate remedy under Prior § 546(c)(2), though. Some courts held that the reclaiming seller's remedy was for the full amount of the valid reclamation claim. *See, e.g., In re Sunstate Dairy & Food Prods Co*, 145 BR at 345-46 (holding that seller's reclamation claim was for the value of the goods in the debtor's possession when the reclamation demand was received); *In re Diversified Food Serv Distribs, Inc*, 130 BR 427, 430 (Bankr SDNY 1991) (same); *In re Marko Elecs, Inc*, 145 BR 25, 29 (Bankr ND Ohio 1992) (holding that claim was for the total amount of goods subject to reclamation).

The majority view, though, was that the seller's remedy was limited to what the seller would have received outside of bankruptcy after the superior claim was satisfied. *See, e.g., In re Victory Markets Inc*, 212 BR 738, 741 (Bankr NDNY 1997) (holding that purpose of [Prior] §546(c) was to recognize right to reclamation that seller may have under nonbankruptcy law); *Galey & Lord Inc v Arley Corp (In re Arlco, Inc)*, 239 BR 261 (Bankr SDNY 1999) (holding goods or proceeds must have value exceeding that of superior claim for reclaiming seller to receive administrative claim or lien in an amount equal to value of remaining goods because bankruptcy filing does not enhance reclaiming seller's rights); *Pester Refining*, 964 F2d at 845; *In re Leeds Bldg Prods, Inc*, 141 BR 265, 268 (Bankr ND Ga 1992) (same).

Essentially, Prior § 546(c) balanced competing interests. That is, the debtor could continue to use the goods for its operations and grant liens to post-petition lenders in exchange for financing, and the reclamation seller received a high-priority claim without having to actually reclaim the goods. (This is what most sellers would prefer in any event—a good chance at cash instead of the opportunity to resell their goods.) In nearly every situation, it made sense for a seller to assert its reclamation rights, because the seller would likely receive *something*. In some instances, the claim the seller would receive in bankruptcy would exceed what the seller would have received outside of bankruptcy. For example, outside of bankruptcy, the seller's reclamation demand is satisfied by the return of the goods—in whatever reduced condition they may be. Then, the seller incurs costs to re-sell the goods, and often, they are worth less on re-sale. Compare to the same seller who asserted a reclamation claim under § 546(c) and was awarded a high priority claim in the amount of the value of the goods when they were sold the first time. That seller received more money in bankruptcy than it would have asserting reclamation under the UCC.

Reclamation in Bankruptcy After BAPCPA

This changed when Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") to 11 USC 546(c) of the Bankruptcy Code in 2005. The changes appeared to enhance sellers' reclamation rights, but, in reality, they restricted sellers' chances of a meaningful recovery when their goods cannot be reclaimed. Section 546(c)(1) now states

> Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods
>
> (A) not later than 45 days after the date of receipt of such goods by the debtor; or
>
> (B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

Section 546 also states that a seller's failure to assert such a claim does not impair its rights under section 503(b)(9), which will be discussed later. 11 USC 546(c)(2).

The good news is that the amendment expanded the reclamation reach-back period

Prior to amendment in 2005, the Bankruptcy Code did not limit reclamation rights.

in two ways. First, the look-back period before bankruptcy during which goods may be subject to reclamation was expanded to 45 days. *See* § 546(c)(1)(A). Second, the time a seller has to file its notice of reclamation after a bankruptcy filing was expanded to 20 days. *See* § 546(c)(1)(B). Allowing sellers more time to make a reclamation claim is always advantageous to them. However, in situations where the buyer is not in possession of the goods and the goods are subject to the superior interest of a secured creditor, BAPCPA significantly limited a seller's recovery.

Before BAPCPA, if a bankruptcy court denied the seller its reclamation claim, the seller was afforded an alternative remedy in the form of an administrative claim or a lien. *See* Prior § 546(c)(2). BAPCPA removed the language that provided for alternative relief. Some bankruptcy courts have interpreted the change to mean that they are *prohibited* from granting a reclaiming seller an administrative claim when the goods cannot be reclaimed.

