The COVID-19 pandemic is impacting global markets, and is already causing some small businesses to confront operational and financial distress. Successful navigation of these challenges will require thoughtful and comprehensive planning. The Small Business Reorganization Act of 2019 (SBRA), effective February 2020, and the recently enacted Coronavirus Aid, Relief, and Economic Security Act (CARES Act), may provide some relief to small businesses distressed by the recent pandemic.

The U.S. Congress passed the SBRA to address concerns that Chapter 11 bankruptcy’s high costs and complex procedures are too burdensome on small businesses in need of restructuring through the bankruptcy courts. The SBRA provides small businesses with a streamlined and cost effective path for debt restructuring by creating a new Subchapter V to Chapter 11 of the Bankruptcy Code. A company filing for Chapter 11 bankruptcy protection may elect to file under Subchapter V if it qualifies as a “small business debtor” with no more than approximately $2 million in combined secured and unsecured debt. In evaluating whether a small business would benefit from reorganizing under the SBRA, the company should consider:

(1) Its goals for the business in the future.

(2) Whether there is a liquid cash flow available to achieve those goals.

The decision to file bankruptcy is a significant one and should be carefully evaluated among all restructuring alternatives in a distressed situation. The SBRA, however, may provide a small business the opportunity to obtain the breathing spell and interim liquidity needed to survive this global crisis and achieve its future goals.

On March 27, 2020, the CARES Act was signed into law, which includes a $2 trillion stimulus spend to counter some of the economic devastation caused by the coronavirus. The CARES Act makes certain government loans available to help cover the cost of things like rent and payroll, which loans may be forgiven when certain conditions are met. Additional information, updates, and analysis regarding the CARES Act is available here.

The CARES Act may provide relief for small businesses to help them avoid a bankruptcy filing under the SBRA provisions. And for those small businesses that cannot avoid bankruptcy, or for those that have previously filed for bankruptcy, the CARES Act modifies the Bankruptcy Code to provide debtors greater protection.
Interplay between the Bankruptcy Code and the CARES Act:

The CARES Act modifies the SBRA to expand the definition of “debtor,” which ordinarily applies only to small business debtors—a debtor with not more than approximately $2 million in secured and unsecured debt. The CARES Act temporarily expands the SBRA to include debtors with $7.5 million in secured and unsecured debt or less. This change applies only to cases filed after the CARES Act becomes effective and is applicable for one year. This will allow many more businesses to take advantage of the SBRA.

Top SBRA Considerations That Allow a Small Business to:

1. Take advantage of Chapter 11 bankruptcy in a more cost effective and expeditious manner than ordinarily available to a small business under Chapter 11.

2. Retain control of its business operations, while being better situated to survive a reorganization by avoiding the high costs and complexities of a chapter 11 case.

3. Reduce creditor leverage and require greater creditor vigilance.

4. Modify a claim secured in real property that is the principal residence of the small business debtor under certain circumstances (e.g., sole proprietorship operating business from the individual principal’s home).

5. Avoid formation of a creditors committees under section 1102(a)(3).

6. Avoid the absolute priority rule under section 1129(b)(1), allowing the small business debtor the possibility of retaining equity in the business without paying all unsecured claims in full.

7. Avoid the requirements under sections 1129(a)(8) and (10) for creditor acceptance of a reorganization plan for the small business.

8. Take advantage of less stringent disclosure statement requirements.

9. Take advantage of a discharge after completion of payments due under a reorganization plan within the 3 to 5-year term of the plan.

Top Provisions in The CARES Act to Help Mitigate the
Effect of the Coronavirus on Small Businesses:

1. Creating a $350 billion loan program to businesses that employ no more than 500 employees, allowing businesses to borrow money to cover certain costs, such as payroll costs, health care benefits, rent, and utilities, among others.

2. Creating loan forgiveness programs through incentivizing business to retain employees and to encourage rehiring of employees.

3. Expanding eligibility Small Business Administration (SBA) Loans, raising the maximum amount for these loans by 2.5 times the average monthly payroll costs, or up to $10 million, with interest rates not to exceed 4%, and waives certain credit and personal guaranty requirements.

4. Expanding relief for businesses in the accommodation and food services industries, certain franchise businesses, and small businesses that receive financing through the Small Business Investment Company Act.

5. Waiving certain fund matching requirements for Women’s Business Centers for three months.

6. Providing the ability for Department of Commerce to give grants to minority business centers and chambers of commerce to educate, train, and provide access to federal resources.

7. Extending Emergency Economic Injury Disaster Loans (EIDL) eligibility to individuals operating sole proprietorships, independent contractors, etc. with no more than 500 employees.

8. Modifying loan terms by (a) appropriating $17 billion to waive limits on the maximum loan maturities for loans given deferral, (b) extending maturity dates on certain qualifying loans during the year following enactment, and (c) extending lender site visit requirement timelines as necessary due to COVID-19 to (i) 60 days of a non-default adverse event and (ii) 90 days of a default.

9. Modifying Net Operating Losses (NOL), providing a temporary repeal of taxable income limitation including: (i) in the case of a taxable year beginning before January 1, 2021, the aggregate of the NOL carryovers to such year, plus the NOL carrybacks to such year, and (ii) in the case of a taxable year beginning after December 31, 2020, the sum of the aggregate amount of NOLs arising in taxable years beginning before January 1, 2018 and the lesser of the aggregate amount of net operating losses arising in taxable years beginning after December 31, 2017 or 80% of the excess of taxable income. Speak with your tax professional regarding the specifics on any potential tax issues facing your small business.

10. Increasing the amount of interest expense businesses are allowed to deduct on their tax returns, by
increasing the 30% limitation to 50% of taxable income for 2019 and 2020.

In summary, it is important for small businesses to be aware of the resources available to help mitigate the effect of the coronavirus on their businesses. For more information about these resources and steps small businesses can take to mitigate these effects, please contact your Foley relationship partner. For additional web-based resources available to assist you in monitoring the spread of the coronavirus on a global basis, you may wish to visit the CDC and the World Health Organization.

Foley will continue to keep you apprised of relevant developments. Click here for Foley’s Coronavirus Resource Center for insights and resources to support your business during this challenging time. To receive this content directly in your inbox, click here and submit the form.