

The CARES Act: Expansion of Bankruptcy Protections for Small Businesses

Client Alert

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The newly enacted Coronavirus Aid, Relief and Economic Security Act (CARES Act) contains some significant bankruptcy-related provisions, including those which amend the Small Business Reorganization Act of 2019 (SBRA) to make bankruptcy relief available to an increased number of small businesses.

For those who are contemplating the need to develop a bankruptcy strategy - and for creditors evaluating a debtor's bankruptcy plan - it is important to understand these changes in the law.

SBRA, which became effective on February 19, 2020, was intended to streamline the reorganization process for small businesses as defined in the Act by eliminating several of the hurdles to reorganization and discharge of debt, and by reducing the cost of the process. SBRA also contains certain tradeoffs for facilitating the process in the form of more stringent requirements for obtaining a discharge (including post-petition earnings and property as "property of the estate") and limiting those businesses which are eligible to be debtors under SBRA.

Section 1113 of the CARES Act expands the debt limitations which previously existed to permit more businesses to access the beneficial aspects of SBRA, which is a voluntary reorganization chapter that can be filed only by a qualifying debtor. Additional changes were made to exclude from the definition of "income" in Chapter 7 and "disposable income" in Chapter 13 payments which may be received from the federal government as coronavirus-related payments.

The following is a summary of the new COVID-19-related provisions of SBRA as amended by the CARES Act:

- Section 101(51)(D) of the Bankruptcy Code, which set the debt limitation for small business debtors at \$2,725,625 including secured and unsecured debt, is amended to increase the debt limitation to \$7,500,000, thereby expanding eligibility to larger debtors.

- The Office of the United States Trustee may appoint a “standing” trustee rather than an operating trustee. The provision provides for the appointment of a trustee in a small business case to monitor the debtor’s operation of the business and compliance with the plan.
- No creditors committee is appointed in a small business debtor’s case; thereby saving the administrative expense of additional professionals.
- A status conference with the Court is to be held not later than 60 days following the entry of the order for relief. Prior to the status conference the debtor must file a report detailing the steps being taken to file and confirm a consensual plan of reorganization.
- The plan can be filed only by the debtor and must be filed within 90 days of the entry of the order for relief; although there are provisions to extend the time for filing. The plan must include:
 - A history of the business;
 - A liquidation analysis; and
 - Projected payments to be made by the debtor.
- The plan may modify the payments to be made on account of secured debt including payments made to the holder of a mortgage encumbering the principal residence of the debtor provided that the loan was not used primarily to acquire the real property or in connection with the business of the debtor.
- The absolute priority rule is abolished. The impact of the abolishment of the absolute priority rule is a dramatic change in the law which precluded owners of chapter 11 businesses from retaining an ownership interest in the reorganized debtor absent payment of 100% of allowed claims to those creditors holding positions senior to the equity holder or attempting to carve out the new value to the absolute priority rule, if it still exists.
- The requirement of filing a Disclosure Agreement is eliminated, thus saving time and expense.
- A plan may be confirmed over the objections of creditors provided that the plan does not discriminate unfairly and is fair and equitable with respect to each class of creditors that is impaired and has not accepted the plan.
- To be fair and equitable the plan must contain the following requirements:
 - All projected disposable income of the debtor to be received in the three-year period following confirmation or a longer period, but not to exceed five years, must be included in the plan;
 - The value of the property to be distributed under the plan during the plan period must not be less than the projected disposable income of the debtor; and
 - The plan must contain appropriate remedies such as liquidation of non -exempt assets if there is a breach under the plan.
- A discharge will be granted only after all plan payments are made. Thus, debtors must wait three to five years and must complete all plan payments before receiving a discharge.

In summary, the recent introduction of SBRA into law, in tandem with the bankruptcy-related provisions of the CARES Act, may provide small businesses with a more efficient, expansive and less expensive means of addressing the dramatic economic impacts of the COVID-19 pandemic.

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