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Congress Opens Streamlined Reorganization Process to More Debtors

An important improvement aimed at ensuring a faster, less expensive, and more tailored approach to reorganizations involving smaller businesses was embedded in the recent \$2 trillion recovery package known as the Coronavirus Aid, Relief and Economic Security Act (CARES Act). The CARES Act temporarily modifies the Small Business Reorganization Act of 2019 (the SBRA) to allow relief to debtors who owe up to \$7,500,000 by including an increase in the previous debt limit from slightly more than \$2.7 million for eligible debtors. The result is that substantially more small businesses will qualify for reorganization under subchapter V of Chapter 11 of the Bankruptcy Code. There are reasons to be hopeful that smaller businesses can now successfully and quickly reorganize rather than file for Chapter 11 only to end up in liquidation.

Subchapter V dramatically streamlines the Chapter 11 reorganization process. Small business debtors do not have to file a disclosure statement—akin to a prospectus received by potential investors before investing in a company—prior to soliciting votes for their plan of reorganization. Small business debtors are also exempt from paying quarterly U.S. trustee fees. These changes alone will measurably reduce the time and expense of reorganization.

Other key differences include eliminating creditors' committees and the litigation that frequently ensues between debtors and committees which can derail a company's reorganization efforts, as well as eliminating the "Absolute Priority Rule." Under this rule, a "regular" Chapter 11 case provides that all creditors must be paid before shareholders retain any value. In a small business case, owners of small business debtors may retain ownership and control of their businesses so long as their plan of reorganization is "fair and equitable," does not "discriminate unfairly," and allows for unsecured creditors to receive a pro rata share of the business's disposable income over a three- or five-year period.

Chapter 11 was perceived by most small businesses as too expensive, uncertain, and time consuming long before the COVID-19 pandemic. Now, with the expansion of the eligibility requirements for small businesses, reorganization is again a feasible alternative to liquidation for small businesses whose debts do not exceed \$7,500,000.

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