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Small Business Bankruptcy Relief Under the CARES Act: “Small” Just Got Larger

*“The weight of this sad time we must obey;
Speak what we feel, not what we ought to say.”**

Congress enacted the Coronavirus Aid, Relief and Economic Security Act (the “CARES Act”) on March 27, 2020. This sweeping legislation contains numerous provisions designed to stem economic decline and assist businesses and individuals to recover economically from the effects of COVID-19. The CARES Act legislation includes amendments to the “small business” provisions of the United States Bankruptcy Code, [11 U.S.C. Section 101](#) et seq., as amended (the “Bankruptcy Code”) that are designed to provide small business and individuals with greater access to bankruptcy relief.

Background

For background purposes, Congress previously enacted (February 19, 2020) permanent amendments to the Bankruptcy Code to facilitate bankruptcy cases of small businesses, generally known as the [Small Business Reorganization Act of 2019](#) or “Subchapter 5” of the Bankruptcy Code (the “SBRA”). The SBRA was in effect at the time the CARES Act was passed, and the SBRA adopted numerous provisions of the Bankruptcy Code to streamline and facilitate bankruptcy cases by small business.

Unlike the typical Chapter 11 reorganization case under the Bankruptcy Code, the SBRA provided for, generally speaking:

- 1) A bankruptcy filing only by a person or entity engaged in business with an aggregate secured and unsecured debt not exceeding \$2,725,625;
- 2) The filing of a plan of reorganization within 90 days of the filing, which plan can be filed only by the debtor and can be combined with or filed without the typical disclosure statement (avoiding the costs and delay of filing and approving both a disclosure statement and plan separately);
- 3) Relaxed plan confirmation standards that permit the debtor to retain ownership of its business without first paying all unsecured creditors in full as long as, generally speaking, the projected disposable income of the business is used to fund the plan for a three- to five-year period (in effect, no “absolute priority rule” as in a Chapter 11) and;

* William Shakespeare’s *King Lear*, Act V, Scene iii. Many sources cite *King Lear* as being written in 1606, during an epidemic in London. After *King Lear* dies in the play, a supporter of the king not only expresses his regret over the state of affairs, but more importantly (as interpreted by many commentators) is saying the outcome could have been avoided had people spoken and acted differently at the outset.

- 4) The appointment of a bankruptcy trustee to oversee the case, instead of an unsecured creditors' committee.

CARES Act Bankruptcy Provisions

While many of the Bankruptcy Code amendments in the CARES Act are material, such amendments are temporary and will sunset one year from the date the CARES Act was enacted. In order to keep this client alert brief, this alert contains a summary of the principal bankruptcy-related provisions of the CARES Act.

- The CARES Act expands the eligibility for small business to file bankruptcy under the SBRA bankruptcy provisions for “small businesses.” While the SBRA limits eligibility under its streamlined provisions to businesses with an aggregate secured and unsecured debt not exceeding \$2,725,625, the CARES Act increases this eligibility limit to \$7,500,000. This expansion will permit a greater number of business to file bankruptcy under the more truncated, less costly and more debtor-friendly provisions of the SBRA and avoid the more complex and expensive provisions of Chapter 11 of the Bankruptcy Code.

While bankruptcy courts have permitted debtors in pending Chapter 11 cases to convert their cases to small business cases under the SBRA or Subchapter 5 of the Bankruptcy Code, the CARES Act expressly provides that its provisions apply only to bankruptcy cases commenced on or after the date of its enactment.

- For individual debtors under Chapters 7 or 13 of the Bankruptcy Code, the CARES Act excludes any COVID-19 related payments to the debtor by the federal government from the debtor's income for eligibility purposes and from a debtor's “disposable income,” which effectively excludes such COVID-19 assistance payments from funds otherwise required to be paid to creditors under an individual's Chapter 13 plan.
- For individual Chapter 13 debtors, the CARES Act permits individual debtors to amend a previously confirmed plan to address financial hardships resulting from COVID-19, including extending plan payments over a seven-year period after the date on which initial payments commenced.

For clarification, the SBRA is not part of the CARES Act and the SBRA, otherwise known as Subchapter 5 of the Bankruptcy Code, for small businesses will not sunset. The CARES Act expansion of the SBRA is scheduled to sunset one year after the CARES Act enactment.

Potential Effect

Businesses and individuals who do not satisfy the eligibility criteria under the SBRA may still file bankruptcy under Chapter 11 of the Bankruptcy Code. However, the CARES Act is generally expected to result in a greater number of bankruptcy filings by small businesses meeting the expanded debt limit for eligibility and may have a broad-reaching effect. The SBRA is designed to facilitate bankruptcy filings by businesses which do not have the resources, or the time, to reorganize under the typical and more expansive provisions of Chapter 11. *See, e.g., In re Ventura*, Case No. 18-77193 (Bankr. E.D.N.Y. Apr. 10, 2020) (“Had Congress been given a crystal ball with the power to

see what the world is facing today, including the severe disruption to our Nation's economy and its impact on small businesses, Congress likely could not have drafted a more effective set of mechanisms to help these businesses reorganize and hopefully survive.”).

Bankruptcy filings under the SBRA, as expanded by the CARES Act, may now include larger businesses. These businesses may be borrowers under loans held by banks or other lenders directly, businesses with loans supporting various bond financings or project financings (including not only project owners, but also tenants or vendors supporting a larger project in such a financing) and businesses with loans placed in commercial loan securitizations.

The CARES Act may also have the effect of increasing negotiating leverage of small businesses which may not otherwise file bankruptcy. The SBRA, as expanded by the CARES Act, may present small businesses with a viable and realistic alternative to turning collateral over to lenders after a default and going out of business.

In enacting the CARES Act, Congress in a largely bi-partisan effort seeks to avoid adverse outcomes by being proactive at the outset.

For more information, please contact your Kutak Rock attorney or a member of the [Bankruptcy, Restructuring and Creditors' Rights group](#).