Before BAPCPA, if a bankruptcy court denied the seller its reclamation claim, the seller was afforded an alternative remedy in the form of an administrative claim or a lien.

For example, a bankruptcy court in Nebraska recently denied a seller's request for administrative claim based on its reclamation rights. *In re Specialty Shops Holding Corp,* No. 19-405, 2020 WL 4260516 (D Neb July 24, 2020). In *Specialty Shops*, McKeeson, a pharmaceutical supplier, sold goods to Shopko. *Id*. at 2. On learning of Shopko's insolvency, McKeeson issued a reclamation demand under state law and sued Shopko in state court seeking the same. *Id*. Before the state court could resolve the reclamation demand, Shopko filed for bankruptcy protection. *Id*. On the petition date, Shopko sought post-petition financing, whereby Shopko would grant a lien on the pharmaceutical goods to the post-petition lenders. *Id.* It also sought authorization to sell the goods. *Id*. McKeeson objected to these requests, claiming they would impair its reclamation rights. *Id*. McKeeson and Shopko resolved the dispute by entering into a settlement that allowed Shopko to sell the goods but preserving any reclamation rights McKeeson might have, subject to the superior rights of the post-petition lenders. *Id*. at 2-3.

Shopko sold most of the pharmaceutical goods, and returned whatever was left to McKeeson. McKeeson filed a reclamation claim for the value of the goods delivered to Shopko in the 45 days prior to Shopko's bankruptcy filing. *Id*. at 3. McKeeson also argued that it was entitled to an administrative claim by virtue of its reclamation rights consistent with "the historical approach of awarding administrative priority claims to reclaiming sellers where the goods are no longer available to be reclaimed." *Id*. at 5. The bankruptcy court rejected this argument, and the district court affirmed, stating that BAPCPA removed the protections for sellers by removing the provision that granted a seller a priority administrative expense claim or a lien if the court denied a valid reclamation claims. *Id*. at 6 (citing *In re Prof'l Veterinary Prods, Ltd*, 454 BR 479, 483 (Bankr D Neb 2011)). The district court found that there is nothing in the language of § 546(c) to indicate that it was intended to create an administrative claim for reclaiming sellers, other than through reference to section 503(b)(9). *Id*. at 7. Under section 546(c) as it now stands, a seller's chance at an administrative claim is limited to what is provided under section 503(b)(9) of the Bankruptcy Code.

BAPCPA gave something back to replace that which it took away, though. It added a reference to section 503(b)(9) in section 546(c)(2). This subsection of section 503(b) was added by BAPCPA. Under section 503(b)(9), a seller can receive an administrative expense claim similar to that which was previously afforded under section 546(c).

> After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including […] *the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business.*

Section 503(b)(9) (emphasis added). Congress may have included section 503(b)(9) to once again attempt to balance competing interests. Sellers need not attempt to establish a valid reclamation claim; they can allow buyers to encumber without objection and rely on an administrative expense to protect them. Under section 503(b)(9), a seller can recover for goods sold to the buyer (within 20 days of the bankruptcy filing) even if the goods are no longer in the possession of the debtor and even if the goods are encumbered by a senior security interest. *Brown & Cole Stores, LLC v Associated Grocers, Inc (In re Brown & Cole Stores, LLC)*, 375 BR 873 (9th Cir BAP 2007); *In re Dana Corp*, 367 BR 409 (Bankr SDNY 2007). Seeking recovery under section 503(b)(9) means sellers do not have

to be as concerned about superior liens and whether those secured creditors are undersecured. Indeed, between the two Bankruptcy Code sections, it is far more likely that a seller will be able to receive payment based on a claim under section 503(b)(9) than it will by asserting a reclamation claim subject to section 546(c). This is especially true in a chapter 11 case, which requires all administrative expense claims to be paid in cash and in full on the effective date of any confirmed plan absent a contrary agreement with the holder of the claim. *See* 11 USC 1129(a)(9)(A).

