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Restructuring Small Businesses: Dodging the Horns of a Dilemma

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Restructuring Small Businesses: Dodging the Horns of a Dilemma
Table of Contents

1. Factoring and Merchant Cash Advance Agreements

This section of the materials provides information about the main characteristics of both factoring agreements and cash advance agreements and the factors that courts consider in determining whether such agreements are construed as a loan or a sale of an asset of the debtor. The distinction between calling an agreement a "loan" or a "sale" of an asset can be important in determining the rights of the parties, which, in turn, can have a significant impact on any type of debt restructuring, whether in a bankruptcy court or other forum.

I. Merchant Cash Advance/Factoring Agreements—What Are They?

One of the numerous alternatives to traditional bank financing for small businesses is the leverage of a business's accounts receivables for immediate cash. Under this alternative, a business owner will enter into an agreement with a "factoring" company and receive an immediate cash payment leveraged upon a certain amount of accounts receivable. The "factoring" company in turn will collect the accounts receivable with the intent of recovering more than the cash advanced, thereby turning a profit. What seems like a somewhat simple form of transaction, however, is sometimes anything but, as "factoring" companies attempt to navigate the statutes and case law governing these types of transactions as the law continues to evolve.

A. What Is "Factoring"?

A basic legal definition of factoring is "[t]he buying of accounts receivable at a discount. The price is discounted because the factor (who buys them) assumes the risk of delay in collection and loss on the accounts receivable." *Factoring*, BLACK'S LAW DICTIONARY (10th ed. 2014). When the owner of receivables enters into a factoring agreement with a party, the transaction may be characterized as either a true sale or a financing agreement. *Dryden Advisory Grp. LLC v. Beneficial Mut. Sav. Bank (In re Dryden Advisory Grp., LLC),* 534 B.R. 612, 620 (Bankr. M.D. Pa. 2015).

The Second Circuit has defined factoring as follows:

> [A] form of financing that allows a manufacturer to obtain immediate payment for the goods it sells even though the buyer is not obligated to pay for those goods until the conclusion of a credit period, usually months after the sale. As soon as the manufacturer ships goods to a buyer, the factor pays the manufacturer the purchase price evidenced by the invoice. In return, the factor obtains the right to receive payment on the invoice from the buyer at the conclusion of the credit period, as well as the right to collect related expenses from the manufacturer. As a condition of factoring invoices, a factor may require the manufacturer to guarantee the invoices against non-payment should the buyer become insolvent. The manufacturer can provide this guarantee by obtaining credit insurance.

Cofacredit, S.A. v. Windsor Plumbing Supply Co., 187 F.3d 229, 234 (2d Cir. 1999).

The Ninth Circuit, in turn, has defined factoring as "'the sale of accounts receivable of a firm to a factor at a discounted price. In return for selling the accounts receivable at a discounted price, the seller receives two immediate advantages: (1) immediate access to cash; and (2) the factor assumes the risk of loss.'" *Aalfs, v. Wirum (In re Straightline Invs., Inc.*), 525 F.3d 870, 876 n.1 (9th Cir. 2008) (quoting *French v. Philip Servs. Corp. (In re Metro. Envtl., Inc.),* 293 B.R. 893, 895 (Bankr. N.D. Ohio 2003).

"Factoring can be accomplished either by an actual sale of accounts or through their assignment." *Id.*; *see also Dobin v. Presidential Fin. Corp. of Del. Valley (In re Cybridge Corp.),* 312 B.R. 262, 265 (D.N.J. 2004) (describing "what is commonly known as a 'factoring' agreement" as a situation in which one party advances a loan to the other for a security interest in the other party's accounts receivable).

B. What Is a Merchant Cash Advance (MCA) Agreement?

An MCA agreement is similar to a factoring agreement, having been described as "a sale of its future receipts to [the debtor] in exchange for an immediate cash advance." *GMI Grp., Inc. v. Unique Funding Sols., LLC (In re GMI Grp., Inc.)*, 606 B.R. 467, 472–73 (Bankr. N.D. Ga. 2019). However, in contrast to an historical factoring agreement, under an MCA agreement, the debtor collects its own receivables. This key difference has been recognized by the Bankruptcy Court for the Eastern District of North Carolina, which described an MCA agreement as an agreement whereby the debtor sells:

> a portion of the business's future cash flow but allows the business to collect its own receivables and retain cash flow so long as a minimum daily payment is made. This mechanism is used both in the form of selling future retail sale proceeds by a store merchant or future accounts receivable generated by a service business. The amount paid by the funding party is based on projected future sales and/or receivables that are deposited into a bank account, thereby creating cash available for daily draws.

