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Legislative Update

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CARES Act, SBRA and Anticipated Wave of Subchapter V Filings

Editor's Note: Bookmark ABI's SBRA Resources website at abi.org/sbra and ABI's Coronavirus Resources for Bankruptcy Professionals website at abi.org/covid19 for the latest developments.



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Much of the recent news surrounding the Coronavirus Aid, Relief and Economic Security Act of 2020 (CARES Act)¹ has been focused on the impacts of direct-to-taxpayer checks, bailouts for major corporations and industries, and other benefits aimed at stimulating the slumping U.S. economy, including the additional funding provided to the Small Business Administration's § 7(a) loan program and the Paycheck Protection Program (PPP). However, there is one aspect of the CARES Act that should not be overlooked by small businesses struggling in these uncertain times: The amendments to the Small Business Reorganization Act of 2019 (SBRA)² that make its streamlined chapter 11 procedures more broadly available for a limited period of time.

The SBRA, which took effect in February 2020 and was clearly not crafted in anticipation of a global pandemic, created a new subchapter V (§§ 1181-1195) of chapter 11 of the Bankruptcy Code, which provides for a modified opt-in chapter 11 procedure for small businesses (originally defined in the SBRA as businesses having aggregate non-contingent, secured and unsecured debts less than or equal to \$2,725,625). Before the SBRA's enactment, the barriers to entry (*i.e.*, the overall length and sheer expense) often prevented such businesses from pursuing the benefits of chapter 11. This left them in a position where a closure and liquidation, or a state law bankruptcy alternative (such as an assignment

for the benefit of creditors), was often their only viable option.

The SBRA's new subchapter V procedures — which vary in key respects from those of a "traditional" chapter 11 proceeding and are designed to substantially streamline the chapter 11 process, reduce administrative costs for small businesses and enable business owners to retain ownership of their businesses post-confirmation — have been extensively written about and commented upon by ABI and in myriad other publications, and as such will not be repeated here.

With the recent passage of the CARES Act, the subchapter V debt limit has now been raised from the original \$2,725,625 to \$7.5 million, with this increase in effect for cases commenced within one year from the date of enactment (specifically, between March 27, 2020, and March 27, 2021). As such, while the number of businesses eligible to take advantage of the SBRA's streamlined chapter 11 process has dramatically increased, thereby offering a favorable alternative to companies that may have otherwise been forced to shutter and liquidate, this increase is only temporary, and companies considering a subchapter V restructuring should act quickly in order to preserve their rights.

With the COVID-19 pandemic wreaking havoc on businesses large and small in myriad industries, the modifications to the SBRA under the CARES Act are a welcome development for small and lower-middle-market businesses, and it is hoped that access to subchapter V will save otherwise healthy businesses from an untimely and unwarranted demise. The ability of these companies to restructure their indebtedness through a fast-tracked, streamlined chapter 11 process benefits nearly every constituency — business owners, vendors, customers, employees, landlords, lenders

¹ Pub. L. 116-136.

² Pub. L. 116-54, 133 Stat. 1079.

and governmental entities — who can preserve the ability to collect tax revenue from restructured businesses in the future. While chapter 11 is not necessarily a panacea for the staggering losses that will be incurred by those constituents, it is an important mitigating event: The health of the U.S. economy after the grip of COVID-19 is loosened is dependent on small businesses — which contribute approximately two-thirds of net new jobs and generate more than 40 percent of the U.S.’s gross domestic product³ — being able to survive and being positioned to eventually resume full operations. Accessibility to the chapter 11 process by small and medium-sized businesses — and the ability of debtors to use the protections of the Bankruptcy Code to restructure debt obligations, renegotiate leases and key supply contracts, and manage trade indebtedness — will enable many small and lower-middle-market businesses to “ride out the storm” and be positioned for the post-COVID-19 economy.

The need for greater access to subchapter V, even if only temporarily, is underscored by the fact that other federal and state small business assistance programs, such as the PPP, are not expected to run indefinitely. While the PPP has been extended on several occasions and was recently reopened to permit new applications through Aug. 8, 2020, it is inevitable that the PPP and similar programs will soon terminate, cutting off eligible businesses from access to emergency federal funding. Moreover, the PPP loan-forgiveness process is a moving target: The SBA and PPP lenders are not even accepting forgiveness applications as of the publication of this article, and the forgiveness process itself has not been finally determined, but in any event is expected to take months to complete. As such, small business recipients of PPP loans will be faced with continuing uncertainty as to the extent to which their loans will be forgiven, or even worse, the possibility that the SBA or PPP lender may determine on eligibility grounds that the entire loan is repayable. These risks alone might compel businesses (especially those having aggregate debts between the original SBRA threshold and the temporary CARES Act threshold) to seek subchapter V protection as a prophylactic measure.