Reclamation Claims Are Not Entirely Dead, Though

From this discussion, it may seem that reclamation claims are strictly historical artifacts. Not quite. A reclamation claim still holds value in certain situations, such as when no secured lien exists to take priority over it. For example, a bankruptcy court in Delaware held that a reclamation seller's claim was subject to the rights of a prepetition secured lender, as expected. Once the prepetition secured lender's debt was repaid, however, the reclamation seller's rights were *not* subject to the post-petition secured lender's lien on the same goods. *In re Reichhold Holdings US, Inc*, 556 BR 107, 111 (Bankr D Del 2016).

In *Reichhold*, the debtor obtained a prepetition loan from Oaktree Capital Management, L.P. ("Oaktree") and granted Oaktree a lien on all of the debtor's assets. *Id*. at 109. Covestro, LLC ("Covestro") had delivered goods to the debtor within 45 days before the filing of the debtor's bankruptcy petition and had made written reclamation demand to the debtor. *Id*. It was undisputed that Covestro's reclamation rights were subject to Oaktree's secured prepetition lien on the goods. But, what *was* disputed was whether Covestro's reclamation claim was subject to the rights of the post-petition lenders whose loan was secured by a first priority lien on all prepetition and post-petition property of the debtor's estate. *Id.*

The liquidating trustee objected to Covestro's reclamation claim, arguing that, even though Oaktree had been paid in full, Covestro's reclamation claim was still subject to the post-petition lender's superior lien. *Id.* at 109. In support of its position, the trustee cited two bankruptcy cases from the Southern District of New York: *In re Dana Corp.* 367 BR 409, 420 (Bankr SDNY 2007), and *In re Dairy Mart Convenience Stores, Inc*, 302 BR 128 (Bankr SDNY 2003). In each of those cases, the opining court had reasoned that the lien chain between prepetition and post-petition lenders represented an "integrated transaction," such that the post-petition lender's rights related back to the prepetition lender's rights. *Id*. at 111 (citing *Dairy Mart*, 302 BR at 135 and *Dana Corp*, 367 BR at 421). Thus, if the trustee were right, Covestro's reclamation claim would be subject to the post-petition lender's claim and would be valueless because the post-petition lenders were not oversecured.

Covestro's position was that the post-petition lien was not a continuation of the prepetition creditor's lien, but instead was an entirely new lien that did not defeat its reclamation rights. *Id*. at 111. In support of its position, Covestro cited *In re Phar–Mor, Inc*, 301 BR 482, 498 (Bankr ND Ohio 2003), *aff'd* 534 F3d 502, 506–07 (6th Cir 2008). In *Phar-Mor*, the court held that a debtor's decision to grant a security interest in goods to a subsequent secured lender cannot defeat a seller's reclamation rights. *Id.* at 111 (citing *In re Phar–Mor*, 301 BR at 498). If Covestro was right, its reclamation claim was valid because the only secured lender to which it could be subordinated (Oaktree) had its claim paid in full.

The *Reichhold* court agreed with Covestro. *Id*. It found that the prepetition loan and the post-petition loan were not integrated. They were two different loans by two different lenders at two different times. Covestro's reclamation rights arose before the post-petition lenders had any rights in the goods. *Id*. at 112. *Reichhold* stands for the proposition that a reclamation claim is valuable so long as the prepetition secured lender's claim is paid in full. Indeed, *Reichhold* would not have been decided in Covestro's favor if Oaktree had been undersecured. Thus, if there is no prepetition secured lender, or if the prepetition secured lender may get repaid via another subsequent lender, a reclamation claim may well be valuable (provided that the other statutory requirements are met).

A reclamation claim still holds value in certain situations, such as when no secured lien exists to take priority over it.

Conclusion

Before BAPCPA, if a reclamation seller's claim was denied by the bankruptcy court, all hope was not lost. Prior section 546(c) required that the bankruptcy court award the reclamation seller with either an administrative claim or a lien; thus, a reclamation seller always received *something*. BAPCPA

removed the language that required bankruptcy courts to award an alternative remedy, and the change to section 546(c) means the seller receives no consolation prize for its reclamation denied. After BAPCPA, a reclamation claim remains useful only in a limited set of circumstances. The main instances are when the buyer has not granted a security interest in the goods, or when the competing secured creditor is oversecured. *Reichhold* teaches that a reclamation claim may also be useful if the debtor seeks to refinance its prepetition secured loan with a new lender, putting creditors on notice to watch for this possibility. Because recovery on a reclamation claim is at best uncertain, though, wherever available, a seller should also assert an administrative expense claim under section 503(b)(9), which may, in fact, prove to be a much more efficient and effective remedy.