Swift Fin. Corp. v. Steele (In re Steele), Case No. 17-03844-5-JNC, Adv. Pro. No. 17-0081-5-JNC, 2019 WL 3756368, at *4 (Bankr. E.D.N.C. Aug. 8, 2018).

II. Is the Transaction a Loan or Sale?

When a small business owner who is a party to either a factoring agreement or an MCA agreement runs into financial difficulty, the legal determination of the nature of the agreement will have a significant impact on the rights of the parties.

Whether the agreement is a loan or a sale of receivables can have a significant impact on the debtor's ability to reorganize in a chapter 11 case or other insolvency-related proceedings or litigation. Significant issues that can arise include whether the receivables at issue are property of the bankruptcy estate; whether the debtor can use the receivables as cash collateral; whether a related claim is secured or unsecured; whether payments made prior to a bankruptcy filing can be clawed back as preferential;

whether the receivables at issue are subject to other statutory trusts, such as under the Perishable Agricultural Commodities Act; and whether a confirmable plan can be negotiated by the debtor with its creditors.

Given the importance of the characterization of the transaction, courts will look beyond the mere title of the agreement to determine its true nature—a true sale of an asset of the debtor or a loan disguised as such. Numerous courts have developed a non-exhaustive list of factors used to analyze the true nature of the transaction in order to properly characterize the agreement at issue, with a focus on which party bears the risk of collection. These factors are discussed in the next section.

A. The Factors that Courts Will Consider

Because many of the agreements that come under analysis in a distressed debt situation have New York choice of law provisions, whether these agreements constitute loans or sales of future receivables has been considered by a number of New York state courts over the last several years. *See Rapid Cap. Fin., LLC v. Natures Mkt. Corp.,* 57 Misc. 3d 979, 982, 66 N.Y.S.3d 797 (N.Y. Sup. Ct. 2017) (collecting cases); *K9 Bytes, Inc. v. Arch Cap. Funding,* 56 Misc. 3d 807, 816, 57 N.Y.S.3d 625 (N.Y. Sup. Ct. 2017) (citing cases and noting that "[m]any trial courts have examined [merchant cash advance] agreements in the last several years[] and have largely determined that most of them are not loans, but purchases of receivables"); *NY Cap. Asset Corp. v. F & B Fuel Oil Co.*, 58 Misc. 3d 1229(A), at *6, 2018 WL 1310218 (N.Y. Sup. Ct. Mar. 8, 2018) ("[P]urchases and sales of future receivables and sales proceeds . . . are common commercial transactions expressly contemplated by the Uniform Commercial Code.").

In analyzing whether these agreements are sales or loans, New York courts have looked to certain factors to determine whether the transaction provides for absolute or contingent repayment. *See, e.g., IBIS Cap. Grp. LLC v. Four Paws Orlando LLC, No. 608586/16*2017 WL 1065071, at *3–7 (N.Y. Sup. Ct. Mar. 10, 2017); *K9 Bytes,* 56 Misc. 3d at 816–18; *NY Cap. Asset Corp.,* 58 Misc. 3d 1229(s), at *7–8. One such factor is the existence of a reconciliation provision in the agreement, which allows for adjustments of the daily withdrawal amounts based upon the seller's actual collection of future receivables. *See K9 Bytes*, 56 Misc. 3d at 817. A second factor is "whether the [buyer] has any recourse should the merchant declare bankruptcy." *Id.* at 818. Finally, a third factor is whether the transaction provides for a definite term. *NY Cap. Asset Corp.,* 58 Misc. 3d 1229(A), at *7.

Other courts have considered additional factors, some of the most common of which include:

1) whether the buyer has a right of recourse against the seller;

2) whether the seller continues to service the accounts and commingles receipts with its operating funds;

3) whether there was an independent investigation by the buyer of the account debtor;

4) whether the seller has a right to excess collections;

5) whether the seller retains an option to repurchase accounts;

6) whether the buyer can unilaterally alter the pricing terms;

7) whether the seller has the absolute power to alter or compromise the terms of the underlying asset; and

8) the language of the agreement and the conduct of the parties.

