Coronavirus Aid, Relief, and Economic Security Act Expands Scope of Small Business Reorganization Act

By Jessica Ljustina (Harvard Law School)

Congress passed the Small Business Reorganization Act of 2019 ("SBRA") to streamline and reduce the cost of bankruptcy for small businesses; it went into effect on February 19, 2020. As originally enacted, the Act allowed certain small businesses with no more than approximately $2.7 million of debt to file for bankruptcy under a new subchapter V of chapter 11 of the Bankruptcy Code. Noncontingent liquidated secured and unsecured debts, excluding debts owed to affiliates or insiders, count toward that limit. At least 50% of the pre-petition debt must also have arisen from the debtor's commercial or business activities. But some small businesses are excluded altogether. Subchapter V is not available to a debtor whose primary activity is owning single asset real estate, who is a corporation subject to reporting requirements under § 13 or § 15(d) of the Securities Exchange Act of 1934 ("SEA"), or who is an affiliate of an issuer, as defined in § 3 of the SEA.

The recently enacted Coronavirus Aid, Relief, and Economic Security ("CARES") Act has temporarily increased the debt limit to $7.5 million for cases commenced in the next year. That may greatly expand the SBRA's scope, as Professor Robert Lawless has estimated that over 50% of businesses that filed under chapter 11 between 2013 and 2017 had debt below $7.5 million. The limit will revert back to just over $2.7 million on March 27, 2021.

Sponsors of the SBRA envisioned that it would "increase debtors' ability to negotiate a successful reorganization and retain control of the business, reduce unnecessary procedural burdens and costs[,] increase[] oversight and ensure[] quick reorganization." Consistent with these goals, the major provisions of the SBRA include:

- The creditors cannot propose a plan, but the debtor must propose one within 90 days of filing; the court may extend this deadline if needed due to circumstances outside the debtor's control;
- No creditors' committee and no disclosure statement required, unless ordered by the court for cause;
- The court shall confirm a plan even without the acceptance of at least one class of impaired claims (the § 1129(a)(10) requirement does not apply);
- Equity holders may retain ownership in the company even if unsecured claims are not paid in full, if the plan is fair and equitable and does not unfairly discriminate (§ 1129(b)(2)(B) and (C) do not apply); "fair and equitable" includes the requirements that all "projected disposable income" (or property of equivalent value) over a 3–5 year period be applied to payments under the plan, and that there is a reasonable likelihood the debtor will be able to make all payments under the plan;
- A subchapter V trustee will be appointed by the United States trustee to facilitate the reorganization, and no United States trustee fees are required to be paid by the debtor; and
- The court will hold a mandatory status conference within 60 days of filing to further the expeditious and economical resolution of the subchapter V case.

The expansion of SBRA complements other provisions in the CARES Act supportive of small businesses (up to 500 employees), including emergency grants, partially forgivable loans, and relief for existing Small Business Administration loans. As COVID-19 continues to have widespread negative economic effects, many businesses may contemplate the option of restructuring under subchapter V.

For those interested in further discussion of the SBRA, two recent publications are of note. First, Bankruptcy Judge Paul Bonapfel has written a comprehensive guide to the SBRA. Second, K&L Gates has written a more concise summary of subchapter V.

For a previous Roundtable post discussing the SBRA in the context of relative and absolute priority default rules, please see Corporate Restructuring under Relative and Absolute Priority Default Rules: A Comparative Assessment.