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The Impact of the CARES Act on US Consumers, Small Businesses, Bankruptcy and Insolvency Laws and Procedures

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Summary

COVID-19 is taking an alarming and unfortunate toll on the world's population. In the United States, the number of COVID-19-related deaths will soon approach 75,000. Billions of dollars of economic output will be lost. As a consequence, on 27 March 2020, US lawmakers signed the Coronavirus Aid, Relief, and Economic Security Act (the 'CARES Act') into law. It provides USD 2.2 trillion in economic stimulus to various sectors of the American economy. This article explains three aspects of the CARES Act: a consumer economic stimulus, a small business payment protection program, and the impact of the CARES Act on US bankruptcy laws and procedures in several of the nation's busiest bankruptcy courts.

Additional consumer protections

The CARES Act provides many Americans with a one-time economic stimulus payment. The amount of this payment is based upon an individual's adjusted gross income reported on the individual's 2018 or 2019 (whichever was most-recently filed) Federal income tax return up to a threshold of USD 99,000 for individuals and USD 198,000 for married couples. Section 1113 of the CARES Act also clarifies that, in chapter 7 liquidation filings, these payments are excluded when calculating current monthly income in deciding a debtor's eligibility. In connection with individual debtors' chapter 13 filings, these payments are excluded when calculating a debtor's disposable income.

Section 1113 of the CARES Act also aids chapter 13 debtors operating under a confirmed bankruptcy plan. As of 27 March 2020, a debtor may extend a confirmed plan for up to seven years from the date the first payment is due under the plan. To qualify for this postponement, a debtor must demonstrate a 'material financial hardship' resulting from the COVID-19

pandemic. Courts will decide what constitutes such a hardship based on the facts of each case.

Paycheck Protection Program

One significant facet of the CARES Act impacting small businesses is the Paycheck Protection Program (the 'PPP'), which is administered by the US Small Business Administration (the 'SBA'). It enables most businesses with less than 500 employees to obtain low-interest loans of up to USD 10 million that may ultimately qualify for partial or complete forgiveness to cover costs while they are shuttered by State and/or local COVID-19-related shutdown orders. The SBA will forgive a borrower's PPP loan if at least 75% of the proceeds are spent on eight weeks' worth of eligible business expenses, which include paying current employees (subject to a cap of USD 100,000 on any one employee's salary) or rehiring workers who had been furloughed or laid off between 15 February 2020 and the date of implementation of the PPP program. Any other PPP loan proceeds may be spent on rent, insurance premiums, utility bills, or interest payments. Any PPP loan proceeds that do not qualify for forgiveness must be repaid over a two-year term at a 1% fixed rate.

Since the inception of the PPP program through the passage of the CARES Act, the SBA has issued guidance to shed additional light on the requirements for obtaining loan forgiveness and the ineligibility of certain businesses to obtain PPP loans. Importantly in the bankruptcy context, the SBA issued an interim final rule on 15 April 2020, confirming that companies currently in bankruptcy are not ineligible for the PPP program. Debtors cannot apply for PPP loans, and companies that previously applied for a PPP loan and later filed for bankruptcy before receiving PPP loan proceeds must cancel the PPP application.² Notably, Chief Bankruptcy Judge David R. Jones of the United

Notes

- 1 Mr. Kodish is admitted to practice law in the State of Maryland and The District of Columbia.
- 2 Business Loan Program Temporary Changes; Paycheck Protection Program – Requirements – Promissory Notes, Authorizations, Affiliation, and Eligibility, 13 CFR 120-121 (2020).

States Bankruptcy Court for the Southern District of Texas and Bankruptcy Judge David Thuma for the United States Bankruptcy Court of the District of New Mexico subsequently made rulings that would either partially or completely invalidate the PPP's bankruptcy exclusion.³ Conversely, Bankruptcy Judge Brendan L. Shannon of the United States Bankruptcy Court for the District of Delaware declined to reach a similar result.⁴ Given that there are at least two similar challenges pending in two other United States Bankruptcy Courts as of the date of this article, it is safe to say that this issue is unsettled and will likely require a more definitive ruling from one of the United States Courts of Appeals or even, potentially, the United States Supreme Court.

