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CARES Act Guide: Overview of Key Reorganization Provisions and Bankruptcy Code Amendments

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On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act or the "CARES Act", into law. The CARES Act will provide significant financial relief to individuals and small businesses, especially those businesses in certain sectors of the U.S. economy that have been hit hardest by the COVID-19 pandemic, by providing \$2 trillion in stimulus to the U.S. economy. The CARES Act is the third round of federal government aid related to COVID-19.

The CARES Act includes several amendments to the Bankruptcy Code (11 U.S.C. §101 *et seq.*), the most important of which is the raising of the debt threshold for small businesses to take advantage of the Small Business Reorganization Act (the "SBRA"), which added a new subchapter to chapter 11 of the Bankruptcy Code, from the current \$2.7 million to \$7.5 million in aggregate debt.

The SBRA was enacted to expedite small business bankruptcies, reduce legal expenses in such cases, and make it easier for qualifying debtors to confirm a plan and maintain ownership over the business (by pledging to disburse income to creditors over a period of 3 to 5 years). The SBRA only became effective in February 2020 but is intended to reduce, perhaps substantially, the duration and expense of a chapter 11 case for qualifying small businesses. By raising the debt threshold to qualify as such a business from \$2.7 million to \$7.5 million, the CARES Act may motivate many more companies to utilize these debtor friendly provisions in response to the current crisis. It is important to note, however, that this change applies only for cases filed until March 27, 2021, at which time the debt threshold returns to \$2.7 million.

A significant portion of the CARES Act focuses on supporting American workers, families and businesses through a combination of unemployment provisions, tax rebates, retirement plan changes and modifications to the Internal Revenue Code of 1986, as amended (the "Code"). This Quick Study focuses on the amendments made to the Bankruptcy Code by the CARES Act. Please note that Locke Lord has separate Quick Studies that review the CARES Act's provisions related to [Business Tax Changes](#), [Employee Benefits Changes](#), [Executive Compensation Limits](#), [Expanded Unemployment Benefits](#), and [Charitable Contributions](#), among other topics.

Amendments to Subchapter V of Chapter 11 (the Small Business Reorganization Act)

The Bankruptcy Code provides special rules and procedures for "small business debtors." See 11 U.S.C. §101(51D). Notwithstanding these provisions, Congress recently determined that "small business chapter 11 cases continue to encounter difficulty in successfully reorganizing." H.R. Rep. No. 116-171, at 4 (2019). In response, Congress enacted the SBRA (see subchapter V of chapter 11 of the Bankruptcy Code, at 11 U.S.C. §1181 *et seq.*), which was signed by President Trump in August 2019 and became effective on February 19, 2020. By enacting the SBRA, Congress intended to streamline small business bankruptcies, reduce legal expenses in such cases, establish an expedited schedule for the debtor to reorganize, and set forth more debtor friendly plan requirements and confirmation standards.

Previously, in order to qualify as a "small business debtor," a business must have had non-contingent, liquidated debts (secured and unsecured) totaling not more than \$2,725,625. See 11 U.S.C. § 1182(1); 11 U.S.C. §101(51D). The CARES Act modifies the SBRA (and thus the Bankruptcy Code) by amending



section 1182(1) to raise this threshold to \$7.5 million in debts, excluding insider and affiliate debt. The CARES Act includes a sunset provision, however, which provides that one year from enactment, the amendment to section 1182(1) is revoked such that the \$2,725,625 threshold is reinstated. Thus, for a period of one year, the CARES Act allows more small businesses to qualify as a debtor under the small business reorganization provisions of chapter 11 recently added by the SBRA. The CARES Act also amends the SBRA to provide that no affiliate of a public company is eligible pursuant to SBRA.

This change is important because more businesses may be motivated to file for chapter 11 in response to the current crisis if they are able to take advantage of the SBRA's more debtor friendly procedures and confirmation requirements. Some of the key provisions that the SBRA added to chapter 11 of the Bankruptcy Code include the following:

- The United States Trustee will be required to appoint a trustee in every small business chapter 11 case. The trustee will have a role in assisting the debtor in developing a plan of reorganization, and will be responsible for disbursing payments under a plan. However, the trustee will serve in a mostly supervisory role and will not generally be involved in any operational aspects of the business. See 11 U.S.C. §§ 1183-1184. In this sense, the SBRA preserves the notion of a "debtor in possession" in small business cases.
- An unsecured creditors' committee will not be appointed unless ordered by the court for cause. See 11 U.S.C. § 1102(a)(3).
- A status conference must be held within 60 days of the date of the petition to determine how best to proceed with the case. The date of the status conference may be extended if cause is demonstrated. See 11 U.S.C. § 1188(a).
- A plan of reorganization must be filed within 90 days of the petition date, although the court can extend the deadline if circumstances outside the control of the debtor merit an extension. Only a debtor may file a plan, and no disclosure statement is required. However, a plan must contain some information, such as a liquidation analysis and a projection of a debtor's ability to make payments under the plan, traditionally associated with a disclosure statement. See 11 U.S.C. § 1189.
- A plan may modify the rights of a secured lender with a lien on the principal residence of the debtor if the "new value" received from the loan was not used primarily to acquire the residence and was used primarily in connection with the small business. See 11 U.S.C. § 1190. Modification of such a loan is otherwise prohibited in chapter 11 cases. See 11 U.S.C. § 1123(b)(5).
- The SBRA makes it easier for a debtor to confirm a plan and maintain ownership of its business. In a typical chapter 11 case, the "absolute priority rule" ensures that owners cannot retain equity in a business unless creditors are paid in full by the chapter 11 plan. The SBRA abrogates this rule and provides that existing owners of a business may retain their full ownership without providing any "new value," *but only if* the plan provides for the debtor to distribute all of its projected disposable income over at least three years and no more than five from the date the first payment is due under the plan. See 11 U.S.C. § 1191.
- In a typical chapter 11 case, a debtor must pay administrative expense claims—claims incurred for goods and services during the post-petition period—on the effective date of a plan of reorganization. Under the SBRA, a small business debtor may stretch payment of administrative expense claims out over the term of the plan. See 11 U.S.C. § 1191(e).
- Under the SBRA, a discharge is not granted until the debtor completes all payments due within the first three years of the plan or a longer period not to exceed five years as the court determines. The discharge applies to all debts addressed by the plan except for debts (1) on which the last payment is due after the first three years of the plan, or such other time fixed by the court not beyond five years, or (2) debts otherwise non-dischargeable. See 11 U.S.C. § 1192.



Months before the current crisis, Congress enacted the SBRA to encourage more small business chapter 11 reorganizations. Since the SBRA became effective only in February 2020, it is too early to determine whether it is likely to accomplish Congress's goals, but the pandemic is likely to accelerate its use. Now that the CARES Act has substantially enlarged the debt threshold for qualifying as a small business, it may spur many more companies to file for chapter 11 as a small business in an attempt to utilize these debtor friendly provisions to navigate the current crisis.

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