See Dryden Advisory Grp., 534 B.R. at 620 (citing Robert D. Aicher, William J. Fellerhoff, *Characterization of A Transfer of Receivables as a Sale or a Secured Loan Upon Bankruptcy of the Transferor,* 65 Am. Bankr. L.J. 181, 186–94 (1991) and collecting cases); *see also Cap Call, LLC v. Foster (In re Shoot the Moon, LLC)*, 635 B.R. 797, 813–14 (Bankr. D. Mont. 2021) (listing the multiple factors and noting that "[c]ourts have formulated a holistic, multipart framework to examine a transaction on the way to classifying it as a sale or a loan").

B. The Totality of the Circumstances—A Deeper Analysis

"Analysis of the various factors and their impact on the nature of the parties' agreement is fact-intensive, and a determination must be made based on the totality of the circumstances." *Dryden Advisory Grp.*, 534 B.R. at 620. In addition to the specific factors identified herein, the court will also examine "the parties' practices, objectives, business activities and relationships and determine[] whether the transaction was a sale or a secured loan only after analysis of the evidence as to the true nature of the transaction." *Id.* (quoting *Major's Furniture Mart, Inc. v. Castle Credit Corp.,* 602 F.2d 538, 545 (3d Cir. 1979)).

As characterized by the United States Bankruptcy Court for the District of Montana, the analysis is an in-depth endeavor by the court:

> As with many multi-factor tests, no individual factor or combination thereof is determinative. The inquiry is not a quantitative exercise susceptible to replication by a computer program, but a comprehensive and heavily contextual endeavor. A court's analysis of the various factors and their impact on the nature of the parties' agreement is fact-intensive, and a determination must be made based on the totality of the circumstances. That said, a consideration that overlays and unites the factors is how the parties allocated risk. A sale typically occurs when the risk of loss from the purchased assets passes to the buyer—a gamble usually reflected in the purchase price. Conversely, in a disguised loan, the parties may employ various methods to allocate risk—the putative seller typically remains exposed to the underlying receivables and may grant the putative buyer recourse to sources of recovery beyond the receivables.

Shoot the Moon, 635 B.R. 797, 813–14 (quotation and internal citations omitted).

2. Guaranty Strategies in Small Business Bankruptcies[1]

This section of the materials provides various strategies for defending and enforcing guaranties when the primary obligor has filed for bankruptcy. The section focuses on the guarantor's rights against the primary obligor, suretyship defenses, and the application of certain bankruptcy laws to guarantors.

I. Guaranty or Surety?

At the outset, a question to consider is whether liability arises as a result of being a guarantor or a surety. A guarantor or surety is one who promises to answer for the debt, default, or miscarriage of another or who hypothecates property as security therefor. Cal. Civ. Code § 2787. The difference may be explained as follows:

A. Definition of Guaranty: [A]n undertaking or promise on the part of one person which is collateral to a primary obligation on the part of another and which binds the guarantor to performance in the event of nonperformance by such other, the latter being bound to perform primarily. *See generally* 38 Am. Jur. 2d Guaranty § 2.

B. Definition of Surety. Generally, one who agrees to become primarily and jointly liable with the principal debtor.

Some authorities find the difference between guaranty and surety to be largely technical. *Mahana v. Alexander*, 263 P. 260 (Cal. Ct. App. 1927). Others, however, have found various distinctions. A contract of guaranty may differ from a contract of surety in that the obligation of a surety is primary, while that of a guarantor is collateral. 38A Corpus Juris Secundum, Guaranty § 8. Further, while each is, as to the principal, collaterally liable, as to the creditor or obligee, the surety is primarily and directly liable on his or her contract from the beginning, whereas the liability of the guarantor is secondary and fixed only by the occurrence of the prescribed condition at a time after the contract itself is made. *Id.* Where the distinction is made, the surety may be sued as a promisor, but the guarantor may not. *Id.* A guarantor, being bound by a separate contract, must be sued separately, in the absence of a statutory provision to the contrary, but a principal and a surety, being equally bound, may be joined in the same suit. *Id.*

Another consideration is whether the guaranty is one of payment or simply of collection. A guaranty of collection signifies that the principal is solvent and that no liability is incurred by the guarantor until the creditor, after using reasonable diligence, is unable to collect the debt from the principal. Cal. Civ. Code § 2800; *Ohio Elec. Car Co. v. Le Sage*, 182 Cal. 450, 454–55 (1920); *Citizens Nat'l Trust & Sav. Bank of Los Angeles v. Seaboard Sur. Corp. of Am.*, 4 Cal. App. 2d 766, 768–70 (1935) (affirming the finding of the lower court that an action against a guarantor was unripe).

