Temporary Adjustments to Bankruptcy Law

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The Coronavirus Aid, Relief, and Economic Security (CARES) Act imposes some temporary but meaningful adjustments to bankruptcy law in the United States which is governed by Title 11 of the United States Code (the Bankruptcy Code).

In February 2020, the Small Business Debtor Reorganization Act of 2019 (SBRA) became effective, permitting small businesses to file under a new Subchapter V of Chapter 11 of the Bankruptcy Code. SBRA streamlines the chapter 11 process for small businesses by, among other things, simplifying plan confirmation requirements and eliminating (in most cases) the requirement for an unsecured creditors committee. In addition to reducing the time and cost associated with chapter 11 cases, SBRA eliminates the absolute priority rule such that business owners may be able to retain an ownership interest in the company post-bankruptcy.

Only businesses with less than a certain amount of aggregate debt qualify to file under the new Subchapter V. The CARES Act increased from $2,725,625 to $7,500,000 the aggregate debt threshold. According to the American Bankruptcy Institute, more than 50% of chapter 11 debtors from 2013-2017 would qualify for new Subchapter V as amended by the CARES Act. The increased maximum aggregate debt threshold sunsets one year from the enactment of the CARES Act.

The CARES Act also modifies chapter 7 and chapter 13 of the Bankruptcy Code for individuals seeking bankruptcy protection. Debtors under chapter 7 (liquidation) must first pass a "means test" which determines if the individual has enough income to repay a portion of their debts to creditors. The CARES Act excludes any stimulus or other payments received under the emergency declaration on COVID-19 from the income calculation under the means test.

Debtors who fail the means test are deemed to have enough income to repay some or all of their debts to creditors under chapter 13 (debt repayment), which is accomplished through a reorganization plan. The CARES Act excludes stimulus or other similar payments from calculation of a debtor's disposable income under chapter 13. Debtors with plans that were implemented before the COVID-19 outbreak may experience a reduction in the income they are using to fund their plan. Therefore, the CARES Act also amends chapter 13 to allow debtors who demonstrate that they are experiencing "a material financial hardship due, directly or indirectly, to the coronavirus disease…" to modify their plan to extend payments over seven years instead of the maximum five year period that is otherwise applicable.

These provisions affecting chapter 7 and chapter 13 bankruptcy cases sunset one year from the enactment of the CARES Act.

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