Meanwhile, COVID-19 has not subsided; in fact, positive cases are now at their highest level since the beginning of the crisis. Certain states and local governments continue to subject businesses to operating restrictions, while other states and governments have rolled back (or are considering rolling back) phased reopenings in light of new outbreaks, particularly in the Southeast and Southwest regions of the U.S. Meanwhile, many small businesses such as restaurants, gyms, retail businesses and performance venues — even after being permitted to fully reopen — will continue to struggle with the restoration of their operations given the public’s continuing concerns about COVID-19 transmission. It should be assumed that the need for bankruptcy protection for these businesses will dramatically increase in the coming months, especially if affected businesses are unable to obtain private financing or are faced with a short-term threat of eviction or foreclosure.⁴

Access to the federal bankruptcy process has taken on a heightened level of importance in the aftermath of COVID-19, given the concern that in the absence of bankruptcy relief — and the benefits afforded by the SBRA — millions of small businesses are at risk of permanent closure. Of the nation’s approximately 30 million small businesses, more than 100,000 already have closed for good since the outbreak.⁵ One in five (22 percent) respondents to the U.S. Chamber of Commerce’s Small Business Coronavirus Impact Poll in May 2020 said that their small businesses are two months or less from closing permanently.⁶ Two in five (43 percent) respondents to an April 2020 *MarketWatch* survey reported that their small businesses will be forced to close permanently within six months without some kind of quick cash infusion or fast improvement in economic conditions.⁷ Meanwhile, Main Street America reported that nearly 3.5 million small businesses are at risk of closure in the next two months, and 7.5 million might be at risk of closing permanently over the next five months.⁸

While the odds of predicted survival may vary among the polls, the results of each poll anticipate that a disturbing number of small businesses might close down permanently as a result of COVID-19. Since many of these businesses were otherwise healthy just before COVID-19, it follows that they might be prime candidates for subchapter V filings.

We are already beginning to see an increase in commercial chapter 11 filing activity, including by small businesses, since the COVID-19 pandemic hit the U.S., following years of historically low filing numbers. Between March 2020 and June 2020, 2,404 commercial chapter 11 cases were filed, an increase of more than 33 percent from the prior year, and June 2020 saw 609 filings, representing a 43 percent increase from June 2019.⁹ More than 500 chapter 11 filings have been filed under subchapter V since the SBRA’s effective date.¹⁰ Many of these filings, particularly those of restaurants and restaurant groups and retailers, can be directly attributed to (or were at least exacerbated by) the pandemic. As certain sectors of the economy (including travel and transportation, brick-and-mortar retail, restaurant dining and entertainment) will be dealing with the after-effects of COVID-19 for many

4 Heather Long, “Small Business Used to Define America’s Economy. The Pandemic Could Change That Forever,” *Washington Post* (May 12, 2020), available at [washingtonpost.com/business/2020/05/12/small-business-used-define-americas-economy-pandemic-could-end-that-forever/](https://www.washingtonpost.com/business/2020/05/12/small-business-used-define-americas-economy-pandemic-could-end-that-forever/); Mary M. Caskey, “Small Business Bankruptcies: New Beginnings in the Midst of COVID-19,” Haynsworth Sinkler Boyd (April 30, 2020), available at [hsblawfirm.com/Connect/Blog/2020/Small-Business-Bankruptcies-New-Beginnings-COVID/](https://www.hsblawfirm.com/Connect/Blog/2020/Small-Business-Bankruptcies-New-Beginnings-COVID/); “Expected Rise in Business Bankruptcies due to COVID-19,” Redmann Law (April 30, 2020), available at [redmannlaw.com/expected-rise-in-business-bankruptcies-due-to-covid-19/](https://www.redmannlaw.com/expected-rise-in-business-bankruptcies-due-to-covid-19/); Sarah O’Brien, “How to Navigate Bankruptcy if the Coronavirus Wrecks Your Business,” CNBC (May 19, 2020), available at [cnbc.com/2020/05/19/how-to-navigate-bankruptcy-if-the-coronavirus-wrecks-your-business.html](https://www.cnbc.com/2020/05/19/how-to-navigate-bankruptcy-if-the-coronavirus-wrecks-your-business.html).