II. Guarantor Rights

[1] Definitions and interpretation of guaranty and surety are generally matters of state law. For purposes of discussion and example, California law is cited throughout this section.

A surety can compel the principal obligor to perform the obligation when due. Cal. Civ. Code § 2846. If the surety satisfies any part of the principal obligation, the surety has reimbursement rights. Cal. Civ. Code § 2847. If the surety satisfies the obligation entirely, the surety is subrogated to the position of the creditor. Cal. Civ. Code § 2848. The surety is also entitled to all security held by the creditor. Cal. Civ. Code § 2849. In addition, the surety has rights of contribution from the co-sureties. Cal. Civ. Code § 2848.

III. Suretyship Defenses

There are a host of suretyship defenses to guaranties. It is important to determine if these defenses apply or if they have been waived.

A. *Is the guaranty limited or conditional?* For example, in *Schwab v. Bridge*, 27 Cal. App. 204 (1915), the creditor failed to observe a condition precedent to the liability of the guarantor by not making a presentation by the deadline set forth in the guaranty; as a result, the judgment in his favor against the guarantor was reversed.

B. *Is the guaranty obligation larger or more burdensome than that of the principal? Or did the guarantor assume liability not knowing that there was no liability on the part of the principal?* Cal. Civ. Code §§ 2809, 2810; *Bank of Am. Nat'l Trust & Sav. Ass'n v. Pauley*, 119 Cal. App. 2d 355 (1953) (guarantors waived their rights to require creditor to first exhaust security and to participate in the security; however, guarantors were entitled to reduction in the original debt by amount realized on security before determination of respective liabilities); *Rochester Cap. Leasing Corp. v. K & L Litho Corp.*, 13 Cal. App. 3d 697 (1970) (leases were actually a loan with usurious interest, and guaranties were unenforceable as to the same); *Regents of University of Cal. v. Hartford Accident. & Indem. Co.*, 21 Cal. 3d 624 (1978) (statute of limitations expiring as to the principal obligation may or may not exonerate the surety); *City Nat'l Bank in Long Beach v. Lemco Mfg. Co.*, 57 Cal. App. 566 (1922) (note was not executed and was void for lack of consideration and guarantor was exonerated); *River Bank Am. v. Diller*, 38 Cal. App. 4th 1400 (1995) (although construction financing to principal was nonrecourse, that did not exonerate guarantors).

C. *Is the guaranty a non-continuing guaranty, or has it been revoked?* Cal. Civ. Code §§ 2814 and 2815; *S. Cal. First Nat'l Bank v. Olsen*, 41 Cal. App. 3d 530 (1974) (guaranty provided that it did not apply to debt incurred after creditor received written notice of revocation, and guarantors were relieved of liability for new debt incurred after creditor received notice of revocation); *Bank of Am. Nat'l Trust & Savs. Ass'n v. Hunter*, 8 Cal. 2d 592 (1937) (guaranty which was executed after notes and provided that it was a continuing guaranty was not limited to future debt incurred).

D. *Was the original obligation altered without the surety's consent, or have the rights and remedies of the surety against the principal been impaired or suspended?* Cal. Civ. Code §§ 2819, 2820, and 2821; *V.I.P. Agency of N. Cal., Inc. v. Duffy Elecs*., 92 Cal. App. 3d 849 (1979) (modification to alter immediate payment obligation to one based on a schedule was a substantial change that exonerated the surety); *Nissen v. Ehrenpfort*, 42 Cal. App. 593 (1919) (increasing interest rate from 6% to 7% exonerated guarantor); *Occidental Life Ins. Co. v.*

McCracken, 19 Cal. App. 2d 239 (1937) (agreement to extend time of payment between mortgagee and mortgagor's successor who obtained ownership of the land, without the consent of the mortgagor, exonerated the mortgagor); *Shuey v. Bunney*, 4 Cal. App. 2d 408 (1935) (subsequent agreement to increase principal's obligation by about $6,000 released surety); *Sumitomo Bank of Cal. v. Iwasaki*, 70 Cal. 2d 81 (1968) (creditor owed a duty to disclose facts to the guarantor that creditor had reason to believe would materially increase the risk that the guarantor intended to assume); *R.P. Richards, Inc. v. Chartered Constr. Corp.*, 83 Cal. App. 4th 146 (2000) (release of the principal without the surety's knowledge exonerated the surety); *Union Bank v. Gradsky*, 265 Cal. App. 2d 40 (1968) (guarantor's right of subrogation was destroyed by non-judicial foreclosure).

