Bankruptcy Law

ALERT

APRIL 2020

CARES Act Expands Small Business Reorganization to Enterprises with Up to $7.5 M in Debt

The recently enacted Coronavirus Aid, Relief, and Economic Security (CARES) Act expands the application of the Small Business Reorganization Act of 2019 (SBRA) to more distressed businesses. The SBRA gives qualifying businesses and their owners more leverage to reorganize in bankruptcy court over the objection of creditors. The SBRA process is also less expensive and more streamlined than a typical Chapter 11 case.

For the next year, an individual or entity “engaged in commercial or business activities” with noncontingent liquidated debts totaling up to $7.5 million may opt for the SBRA when filing for a Chapter 11 reorganization. This qualifying debt limit is up from just $2,725,625, applicable before March 27. Debts to insiders and affiliates are not counted against this limit, but at least one-half of the total must arise from the debtor’s commercial or business activities—a threshold likely to be met by a business entity. Companies required to file reports with the Securities and Exchange Commission (SEC) and their affiliates, businesses with the primary activity of owning single-asset real estate, and companies in affiliated debtor groups with debt totaling more than $7.5 million cannot elect the SBRA in Chapter 11.

As in other Chapter 11 cases, the debtor’s management presumptively remains in place under the SBRA. However, electing to invoke the SBRA provisions affords qualifying businesses and their owners a number of advantages unavailable in a typical Chapter 11:

- **Owners can keep their reorganized business even if creditors are not paid in full.** In a typical Chapter 11 that does not fully pay creditors, equity owners are often wiped out or need to reinvest a substantial amount to “buy back” the company. The SBRA allows for confirmation of a Chapter 11 plan that maintains pre-bankruptcy ownership and discharges the reorganized debtor from unpaid debts as long as the debtor’s plan dedicates three to five years of the debtor’s “projected disposable income” to creditor distributions, subject to certain other conditions.

- **Modifications permitted to certain debt secured by the debtor's residence.** In a non-SBRA Chapter 11 case, an individual debtor cannot modify debt secured by his or her principal residence. The SBRA permits this modification as long as the debt was used primarily in connection with the debtor’s business and not to acquire the residence. As in all Chapter 11 cases, in order for a reorganized debtor to retain a secured creditor’s collateral, the SBRA requires that any plan (1) maintain a secured creditor’s lien on its collateral and make payments to the secured creditor over the life of the plan equivalent to the collateral’s value, which can have the effect

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of stretching out the mortgage maturity date; or (2) provide the secured creditor the "indubitable equivalent" of its secured claim.

- **The SBRA permits the debtor to pay post-petition "administrative" claims over time under a plan, even if creditors object.** While administrative claims—those incurred during the bankruptcy—must be paid on the effective date of the plan in a typical Chapter 11 case, the SBRA permits the debtor to stretch out many obligations incurred during the Chapter 11 process.
- **The SBRA waives certain government fees that a debtor in a non-SBRA Chapter 11 case would have to pay.** This benefit reduces the cost of the Chapter 11 case.
- **Procedural Advantages.** The SBRA gives the debtor many procedural advantages and cost-saving efficiencies to achieve a "cram down" plan confirmation:
  - Only the debtor can file and seek confirmation of a reorganization plan to exit bankruptcy under the SBRA.
  - The debtor need not file a separate disclosure statement with the plan, reducing the paperwork burden on the debtor.
  - No impaired class of claims need vote in favor of a plan's confirmation, even if the plan pays creditors less than in full. This minimal affirmative vote is a confirmation requirement in a non-SBRA Chapter 11.
  - Unlike other Chapter 11 cases, there is no presumption of a creditors' committee appointment. A standing trustee monitors the SBRA case, including to ensure that a plan is confirmed and that the debtor complies with it.
  - The debtor must file the plan in the first 90 days of the case. However, the court can extend this time if "attributable to circumstances for which the debtor should not justly be held accountable." We would expect courts to be flexible on this deadline in the face of the uncertainty surrounding COVID-19.

COVID-19 Resource Center

For more information on the business impacts of COVID-19, we encourage you to visit our COVID-19 Resource Center, which we will continue to update as the situation evolves. If you have questions about COVID-19's impact on your business, please reach out to your Loeb relationship partner, or email us directly at COVID19@loeb.com.

Related Professionals

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