5 Joseph Guzman, “More than 100,000 Small Businesses Have Permanently Closed Due to Coronavirus, Study Estimates,” *The Hill*, available at thehill.com/changing-america/well-being/longevity/497519-more-than-100000-small-businesses-have-permanently; see Long, *supra* n.4.

6 “Small Business Coronavirus Impact Poll,” U.S. Chamber of Commerce (May 5, 2020), available at [uschamber.com/report/small-business-coronavirus-impact-poll](https://www.uschamber.com/report/small-business-coronavirus-impact-poll).

7 Andrew Keshner, “43% of Small Businesses Say They’ll Be Forced to Close Permanently if They Don’t Get Help Soon, Survey Says,” *MarketWatch* (April 13, 2020), available at [marketwatch.com/story/43-of-small-businesses-say-theyll-be-forced-to-close-permanently-if-they-dont-get-help-soon-survey-says-2020-04-03](https://www.marketwatch.com/story/43-of-small-businesses-say-theyll-be-forced-to-close-permanently-if-they-dont-get-help-soon-survey-says-2020-04-03).

8 “New Report: The Impact of COVID-19 on Small Businesses,” *Main St. Am.* (April 9, 2020), available at [mainstreet.org/blogs/national-main-street-center/2020/04/09/new-report-the-impact-of-covid-19-on-small-business](https://www.mainstreet.org/blogs/national-main-street-center/2020/04/09/new-report-the-impact-of-covid-19-on-small-business).

9 “June 2020 Bankruptcy Statistics — Commercial Filings,” compiled by Epic AACER, available at [abi.org/newsroom/bankruptcy-statistics](https://www.abi.org/newsroom/bankruptcy-statistics) (these figures do not account for several large chapter 11 cases in which dozens of affiliated entities were filed under joint administration).

10 Aisha Al-Muslim, “Chapter 11 Business Bankruptcies Rose 26% in First Half of 2020,” *Wall Street Journal* (July 2, 2020), available at [wsj.com/articles/chapter-11-business-bankruptcies-rose-26-in-first-half-of-2020-11593722250](https://www.wsj.com/articles/chapter-11-business-bankruptcies-rose-26-in-first-half-of-2020-11593722250).

3 Kathryn Kobe & Richard Schwinn, “Small Business GDP, 1998-2014,” Small Bus. Admin. Office of Advocacy (December 2018), available at cdn.advocacy.sba.gov/wp-content/uploads/2018/12/21102039/rs444-Small-Business-GDP-1998-20141.pdf (unless otherwise specified, all links in this article were last visited on June 23, 2020).

months to come, chapter 11 filings in those sectors are likely to increase to levels not seen since the 2008 global recession. As these industries are heavily populated by small businesses, meaningful increases in subchapter V filings — particularly compared to pre-SBRA numbers — are virtually guaranteed.¹¹

There is every reason to believe that there would have been an increase in small business filings even without the intervention of COVID-19, given the substantial benefits accorded small business debtors under the SBRA. Debtors will now make a concerted effort to elect subchapter V where they may not have previously seen the value in making a small business election, and companies that would have otherwise avoided chapter 11 (especially those for which incumbent ownership would have been forced to relinquish their equity by operation of the absolute-priority rule) will now look at it as an attractive option. The tripling of the debt limit under the CARES Act, and its unprecedented impact to the national economy, will very likely cause an exponential increase in filings when compared to pre-COVID-19 estimates. Even if only 1 percent of the 3.5 million small businesses at risk of immediate closure were to file, that would result in 35,000 filings, representing an over 50 percent increase in overall business filings from 2019. What if 2 percent, 5 percent or 10 percent of those companies file? We could be seeing a “rush to the courthouse” unprecedented in the Bankruptcy Code era that could run the risk of overwhelming the court system for the foreseeable future.¹² **abi**

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¹¹ The National Restaurant Association states that nine in 10 restaurants have fewer than 50 employees, and that seven in 10 restaurants are single-unit operations. “Restaurant Industry Facts at a Glance,” Nat’l Rest. Ass’n, *available at* restaurant.org/research/restaurant-statistics/restaurant-industry-facts-at-a-glance.

¹² Since 1980, the highest number of business bankruptcy filings was in 1987, when 82,849 cases were filed. Even if only 5 percent of troubled small businesses filed for subchapter V relief, the resulting figures (exceeding 150,000 cases) would be historic. “Quarterly U.S. Business Filings (1980-Present),” ABI, *available at* abi.org/newsroom/bankruptcy-statistics (listed under “Statistics from the Administrative Office of the U.S. Courts” section).