E. *Did the principal perform its obligation or offer to perform its obligation? Did the guarantor make such an offer?* Cal. Civ. Code §§ 1485, 2839; *Daneri v. Gazzola*, 139 Cal. 416 (principal of note offered to pay, but payee declined and granted extension; sureties were exonerated).

F. *Did the creditor fail or neglect to pursue the principal first or other remedies which it has that the surety lacks, including collateral?* Cal. Civ. Code §§ 2845, 2849, and 2850; *United Cal. Bank v. Matzman*, 44 Cal. App. 3d 41 (1974); *Moffett v. Miller*, 119 Cal. App. 2d 712 (1953); *Engleman v. Bookasta*, 264 Cal. App. 2d 915 (1968); *Eppinger v. Kendrick*, 114 Cal. 620 (1896); *Everts v. Matteson*, 21 Cal. 2d 437 (1943).

G. *Is the underlying transaction illegal or against public policy? Or are there defenses of the principal that the surety can assert? WRI Opportunity Loans II LLC v. Cooper*, 154 Cal. App. 4th 525 (2007) (loan was usurious; thus, summary judgment against guarantor was reversed); *see* new Small Business Lender Disclosure Rules, section 3, *infra*.

H. *Is the guaranty a "sham" and therefore unenforceable because a guarantor cannot guaranty its own debts, or is it actually the principal? Union Bank v. Dorn*, 254 Cal. App. 2d 157 (1967); *Union Bank v. Brummell*, 269 Cal. App. 2d 836 (1969); *Torrey Pines Bank v. Hoffman*, 231 Cal. App. 3d 308 (1991); *Cadle Co. II v. Harvey*, 83 Cal. App. 4th 927 (2000).

I. *Did the creditor fail to comply with Article 9 of the Uniform Commercial Code or with requirements of local law (i.e., anti-deficiency rules) with respect to collateral pledged by the borrower or guarantor?* Cal. Comm'l Code § 9626; *Hollander v. Cal. Mfg. Enters. Inc.*, 44 Cal. App. 4th 561 (1996); *Sec. Pac. Nat'l Bank v. Wozab*, 51 Cal. 3d 991 (1990); *In re Pajaro Dunes Rental Agency, Inc.*, 156 B.R. 263 (N.D. Cal. 1993).

J. *Have all of the various defenses, statutory or otherwise, been waived?* Cal. Civ. Code §§ 2856 (permitting waivers with respect to real property collateral), 3268 (permitting waiver of statutory defenses except where against public policy); *Engleman v. Bookasta*, 264 Cal. App. 2d 915 (1968); *Bloom v. Bender*, 48 Cal. 2d 793 (1957); *Wiener v. Wan Winkle*, 273 Cal. App. 2d 774 (1969); *Am. Sec. Bank v. Clarno*, 151 Cal.App.3d 874 (1984).

K. *Is there a provision in the underlying contract that will not be enforced against a resident of the state where the guarantor is located? G Cos. Mgmt., LLC v. LREP Ariz. LLC*, 88

Cal. App. 5th 342 (2023) (Arizona's forum selection clause was successfully challenged as to California guarantors as it would override usury protections of California law); *Handoush v. Lease Fin. Grp. LLC*, 41 Cal. App. 5th 729 (2019) (forum selection clause of New York was invalidated as it deprived California resident of jury trial).

L. *Is there a contract formation issue? Riverisland Cold Storage, Inc. v. Fresno-Madera Prod. Credit Ass'n*, 55 Cal. 4th 1169 (2013) (fraud).

IV. Bankruptcy Rights and Remedies of Guarantors

A. 11 U.S.C. §§ 105, 362, and 524(e)

1. Pre-Confirmation Injunctions

Although by its literal language the automatic stay applies only to the debtor, some courts have nonetheless extended the automatic stay to enjoin litigation against nondebtor guarantors and other nondebtors, where "unusual circumstances" are present. Other courts have used Bankruptcy Code § 105(a) to enjoin litigation against a nondebtor guarantor.

In *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 999 (4th Cir. 1986), the Fourth Circuit determined that courts may extend § 362(a) to stay proceedings against nondebtor codefendants in unusual circumstances. The court defined "unusual circumstances" as situations in which "there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor." *Id.* An example of such circumstances, the court said, would be a lawsuit against a third-party defendant "entitled to absolute indemnity by the debtor on account of any judgment that might result against them." *Id.* In *A.H. Robins Co.*, the court reasoned that the debtor's products liability insurance was property of the estate that should be available to creditors. With 5,000 lawsuits pending against the debtor and hundreds of millions of dollars spent in litigating just forty cases, the court concluded that the continuation of litigation against the debtor's insurer would frustrate any effort of the debtor at reorganization. *Id.* at 1008. Accordingly, the Fourth Circuit affirmed the district court's stay of proceedings against the debtor's insurer pursuant to § 362(a). *Id.* at 1016.

