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THE INTERSECTION OF THE NEW CHAPTER 11- SUBCHAPTER V (SMALL BUSINESS REORGANIZATION) AND COVID-19

There is a connection between the two. . .

In 2019, without yet being aware of the soon to arrive Coronavirus pandemic, the United States Congress amended Chapter 11 of the Bankruptcy Code in order to make the bankruptcy reorganization "tool" more expedient, accessible, efficient and practical. The Small Business Reorganization Act (SBRA) became effective on February 19, 2020. That effective date of this "new and improved" small business bankruptcy reorganization law was quickly followed by the passage of the CARES Act, though the proximity of those two major pieces of legislation was certainly not anticipated when the SBRA was enacted. As further explained below, these two milestone pieces of legislation are now inextricably linked. And, that's a good thing, particularly under the present economic circumstances.

The apparent intent of the SBRA was to make the bankruptcy reorganization process (Chapter 11) more accessible and less costly than would otherwise be the case under a "standard" Chapter 11 proceeding. That process benefits both debtors and creditors alike. An entirely new "Subchapter" of Bankruptcy Code Chapter 11 was created by this legislation – Subchapter V – which is available to qualified small businesses seeking to reorganize under Chapter 11 of the Bankruptcy Code. The two key facets of the SBRA are expedience and lower cost. Some of the major pieces of the SBRA, Subchapter V process include the following:

1. No Official Creditor's Committee. This represents a significant cost savings relating to the administration of a Chapter 11 case under Subchapter V.
2. No payment by the Debtor-in-Possession (DIP) of United States Trustee fees. Again, a significant cost savings to the DIP.
3. No Disclosure Statement required. Another major cost savings and time savings in the pursuit of seeking confirmation of a reorganization plan.
4. Mandatory case "status conference" to be held not later than 60 days after the bankruptcy petition is filed. Such status conferences are used by the Judge presiding over the case to ensure that the DIP is actively and vigorously moving the case ahead towards a consensual Plan of Reorganization.
5. Mandatory pre-status conference report to be filed by the DIP no later than 14 days prior to the mandatory status conference. This pre-conference report requires that the DIP demonstrate the debtor's efforts to attain a consensual reorganization plan.
6. Only the DIP can file a proposed plan of reorganization.

7. Mandatory requirement that DIP files a proposed reorganization plan within 90 days after the petition is filed. A significant facet of expediting the reorganization process. Also, less time in court, less legal expense for all.

Under the SBRA statute as enacted, there was a mandatory jurisdictional "debt limit" of all debt, in the amount of $2,566,000.

Here's the connection.

In an effort to try to address the devastation of COVID-19 and the Coronavirus pandemic, Congress passed and the President quickly signed the Coronavirus Aid, Relief and Economic Security Act (CARES Act), effective as of March 27, 2020. While there are many component parts to this Act touching upon a wide variety of issues and activities impacted by this pandemic, the over arching objective is to help sustain the United States' economy. The CARES Act is supposed to provide some relief to individuals and businesses which are negatively impacted by the pandemic. Though the benefits of this Act may not have yet trickled down to all the necessary layers of our economy, the objective of the CARES Act is to infuse funds into the economy and the employment world, in an effort to mitigate the devastating effect of this once-in-a-lifetime worldwide scourge. Literally billions of dollars are to be pumped into the economy, much of it through Small Business Administration guaranteed loans under Section 7(a) of the Small Business Act. The underlying goals of the Act include saving businesses and saving jobs.

But the CARES Act did something else: it temporarily modified the SBRA to increase the jurisdictional debt limit from the then existing $2,566,000 combined debt to $7,500,000. Consequently, significantly more small businesses will have the opportunity to utilize the new Subchapter V form of reorganization. This one-year increase in the debt limit to take advantage of the more economical, more expedient Subchapter V form of Chapter 11 is believed by most commentators to provide an opportunity parallel to and in conjunction with the CARES Act - making the opportunity to save business and jobs available to more "small businesses".

But, there's a glitch. Though it is not mentioned in the CARES Act itself, nor in any existing SBA regulation, the guidelines imposed by the SBA with respect to making funds available to businesses (including the Payroll Protection Program) preclude participation by a business in a Chapter 11 proceeding. At the same time that the SBRA makes restructuring more feasible and expedient through the new Subchapter V process, the SBA guidelines take away what would otherwise be a valuable tool in making an SBRA Chapter 11 case feasible. Oddly, there appears to be no prohibition (practical or otherwise) upon a business obtaining PPP funding and THEN filing for bankruptcy relief.

The SBA Section 7(a) PPP loan application form and guidelines specifically provide – in their current form – that if an applicant is presently in a bankruptcy proceeding, that applicant is deemed not eligible for the program. In effect therefore, the SBA, a governmental agency, is discriminating against a business on the basis of being in a bankruptcy proceeding. This violates a Bankruptcy Code section that prohibits discrimination against an entity because that entity is in a bankruptcy proceeding. There are currently bankruptcy adversary proceedings challenging the SBA's ability to discriminate in that fashion. Judicial determinations against the SBA in one or more of these cases may change the direction currently being taken by the SBA.

In addition to possible court influence over how the SBA administers the CARES PPP loan program, the SBA may take note of the possible (likely?) scenario that a business first applies for the PPP loan (where there is essentially NO credit underwriting), gets the loan, and THEN files for bankruptcy relief. That scenario highlights the incongruity of the SBA denying access to the PPP loan program because a business is involved in a Bankruptcy reorganization proceeding at the time its PPP loan application is submitted.

The PPP loan program is intended to save businesses, and to save jobs. There are no "creditworthiness" criteria to qualify for such loans. The SBRA, the new small business Chapter 11 procedure is intended to save small businesses, and to save jobs. It is hard to discern why the SBA would contradict the intention of both the SBRA and the CARES Act as it pertains to PPP loans, rather than leveraging both procedures to maximize job preservation and save more businesses.

Successful Chapter 11 reorganization proceedings benefit both debtor and creditor alike. The SBRA helps achieve the goal of an early, efficient resolution for a small business reorganization. A PPP loan under the CARES Act increases the opportunity for a small business to survive, obtain plan confirmation, and retain jobs. Particularly during the current economic crisis, it might be beneficial to find a way for those two programs to work together.

Please feel free to contact the following individuals at Updike, Kelly & Spellacy, P.C. who are part of the UKS COVID-19 Response Team with respect to creditor's rights and bankruptcy matters.

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