CARES Act amends Bankruptcy Code to raise debt limit on subchapter V cases

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The Small Business Reorganization of 2019 (“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 is to “streamline the process by which small business debtors reorganize and rehabilitate their financial affairs.” A sponsor of the legislation, Representative Cline, 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.

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. While not as widely reported, the CARES Act amended the SBRA and the Bankruptcy Code in an important respect that should further facilitate reorganizations under the Bankruptcy Code for small businesses.

The CARES Act amended section 1182(a) of the Bankruptcy Code to increase the debt eligibility from $2,725,625.00 to $7,500,000.00. After one year, the eligibility threshold will revert back to $2,725,625.00. The $7,500,000.00 cap more closely aligns with the recommendations on the American Bankruptcy Institute Commission to Study the Reform of Chapter 11, which sought to raise the debt limit to $10,000,000.

The remainder of the SBRA was left undisturbed by the CARES Act. With regard to eligibility, fifty percent or more of the debt must arise from the commercial or business activities of the debtor. Also, a debtor whose principal activity is the business of owning or operating real property is not eligible. Paragraph (B) of current section 101 (51D) provides that the term “small business debtor” excludes any member of a group of affiliated debtors that has aggregate debt in excess of the debt limit (excluding debts to affiliates and insiders).

There is potential that small business cases may become even larger under subchapter V. Interim Bankruptcy Rule 2009 permits the appointment of a single trustee in a jointly administered case under subchapter V, so it is clear that a court may order a joint administration of two or more subchapter V estates under the SBRA.[1] Joint administration of two or more subchapter V estates may further streamline the process and limit expense for affiliated small businesses.

In addition to potentially increasing the number of new subchapter V filings, raising the debt limit could cause certain current chapter 11 debtors to convert their pending cases to subchapter V cases. By converting to subchapter V, these debtors could take advantage of some of the most beneficial aspects of subchapter V: the expedited timeline, the elimination of creditors’ committees, and the application of the best efforts standard (instead of the absolute priority test) for confirming a chapter 11 plan. Subchapter V is intended to be a better fit for small businesses, and the CARES Act amendment opens the door for many previously excluded businesses to take advantage of subchapter V.

1 It is currently unknown whether two or more estates may be substantively consolidated under the SBRA. Given the complexity of a substantive consolidation request and determination process, it is unlikely that such a request would fit in with the purpose of the SBRA and timeline of a subchapter V case.

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