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A Little Known Secret of the CARES Act – Increased Ability for Companies to Seek Relief Under the Newly Enacted Small Business Reorganization Act

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As a result of COVID-19, it is likely that there will be a tsunami of restructuring activity this year and for the near future. Typically, when a business was in financial distress, it would first try out-of-court workout solutions as an alternative to filing a formal bankruptcy proceeding. These out-of-court remedies have included forbearance agreements with a company's lender, an amendment to or restatement of its credit facility, raising capital, surrendering of collateral to a secured creditor or trying to sell assets outside of bankruptcy to gain liquidity.

With the recent virtual shutdown of all non-essential businesses for upwards of eight weeks, many of these out-of-court restructuring solutions will be either limited or unavailable, and companies that are unable to restructure their operations outside of bankruptcy will find it necessary and, in some cases, imperative to file a formal bankruptcy proceeding.

In a conventional Chapter 11 bankruptcy, after filing the bankruptcy petition, the debtor either seeks to sell substantially all of its assets and then proceed with a plan of liquidation or otherwise to reorganize pursuant to a plan of reorganization. Often times, the plan of reorganization process is time consuming and costly, which is one of the reasons Congress enacted the Small Business Reorganization Act a/k/a "SBRA," which became effective on February 19, 2020. SBRA streamlines the bankruptcy reorganization process for debtors by eliminating certain disclosure and solicitation obligations while simultaneously tightening case deadlines to ensure a quick trip through bankruptcy. As originally enacted, to qualify under SBRA, at least 50 percent of the debtor's debt must have arisen from commercial or business activity.

The well-publicized Coronavirus Aid, Relief, and Economic Security Act (CARES), passed by Congress in late March in response to the global coronavirus pandemic, not only allows small businesses to apply for "forgivable" loans in two rounds of funding through the Paycheck Protection Program (PPP), but it also increased the debt limit for businesses looking to file under SBRA. While companies that have filed for bankruptcy are not entitled to apply for, or receive, a disbursement of a PPP Loan, the issue of whether a PPP Loan is forgivable if a company subsequently files for bankruptcy, but has met the other requirements for loan forgiveness under the CARES Act, has not been addressed by Congress or the courts.

Many have heard of the Paycheck Protection Program, allowing businesses with under 500 employees to apply for loans, subject to forgiveness as long as the recipient of the loan satisfies certain requirements regarding use of the proceeds and maintaining levels of employment. What has not been as well-publicized, however, is that the CARES Act also increased the debt cap for businesses to qualify for filing under SBRA from $2,725,625 to $7.5 million in an effort to assist smaller companies struggling from the widespread business shutdowns as a result of the spread of the virus. The good news is that businesses that could not have previously taken advantage of SBRA, given that the debt limit was too low, can now do so.

SBRA has not been widely tested over the past two months since the soon to follow stay-at-home orders took effect shortly after its enactment. However, it is an option more small businesses should consider when access to liquidity has run dry or a further lifeline is required while the economy looks for the “new normal.”

The shining light in all of this is that SBRA, in conjunction with the CARES Act, will provide companies with greater access to restructuring opportunities previously unavailable.

Saul Ewing Arnstein & Lehr’s restructuring team is continually tracking the developments of other potential effects stemming from COVID-19. For questions about how to handle financial challenges at this time, please reach out to the chairs of the Firm’s Bankruptcy and Restructuring Practice: Jeffrey C. Hampton, Mark Minuti or Michael L. Gesas.

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