Another example of "unusual circumstances" was found in *First National Bank of Louisville v. Kanawha Trace Development Partners (In re Kanawha Trace Development Partners)*, 87 B.R. 892, 896–97 (Bankr. E.D. Va. 1988), in which the court stayed the litigation against the guarantor because the guarantor had a right to be indemnified for any amount it paid under its guaranty.

Courts have largely not extended *A.H. Robins* to protect nondebtor guarantors, ruling that nondebtor guarantors should not enjoy the benefit of the automatic stay, where enjoining the action will not enhance the assets of the estate or assist the debtor in its reorganization effort. *See, e.g., Credit Alliance Corp. v. Williams*, 851 F.2d 119, 122 (4th Cir. 1988) (not extending the stay to guarantor where "[t]he purpose of the guaranty would be frustrated").

Some courts have used § 105(a) to shield guarantors in order to ensure the success of a reorganization or enhance the assets of the bankruptcy estate. These injunctions are premised on the traditional injunction standard, with the likelihood of success on the merits being replaced with the likelihood of reorganization. In *Otero Mills, Inc. v. Security Bank & Trust (In re Otero Mills, Inc.)*, 21 B.R. 777, 778–80 (Bankr. D.N.M. 1982), the court enjoined an action against the guarantor who was the president of the debtor, applying the following test: (i) irreparable harm to the bankruptcy estate if the injunction is not issued; (ii) a strong likelihood of success on the merits; and (iii) no harm or minimal harm to other parties.

2. Post-Confirmation Injunctions

The issue of third party releases as part of a plan, including guarantor releases, is its own broad topic for another panel. The discussion below provides a sampling of some of the basic issues.

Section 524(e) of the Bankruptcy Code provides in pertinent part that a bankruptcy discharge of a debtor "does not affect the liability of any other entity" on the debt. 11 U.S.C. § 524(e). Notwithstanding this prohibition, there are numerous instances in which chapter 11 debtors have sought to confirm plans of reorganization containing such injunctions. In one case, the Ninth Circuit held that the bankruptcy court lacked the jurisdiction and authority to enjoin a creditor permanently, beyond confirmation of a plan, from enforcing a state court judgment against the debtor's guarantors. *Am. Hardwoods, Inc. v. Deutsche Credit Corp. (In re Am. Hardwoods, Inc.),* 885 F.2d 621, 622 (9th Cir. 1989). About twenty years later, the Ninth Circuit prohibited a post-confirmation injunction against suing nondebtors on the basis that the case provided permanent relief that had the effect of releasing the nondebtor party from liability, but acknowledged that allowing a pre-confirmation injunction using § 105(a) may be appropriate. *Solidus Networks, Inc. v. Excel Innovations, Inc. (In re Excel Innovations, Inc).*, 502 F.3d 1086, 1093–96, 1100 (9th Cir. 2007); *see also Seaport Auto., Warehouse, Inc. v. Rohnert Park Auto Parts, Inc. (In re Rohnert Park Auto Parts, Inc.),* 113 B.R. 610 (B.A.P. 9th Cir. 1990) (reversing the lower court's confirmation of plan with temporary post-confirmation injunction on particular factual circumstances of that case).

In contrast to these cases, other bankruptcy court opinions have effectively allowed such post-confirmation injunctions on the grounds of waiver and estoppel. In *Zenith Electronics Corp.,* 241 B.R. 92, 110–11 (Bankr. D. Del. 1999), the Delaware bankruptcy court approved the non-debtor releases of non-derivative third party claims by creditors who voted in favor of the plan. *See also In re Coram Healthcare Corp.,* 315 B.R. 321, 335–36 (Bankr. D. Del. 2004) (stating that a plan is a contract that may bind those who vote in favor of it and, to the extent that creditors or shareholders voted in favor of the plan, which provides for the release of claims they have against the non-holders, they are bound by that). In the case of *In re DBSD N. Am., Inc.,* 419 B.R. 179, 218 (Bankr. S.D.N.Y. 2009), *aff'd*, 2010 WL 1223109 (S.D.N.Y. Mar. 24, 2010), the court found that consent to a third party release existed when a party had adequate notice of the opportunity to affirmatively opt out of the plan providing for the release but failed to do so. As is evidenced from the foregoing, creditors/obligees bear a serious responsibility to carefully monitor the chapter 11 case and take specific actions as may be required.

