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Client Advisory

Impact of the CARES Act on the Small Business Reorganization Act

While certain elements of the CARES Act have received much press and public attention recently – including stimulus checks expected to reach some 150 million Americans – a much lesser-known provision embedded in the CARES Act stands to potentially affect a large number of small business owners who have been impacted by the 2020 coronavirus pandemic. That provision broadens the eligibility requirements for a business seeking to take advantage of the recently passed Small Business Reorganization Act ("SBRA").

The SBRA: A Significant Change for Small Businesses Filing for Bankruptcy

The SBRA was passed into law last year and became effective on February 19, 2020. The SBRA seeks to address problems encountered by small business debtors in reorganizing under the provisions of the United States Bankruptcy Code (the "Bankruptcy Code"). Many small businesses found traditional chapter 11 proceedings too difficult and expensive, and not a practical tool for reorganization. Small businesses would often end up in liquidation under chapter 7 of the Bankruptcy Code, or simply abandon the notion of filing bankruptcy altogether.

The SBRA created a new Subchapter 5 under chapter 11 of the Bankruptcy Code. Subchapter 5 aims to provide businesses with debts under a certain threshold a faster, more streamlined, and less expensive option for reorganizing than under chapter 11. Some of the benefits of filing bankruptcy under Subchapter 5 include:

- An expedited case schedule, including early status conference and a plan submission deadline of 90 days.
- Only the debtor may file a proposed plan, and no separate disclosure statement is required.
- Owners are able to retain their interests in their business and there is no "new value" rule applied to equity holders.
- A trustee is appointed, but primarily to assist in the formulation of the plan.
- No unsecured creditors committee is appointed.
- A plan may be confirmed even without an accepting "impaired class" so long as the debtor's disposable income is put to plan payments to creditors, with the plan period being anywhere between three and five years.
- If the debtor completes the payments required under a confirmed plan, it receives a discharge of the remaining debt.

The CARES Act Nearly Triples the Debt Limits for Eligibility under Subchapter 5

Prior to passage of the CARES Act, a debtor (whether an entity or an individual) had to be engaged in business and have total debt, secured and unsecured, not exceeding $2,725,625 in the aggregate. The CARES Act raised this debt limit to **$7,500,000**. At least 50% of those debts must come from business activity (excluding debts owed to affiliates or insiders), and the debtor's principal activity cannot be a single-asset real estate operation. The small business debtor would need to file bankruptcy within one year of the effective date of the CARES Act and elect to proceed under Subchapter 5 in order to take advantage of the increased debt ceiling.

With the CARES Act nearly tripling the debt limits for eligibility under Subchapter 5, many more small businesses which have been adversely impacted by the COVID-19 pandemic will be able to benefit from a more cost-efficient and faster reorganization process under Subchapter 5.

If you believe that filing for bankruptcy under Subchapter 5 may be right for you or your business, or have any questions about any other bankruptcy or restructuring issue affecting your business, please contact Douglas Leney at 215- 246-3151 or dleney@archerlaw.com.

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