NOTES

1. This article does not discuss the proper way to assert a reclamation claim in bankruptcy; however the authors note that there is a split in authority on whether a seller must seek relief from the automatic stay before making the demand for reclamation. *E.g.*, *compare In re Circuit City Stores, Inc*, 441 BR 496, 506–07 (Bankr ED Va 2010) (holding that "enforcement of a reclamation demand in a bankruptcy case would require, at a minimum, a motion for relief from the automatic stay") *with Cowles Tool Co v Production Steel, Inc (In re Prod Steel, Inc)*, 21 BR 951, 953 (Bankr MD Tenn 1982) (holding "that the giving of a notice of a seller's intention to seek reclamation of goods is not itself an 'act to obtain possession of property' subject to the stay of §362(a)(3)").

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Case Digests

Farmland Capital Sols, LLC, v Michigan Valley Irrigation Co, No 352689 ___ Mich App ___, ___ NW2d ___ (Jan 14, 2021)

This case concerns the priority of two creditors regarding their respective security interests in pivots purchased by non-party Boersen Farms, Inc (Boersen).

In 2014, Farmland Capital Solutions' (Farmland) predecessor in interest recorded a Uniform Commercial Code (UCC) financing statement as a secured creditor of Boersen. The financing statement covered all personal property of Boersen and included language consisting of a "standard 'after-acquired' clause." In 2016, Boersen ordered pivots from Michigan Valley Irrigation Company (Michigan Valley), which were invoiced on April 22, 2016. On June 2, 2016, when Boersen failed to pay, Michigan Valley issued another set of invoices. That same day, Boersen entered into an "equipment lease agreement" (Lease) for the pivots with non-party lender, Bank of the West (BOW), that purported "renting" the pivots to Boersen while BOW retained ownership. However, the parties proceeded as though BOW had financed Boersen's purchase of the pivots, and they seemed to agree that the "Lease" was a purchase-money security instrument (PMSI). BOW filed a UCC financing statement listing Boerson as a secured debtor, listing as collateral the pivots covered by the Lease and paying Michigan Valley the entire purchase price for the pivots. At some point, Boerson defaulted on its payments under the Lease. BOW foreclosed, and Michigan Valley purchased the pivots at the foreclosure sale.

Farmland filed suit, and both parties moved for summary disposition arguing over which security interest had priority. Farmland argued it possessed a superior interest in the pivots based on the financing statement filed in 2014, and that BOW failed to perfect its PMSI within twenty days of Boerson taking "possession" of the pivots. Farmland alleged Boersen took possession when the pivots were delivered or when the invoices were issued, and BOW's interest were therefore second in priority. After hearing, the trial court granted Michigan Valley's motion, holding that BOS had timely filed its PMSI, and that repossession and sale to Michigan Valley was therefore valid. Farmland appealed.

At issue in the appeal is what constitutes a "debtor receiving possession of the collateral" under MCL 440.9324(1). Farmland argued that no later than May 13, 2016, Boersen took "possession" of the pivots when installation was complete. However, Farmland provided no legal support that installation of the pivots fulfilled the "possession" requirement, or that the date of the invoices is a relevant date for purposes of determining when the twenty-day clock begins to run.