3. Gatekeeper Provisions

As under the Barton doctrine, a plan may contain "gatekeeper" provisions that require bankruptcy participants to bring all claims against exculpated parties first to the bankruptcy court to determine whether those claims are colorable and able to proceed. *See NexPoint Advisors, L.P. v. Highland Cap. Mgmt., L.P. (In re Highland Cap. Mgmt*, *L.P.)*, 48 F.4th 419, 439 (5th Cir. 2022) ("Courts have long recognized bankruptcy courts can perform a gatekeeping function.") The *Highland* court was not persuaded that the record supported a finding that the requested injunction was overbroad and vague for failing to define a term or that the gatekeeper provision "impermissibly extends to unrelated claims over which the bankruptcy lacks subject-matter jurisdiction." *Id.* at 439. The court explained that it did not need to "evaluate whether the bankruptcy court would have jurisdiction under every conceivable claim falling under the widest interpretation of the gatekeeper provision" and that it would leave that [question] to the bankruptcy court in the first instance."

4. Tolling of Statutes of Limitation and "Temporary" Post-Confirmation Injunctions

In lieu of a permanent prohibition, a plan may contain a provision temporarily barring creditors from pursuing claims post-confirmation (i.e., suing guarantors), while at the same time tolling the statutes of limitation for such claims. *In re Bernhard Steiner Pianos USA, Inc.*, 292 B.R. 109, 117 (Bankr. N.D. Tex. 2002) ("Pursuant to 28 U.S.C. §§ 1332(b) and 157(a), the Court has jurisdiction to issue a post-confirmation stay as between Debtor's creditors and [Debtor's principal]. A plan may 'include any other appropriate provision not inconsistent with the applicable provisions of this title.' 11 U.S.C. § 1123(b)(6). The Court's authority to issue the limited stay and toll the statute of limitations falls within its grant of equitable power under §§ 105(a) and 1123(b)(6) of title 11."). *See also In re Couture Hotel Corp.*, 536 B.R. 712, 749–50 (Bankr. N.D. Tex. 2015) (quoting plan provision stating that "[a]ny applicable statute of limitations against collection from any of the injunctive relief parties is specifically tolled from the period of time from the petition date until the date upon which the Debtor fails to timely cure any written notice of default as set forth in the plan. Failure by the Debtor to cure any written notice of default as set forth in the plan shall result in the dissolution of the injunction granted hereunder as to the affected creditor without further order of court."); *In re K3D Prop. Servs., LLC*, 635 B.R. 297, 305 (Bankr. E.D. Tenn. 2021) ("While the injunction operates, any applicable statute of limitations shall be tolled to preserve any claim or cause of action.").

B. 11 U.S.C. §§ 502 and 509—Reimbursement and Subrogation

Section 502 of the Bankruptcy Code permits allowance of a claim for reimbursement or contribution by a guarantor unless the claim is "contingent as of the time of allowance or disallowance of such claim" or if the underlying "claim against the estate is disallowed." 11 U.S.C. § 502(e)(1). In lieu of section 502, section 509 may be used instead by the guarantor to subrogate itself to the claim of the creditor against the debtor. But each remedy has its own limitations.

As stated above, section 502(e)(1)(B) disallows the guarantor's claim if the claim is contingent (*i.e.*, the guaranty has not been triggered yet). Likewise, section 509(c) subordinates the claim of the guarantor for subrogation or for reimbursement or contribution until such time that the claim of the creditor is paid in full. Read together, the disallowance of contingent claims and the subordination of any guarantor claim until such time that the creditor is paid in full work to ensure that the guarantor pays the creditor's claim in full before it is entitled to a distribution from the debtor's estate. This prevents a competition between the guarantor and the creditor as to the debtor's assets.

There are a number of factors to consider in determining whether to proceed with subrogation to the creditor's claim or with a direct claim for contribution or reimbursement. For instance, a guarantor with an otherwise unsecured contribution or reimbursement claim who fully pays off a creditor would likely prefer to be subrogated to the claim of the creditor if the creditor's claim were secured in order to enjoy the benefit of the collateral. Similarly, a guarantor may prefer subrogation where the debtor breaches the guarantied obligation on a post-petition basis, thereby potentially allowing the guarantor to be subrogated into the position of an administrative expense claimant. On the other hand, the guarantor may prefer to proceed with its contribution or reimbursement claim if its guaranty, secured by the primary obligation to which it could be subrogated, is unsecured.

