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CARES ACT TEMPORARILY INCREASES DEBT LIMITATION FOR SMALL BUSINESS DEBTORS

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) provides much-needed assistance to small businesses affected by the coronavirus pandemic. In addition to providing forgivable loans of up to $10,000,000, the CARES Act more than doubles the debt limitation under the Small Business Reorganization Act of 2019 (SBRA) for a one-year period commencing March 27, 2020. This change will allow more small businesses to reorganize under the newly created Subchapter V of Chapter 11 of the Bankruptcy Code.

Small Business Reorganization Act of 2019

Chapter 11 of the Bankruptcy Code governs business reorganization. In amendments to the Bankruptcy Code in both 1994 and 2005, Congress distinguished small businesses and attempted to provide for a streamlined small business reorganization process. Unfortunately, these efforts have largely proved unworkable for most small businesses as the amendments were tightly confined within the strictures of Chapter 11.

For many small businesses, a Chapter 11 reorganization is not practical because the traditional proceedings are expensive and cumbersome. The SBRA, which took effect on February 19, 2020, created an entirely new subchapter of Chapter 11—Subchapter V—which eliminates some of the procedural barriers and costs of a traditional Chapter 11 proceeding in an attempt to make reorganization more viable for small businesses. Subchapter V includes the following provisions:

- The court must hold a status conference within 60 days of the petition date to discuss the "expeditious and economical resolution of the case," and the debtor must file a report 14 days before the conference detailing how it is attempting to obtain a consensual plan of reorganization;
- The debtor has the exclusive right to propose a plan of reorganization and it must be filed within 90 days of the petition date;
- There is no committee of unsecured creditors unless the court orders otherwise for cause;
- No disclosure statement is required unless the court orders otherwise for cause;
- The debtor is excused from paying quarterly U.S. trustee fees;
- The court may confirm a non-consensual plan of reorganization if the plan does not "discriminate unfairly" and is "fair and equitable" as to each class of impaired creditors

that has not accepted the plan; and
- The absolute priority rule is eliminated, which makes it easier for owners to retain their stake in the business.

Cases filed under Subchapter V have similarities to cases under Chapters 12 and 13.

A trustee is appointed to investigate the financial affairs of the debtor, help administer claims, and act as a conduit for the debtor's payments under its confirmed plan. The debtor remains in possession of its property and continues to operate the business. And a plan can be confirmed without the acceptance of a class of creditors if it treats creditors within the class fairly and the debtor commits all of its projected disposable income to making payments under the plan over the course of a three- or five-year period.

To be eligible under the SBRA, a small business must be engaged in commercial or business activities and cannot have more than $2,725,625 of secured and unsecured debt. Additionally, 50% of the pre-petition debt must have been generated from commercial or business activities. A small business is ineligible if its primary activity is owning single-asset real estate. Thus, whether a business qualifies as a small business debtor largely depends on its debt threshold.

Debt Limitation Increase Under the CARES Act

While Subchapter V appears to have created a more workable framework for small business debtors looking to reorganize their financial affairs, it remains inaccessible to many businesses that might otherwise qualify because of the debt threshold proscribed in the SBRA. The CARES Act represents a significant step toward expanding the scope of Subchapter V by increasing the debt limitation under the SBRA from $2,725,625 to $7,500,000. This increase, however, is only temporary and will sunset on March 27, 2021, unless further action is taken by Congress. Some proponents of the SBRA, such as the American Bankruptcy Institute, lobbied Congress for a debt threshold of $10 million before the SBRA was signed into law. While it remains uncertain whether Congress will permanently extend or increase the new debt limitation under the SBRA, it is clear that a much greater number of small businesses will be able to take advantage of Subchapter V over the next year.

For further information regarding the SBRA, the impact of the CARES Act on your business, or insolvency concerns relating to bankruptcy or receivership, please contact attorneys Jessica K. Haskell and Nicholas G. Chmurski.