The CARES Act's Expansion of Relief for Small Business Debtors

While it did not focus on bankruptcy relief, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act contained provisions relating to small bankruptcy debtors.

- The CARES Act increased the debt limit for debtors interested in taking advantage of the Small Business Reorganization Act of 2019 (the "SBRA"), which became effective in mid-February 2020. This makes it a viable option for a wider group of entities.
- As background, the SBRA added subchapter V to Title 11 of the Bankruptcy Code. This new law is designed to allow small business debtors "to file bankruptcy in a timely, cost-effective manner . . . [which] hopefully allows them to remain in business, [and] not only benefits the owners, but employees, suppliers, customers, and others who rely on that business." H.R. REP. No. 116-171, at 2 (2019).
- Bankruptcy courts will likely see an increase in chapter 11 filings during the next twelve months, as the fallout from the coronavirus epidemic continues.

SBRA Background

The motivations behind the SBRA were explained by the Chairman of the Senate Committee on the Judiciary, Senator Charles "Chuck" Grassley:

> "Our bankruptcy system is designed to help highly complex businesses reorganize after falling on hard times, but for many small businesses going through bankruptcy, these requirements can create unnecessary burdens that stall recovery. The Small Business Reorganization Act takes into account the unique needs of small businesses and streamlines existing reorganization processes. A well-functioning bankruptcy system, specifically for small businesses, allows businesses to reorganize, preserve jobs, maximize the value of assets and ensure the proper allocation of resources."

Indeed, the SBRA is debtor-friendly for the following reasons:

- A subchapter V debtor does not need to make quarterly payments to the Office of the United States Trustee;
- A subchapter V case dispenses (unless the Bankruptcy Court orders otherwise) with the appointment of a creditors committee, which can often challenge the debtor's reorganization efforts;
- In addition, a subchapter V debtor does not need to file a disclosure statement with a plan of reorganization, and the debtor is the only party that is eligible to file a reorganization plan;
- Finally, such plan of reorganization does not need to comply with the absolute priority rule, so that a debtor could retain an ownership interest in its assets even where all creditor claims are not paid in full.

These provisions, among others, are aimed to assist distressed small businesses, which Congress considers to "form the backbone of the American economy." Report from the House Committee on the Judiciary, 11 H.R. Rep. 116-171, at 1-2.

CARES Act Increases Debt Limit and Bankruptcy Courts' Allowance of Amended Petitions

Previously, the debt limit for subchapter V cases was $2,725,625. This amount seemed low, particularly in

large metropolitan areas such as Los Angeles or New York. Prior to enactment of the SBRA, the National Bankruptcy Conference had advocated a much higher debt limit of $7.5 million. In response to the pending financial crisis, the CARES Act increased the eligibility threshold to $7.5 million in total debt for a one-year period. Undoubtedly, the modification was designed to provide relief for small business debtors during the uncertainty of the coronavirus epidemic.

As stated above, an increase in the debt limit will likely increase the number of cases filed under subchapter V. This will add to the volume of cases in subchapter V, which have already been recently increased due to bankruptcy courts allowing amended subchapter V petitions to be filed under Bankruptcy Rule 1009. Since the SBRA was enacted a month ago, debtors in pending small business chapter 11 cases have been successful in converting or "re-designating" their cases to subdivision V. In reviewing re-designation requests, courts have "found no legal reason to restrict a pending chapter 11 case to re-designate to a Subchapter V case." See *In re Progressive Solutions, Inc.*, 2020 Bankr. LEXIS 467, at *13 (Bankr. C.D. Cal. Feb. 21, 2020); *In re Ventura*, 2020 Bankr. LEXIS 985, *23 (Bankr. E.D.N.Y. Apr. 10, 2020) ("[T]he Court finds that it is within the Court's discretion to reset the timelines to allow the Debtor to avail herself of the newly enacted law that was not at her disposal when she filed the Current Case."); *In re Bello*, 2020 Bankr. LEXIS 813 (Bankr. E.D. Mich. 2020) ("This Court agrees with the reasoning and holding in the recent case of *In re Moore Properties* . . . . That case held that a debtor in a chapter 11 case that was pending before the February 19, 2020 effective date of the SBRA could elect to proceed under Subchapter V."); *In re Body Transit*, 2020 Bankr. LEXIS 740, *15 (Bankr. E.D. Pa. March 24, 2020); *In re Moore Props. of Person Cty., LLC*, 2020 Bankr. LEXIS 550, *17 (Bankr. M.D.N.C. Feb. 28, 2020) (finding that a small business debtor "was entitled to make the election to have subchapter V apply").

In reaching its decision, the *Body Transit court* "consider[ed] the extent to which parties in interest have invested in the case and whether the court has entered orders that create sufficient vested property interests or post-petition expectations such that the application of subdivision V to those rights or expectations would offend 'elementary considerations of fairness.'" *Body Transit*, 2020 Bankr. LEXIS 740, at *14-15 (quoting *Moore Properties*). Further, in determining whether re-designation was appropriate, the *Body Transit* court considered "whether the amendment is made in bad faith or would unduly prejudice a party." *Id.* at 15. The court placed the burden of showing prejudice on the party objecting to the re-designation, which was the senior secured creditor.

In sum, the caselaw trend is to allow debtors that were in chapter 11 cases prior to the enactment of the SBRA to amend their petition to proceed under subchapter V.

Potential Side Effect of PPP Legislation on Debtors Already in Subchapter V

Initially, however, another provision of the CARES Act might be dissuading small businesses from filing subchapter V cases. Indeed, certain debtors presently in subchapter V cases are seeking dismissal of their existing cases due to CARES Act section 4003, which is the provision concerning the Federal Reserve's $500 billion business loan program. Specifically, section 4003(c)(3)(D)(i)(V) provides that mid-size businesses that would normally be eligible for low interest loans cannot obtain such loans if they are a debtor in a bankruptcy case. Accordingly, debtors seeking access to the loans have filed motions to dismiss their cases. E.g., In re CNC Puma Corporation, Inc., United States Bankruptcy Court for the Central District of California, Case No. 6:20-bk-12069-WJ. Dismissal motions might be granted under Bankruptcy Code section 1112 if the pending case is not at the confirmation stage. Unfortunately, however, from a timing basis, these debtors may not be able to dismiss their cases until after the CARES Act funding runs out. Without additional funding from Congress, these debtors find themselves in a regrettable situation.

Author:

Greg Jones
424.214.7044
gjones@sycr.com