Guaranties of leases may be entitled to special protections and disadvantages. As a preliminary matter, lease rejection damages are capped under section 502(b)(6) of the Bankruptcy Code. Most courts hold that nondebtor guarantors may not benefit from this provision to reduce the debt that they owe under their guaranty. *See, e.g.*, *In re Scranes, Inc.*, 67 B.R. 985, 989 (Bankr. N.D. Ohio 1986) (citing 11 U.S.C. § 524(e)); *Bel-Ken Assocs. Ltd. P'ship v. Clark*, 83 B.R. 357, 359 (D. Md. 1988) ("[C]ommon sense dictates that the guarantor remain fully liable even when the principal debtor seeks relief under the Bankruptcy Code. After all, what good is a guaranteed lease if the guarantor escapes liability when the debtor does?"); *Kopolow v. P.M. Holding Corp. (In re Mod. Textile, Inc.)*, 900 F.2d 1184, 1191–92 (8th Cir. 1990) ("[T]he liability of a guarantor for a debtor's lease obligations is not altered by the Trustee's rejection of the lease. This conclusion is supported by the fact that, under the Bankruptcy Code, even the 'discharge of a debt of the debtor does not affect the liability of any other entity on . . . such debt.'") (quoting 11 U.S.C. § 524(e)); *Things Remembered, Inc. v. BGTV, Inc.*, 151 B.R. 827, 831 (Bankr. N.D. Ohio 1993) ("A guarantor's liability to a lessor is not limited to the amount of § 502(b)(6) damages."); *Lariat Cos., Inc. v. Wigley (In re Wigley)*, 951 F.3d 967, 970 (8th Cir. 2020) ("[D]ischarge destroys the remedy, but not the indebtedness."). But when the debtor is the guarantor of the lease, courts tend to rule that the debtor/guarantor is entitled to a reduction in the guaranty claim under § 502(b)(6). *See, e.g.*, *In re Interco Inc.*, 137 B.R. 1003, 1005–07 (Bankr. E.D. Mo. 1992); *In re Episode USA, Inc.*, 202 B.R. 691, 695 (Bankr. S.D.N.Y. 1996); *Arden v. Motel Partners (In re Arden)*, 176 F.3d 1226, 1229 (9th Cir. 1999). If the guarantor of the lease is not the debtor, sections 502(e)(1)(B) and 509(c) work with section 502(b)(6) to limit the guarantor's claim for reimbursement or contribution, or to be subordinated, to the amount of the landlord's claim. *See, e.g.*, *In re Amatex Corp.*, 110 B.R. 168, 170–71(Bankr. E.D. Pa. 1990) (discussing how § 502(e)(1)(B) and § 509(c) operate in tandem); *In re Tri-Union Dev. Corp.*, 314 B.R. 611, 624 (Bankr. S.D. Tex. 2004).

3. Small Business Lender Disclosure Rules

To date, certain states like New York, Utah, Virginia, and California have passed commercial financing disclosure laws similar to consumer financing disclosure laws. Although the California statute authorizing the regulations was passed in 2018, the regulations came into effect on December 9, 2022. https://dfpi.ca.gov/2022/06/14/dfpis-commercial-financing-disclosure-regulations-approved-to-become-effective-as-of-december-9-2022/

For California, the regulations affect offers of financing that are equal to or less than $500,000. Cal. Code Regs. tit. 10, § 921 (2022). Types of transactions covered are: (a) open-end financing (credit lines); (b) closed-end financing (term loans/equipment financing agreements); (c) sales-based financing; (d) factoring transactions; (e) lease financing that is not a true lease; (f) asset-based financing; and (g) other forms of financing. *Id*. at §§ 910–917.By regulation, the disclosures to be given cover the font size, what language must be capitalized, certain required statements, the term of the transaction, the annual percentage rate, how the disclosures are provided (*i.e.*, whether as part of the contract or a separate document), column width, etc.

Exemptions abound with respect to providing the disclosures for depository institutions, lenders regulated by the Farm Credit Act, motor vehicle dealers and rental vehicle companies as defined under California law, commercial transactions secured by real property, a person's sole commercial transaction in any one twelve-month period, and five or fewer commercial transactions in any twelve-month period where the loans are incidental to the business of the person relying on the exemption. Cal. Fin'l Code § 22801.