Michigan Valley argued, and the trial court found, that the twenty-day perfection period does not begin to run until the goods in question actually become "collateral" subject to a security interest. The argument comports with comment 3 to MCL 440.9324, which provides an example in which a debtor "acquires possession of goods under a transaction that is not governed by this Article and then later agrees to buy the goods on secured credit." Comment 3 makes clear that in such a case there is no need to file a financing statement to protect a secured creditor's interest until the creditor's secured interest comes into being. According to comment 3, "the 20-day period in subsection (a) does not commence until the goods become 'collateral' …, i.e., until they are subject to a security interest." Under this rationale, called the "obligation" standard, Boersen was not a "debtor" and the pivots were not "collateral" until Boerson entered into the Lease with BOW. *See* MCL 440.9102(bb)(i), MCL 440.9103(1)(a). The court of appeals adopted the "obligation" standard, and interpreted MCL 440.9324(1) to require the existence of "collateral" before there can be a "debtor" found, that BOW had timely perfected its PMSI in the pivots, and that the repossession and sale to Michigan Valley was valid. The trial court's granting of Michigan Valley's motion for summary disposition was affirmed.

Veritas Auto Mach, LLC v FCA Int'l Operations, LLC, No 346985, ___ Mich App ___, ___ NW2d ___ (Jan 28, 2021)

Plaintiff, a Delaware LLC with its principal place of business in Southfield, sold motor vehicles and parts manufactured by defendant pursuant to a written distributor agreement (Agreement) executed in 2008. While not explicitly stated, apparently all of plaintiff's motor vehicle sales took place in Iraq. Prior to its expiration, defendant terminated the agreement. Plaintiff filed suit alleging that defendant violated the Automobile Dealer's Day in Court Act (ADDCA), 15 USC 1221 *et seq*., and Michigan's Motor Vehicle Franchise Act (MVFA), MCL 445.1561 *et seq*., when it terminated the agreement. Defendant moved for summary disposition under MCR 2.11(C)(8) arguing that plaintiff was a "foreign dealer" and not entitled to the protections afforded under the ADDCA and the MVFA. In its response, plaintiff pointed out that its complaint stated it was a Delaware LLC, with principal place of business in Southfield, and attached the Agreement containing the same information. The trial court denied defendant's motion, stating it could not "conclude on the basis of the allegations alone that Plaintiff was not 'resident in the United States'" under the terms of the ADDCA. With respect to the MVFA claim, the trial court determined that plaintiff was entitled to bring suit under the act because the complaint alleged sufficient facts demonstrating an established place of business in Michigan and was a "new motor vehicle dealer" under the act. Defendant appealed.

The relevant issue was whether plaintiff is "resident in the United States," a term that is not statutorily defined. 15 USC 1221(c). Defendant's argued that plaintiff is a "foreign dealer" for purposes of both acts. With respect to ADDCA, plaintiff alleged that it "is a Delaware limited liabil-

ity company whose principal place of business is located at 29580 Northwestern Hwy., Suite 1000, Southfield, Michigan 48034." As the court must accept the representations as true, it is clear that the complaint alleges that plaintiff was "resident in the United States."

The court of appeals found no error in the trial court's denial of defendant's motion for plaintiff's claim under ADDCA. The plaintiff alleged in its complaint that it is a Delaware limited liability company whose principal place of business is Southfield, Michigan, and the pleadings, viewed in the light most favorable to plaintiff, indicate plaintiff was a resident of the United States and not a "foreign dealer." It is also reasonable to infer that the business relationship arose in Michigan, and that any breach would have taken place in Michigan even if the breach was based on plaintiff's conduct in Iraq. Plaintiff's pleadings do not present facts necessary to determine whether application of the ADDCA in this case would be extraterritorial. While there is a presumption that Congress does not intend for its legislation to have extraterritorial effect, granting defendants motion at this stage would deny plaintiff the opportunity to rebut the presumption.

The parties' dispute with regard to the MVFA turns on whether plaintiff is a "new motor vehicle dealer." *See* MCL 445.1561 *et seq*. The court of appeals agreed with defendant that the trial court erred in denying defendant's motion. "New motor vehicle dealer" requires a party to have an "established place of business in this state." MCL 445.1565(2). Plaintiff concedes it cannot factually satisfy the statutory requirements of MCL 445.1563(2), because it did not and could not lawfully display and repair motor vehicles at its Michigan facility. Affirmed in part and remanded to the trial court to enter an order granting summary disposition to defendant regarding plaintiff's MVFA claim.

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