

R-E-L-I-E-F for small business debtors: CARES Act and SBRA



David A. Agay, M. Colette Gibbons, Stephen M. Gross, Ashley J. Jericho | Tuesday, April 14, 2020

The Small Business Reorganization of 2019, also known as the SBRA, signed by the president on August 23, 2019, enacted a new subchapter V of Chapter 11 of the Bankruptcy Code. The purpose of the SBRA was to “streamline the process by which small business debtors reorganize and rehabilitate their financial affairs.”^[1] The goal is to address the fact that chapter 11 is too expensive and too impractical for most small and not so small businesses. A sponsor of the legislation stated that the SBRA allows small business debtors “to file bankruptcy in a timely, cost-effective manner, and hopefully allows them to remain in business” which “not only benefits the owners, but employees, suppliers, customers, and others who rely on that business.”^[2]

The Covid-19 outbreak resulted in the passage of the Coronavirus Aid, Relief and Economic Security Act, or “CARES Act,” which was signed by the president on March 27, 2020. The CARES Act amended the SBRA and the Bankruptcy Code. As a result, it should be even easier for a “small business” to seek relief, successfully reorganize, and stay in business.

Highlights of CARES Act Changes

First and most importantly, section 1182(a) of the Bankruptcy Code increases the eligibility threshold of new subchapter V debtors from \$2,725,625 of debt to \$7,500,000. After one year, the eligibility threshold will revert to \$2,725,625.

The raising of the debt limit to \$7,500,000 not only makes more businesses eligible for filing a small

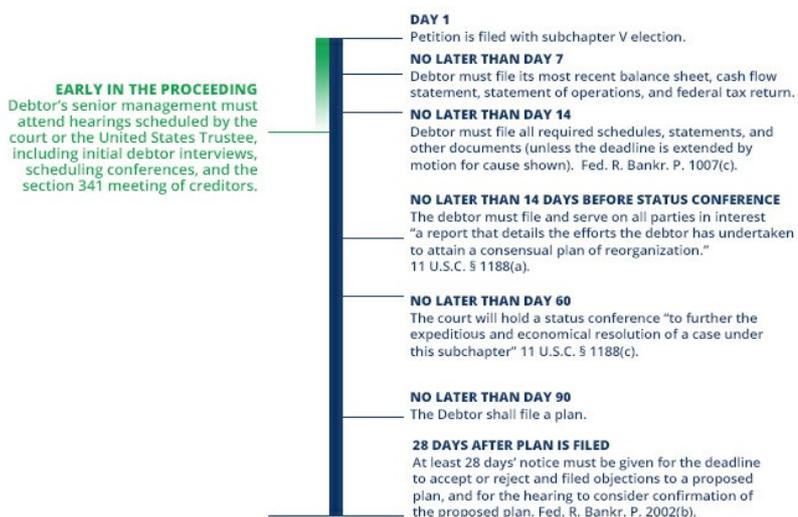
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business subchapter V chapter 11 case; existing chapter 11 debtors can elect to convert their pending Chapter 11 case to a subchapter V case in order to eliminate creditors' committees and the application of the absolute priority rule. The absolute priority rule severely limits the options for reorganization by requiring that creditors are paid in full before equity can receive anything, thereby often wiping out equity owners.

Second, the remainder of the SBRA was left undisturbed by the CARES Act. The existing limitations of subchapter V as originally enacted still apply for determining eligibility as a small business debtor. To be eligible as a small business debtor, 50 percent or more of the debt must arise from the commercial or business activities of the debtor. A debtor whose principal activity is the business of owning or operating real property is not eligible.

What to Expect in a Subchapter V Case

Here is a timeline of subchapter V case:



Immediately after the case is filed, the United States Trustee will appoint a subchapter V trustee. The role of the subchapter V trustee is to work with the debtor and the creditors, in a manner similar to a mediator, to facilitate a consensual reorganization. Within 60 days of filing, the Court holds a status conference to review the status of the case and "to further expeditious and economical resolution" of the case. Within 90 days of the order for relief, the debtor must file a plan. Only the debtor may file a plan under subchapter V.

The plan must contain a brief history of the operations of the debtor, a liquidation analysis, and projections regarding the ability of the debtor to make payments under the proposed plan. The plan must provide for the submission of "all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan." The plan can be confirmed on a consensual **or nonconsensual basis**, so long as the plan is deemed to be "fair and equitable" with respect to each class of claims.

If the court confirms a consensual plan, the service of the trustee terminates upon "substantial consummation," which generally occurs when distributions under the plan commence. The debtor must serve notice of substantial consummation on all parties in interest. The debtor then makes the payments under the plan, and the debtor will receive a discharge upon confirmation.

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If the court confirms a nonconsensual plan, the trustee will make the payments under the plan, unless the plan or confirmation order provides otherwise. The debtor will not receive a discharge until completion of the payments due within the first three years, or such longer period not to exceed five years as the court may fix.

Retention of equity by debtors in a viable business under consensual plans – one of the primary goals under the SBRA – is more likely due to the elimination of creditors’ committees and of the delay and expense associated with traditional chapter 11 cases.

The overwhelming number of business bankruptcies are filed by small and medium-sized enterprises. The CARES Act and the SBRA should facilitate the reorganization of even more businesses – a positive development for small business owners and the American economy.

The members of the Business Restructuring Department of McDonald Hopkins – many of whom have represented struggling businesses for their entire careers – are here to help small business reorganize and thrive.

[1] Report of Committee on the Judiciary, House of Representatives, Report 116-171, 116th Cong., 1st Sess., on Small Business Reorganization Act of 2019, at 1, available at <https://www.gov.infor.gov/content/pkg/CRPT116hrpt171/pdf/CRPT-116hrpt171.pdf>. For a summary of small business reorganizations under the Bankruptcy Code, see Ralph Brubaker, *The Small Business Reorganization Act of 2019*. 39 No. 10 BANKRUPTCY LAW LETTER (October 2019) at 1-4.

[2] Statement of Rep. Ben Cline, quoted in House Report 116-171, *supra* note 3 at 4.



David A. Agay

[Team member bio](#)



M. Colette Gibbons

[Team member bio](#)



Stephen M. Gross

[Team member bio](#)



Ashley J. Jericho

[Team member bio](#)