Expansion of streamlined bankruptcy process

In August 2019, the Small Business Reorganization Act of 2019 (the 'SBRA') took effect. Its primary benefit is that companies with debts under USD 2,725,625 can file for chapter 11 bankruptcy. Among other protections, debtors benefit from the Bankruptcy Code's automatic stay: actions by creditors to pursue lawsuits, enforce liens, and collect debts against debtors are placed on hold. The SBRA also streamlines and reduces other costly expenses that are often incurred in bankruptcy cases. Importantly, Section 1113 of the CARES Act amends the SBRA to provide eligibility for small businesses with debts up to USD 7,500,000 to file under the SBRA's standards. This new limit will remain in effect for one year, when the threshold will revert to USD 2,725,625. The increased debt limit applies only to cases filed after the effective date of the CARES Act (*i.e.*, 27 March 2020).

Many bankruptcy courts in the United States have adopted special rules and procedures in light of the pandemic and the enactment of the CARES Act. For instance, on 20 April 2020, the United States Bankruptcy Court for the District of Delaware issued an Interim Order which amends Interim Bankruptcy Rule 1020 to comport with the provisions of the CARES Act and provides the benefits and expedited procedures

afforded by the SBRA. This Interim Order expands Interim Rule 1020 to include small business debtors with debts up to USD 7,500,000 as otherwise defined by section 1182(1) of the Bankruptcy Code. The amended version of Interim Rule 1020 will remain in effect for one year following the enactment of the CARES Act.⁵ On 23 April 2020, the United States Bankruptcy Court for the Southern District of New York issued General Order M-546, which has the same practical effect as the Interim Order signed three days earlier by the Bankruptcy Court for the District of Delaware.⁶

Telephonic and electronic hearings

Most US bankruptcy courts have altered their practices and procedures in other ways to mitigate the spread of COVID-19. For example, the United States Bankruptcy Courts for the Southern District of New York, the Eastern District of New York, the District of Delaware, and the Southern District of Texas have each issued Orders that require most, if not all, hearings to proceed electronically or telephonically. In the Southern District of New York, General Order M-543 provides that hearings and conferences scheduled for the Manhattan, White Plains, and Poughkeepsie Divisions of the Bankruptcy Court will be held telephonically. Parties can also request adjournments of hearings or conferences by filing a motion or request detailing the request and its basis. Effective as of 13 March 2020, all in-person chapter 7, 12, and 13 section 341 meetings⁷ scheduled through 10 April 2020 have been continued to a later to be determined date, and section 341 meetings cannot proceed during this period except by telephonic or other alternative means that do not require the personal appearance of debtors.⁸

In the Eastern District of New York, all hearings will be held by phone and recorded by the Court until further notice.⁹ Other recordings of those telephonic hearings may not be made. All in-person chapter 7, 12, 13 and section 341 meetings scheduled through 10 April 2020 have been continued to a later to be determined date, and section 341 meetings may not proceed unless

Notes

- 3 See *Hidalgo County Emergency Service Foundation v Jovita Carranza*, In Her Capacity as Administrator for the U.S. Small Business Administration, Case No. 20-2006 (Bankr., S.D. Tex., 24 April 2020) and *In re Roman Catholic Church of the Archdiocese of Santa Fe*, Case No. 18-13027 (Bankr. D. N.M., 1 May 2020).
- 4 *Cosi Inc. v Small Business Administration et al.*, Case No. 1:20-ap-50591 (Bankr. D. Del., 30 April 2020).
- 5 *In Re: Adoption of Cares Act Changes To Interim Bankruptcy Rule 1020*, Bankr. D. Del., 20 April 2020.
- 6 *In Re: Adoption of Temporary Amendment to Interim Bankruptcy Rule 1020 Corresponding to the Coronavirus Aid, Relief, and Economic Security Act*, Bankr. D. S.D.N.Y., 23 April 2020.
- 7 A 341 meeting takes place about one month after an individual files for chapter 7 bankruptcy and includes the individual filer (and his/her attorney, if applicable) and the chapter 7 trustee. The meeting is optional for creditors or their attorneys. The purpose of a 341 meeting is to confirm that: (a) all required Court filings and exhibits are in order, (b) the individual filer is not attempting to commit fraud, and (c) which of the filer's non-exempt assets can be sold to repay creditors.
- 8 General Order M-543, Bankr. S.D.N.Y., 9 April 2020.
- 9 Home page, Bankr. E.D.N.Y., <<https://www.nyeb.uscourts.gov/>>, 8 April 2020.

by telephonic or other means not requiring a personal appearance.¹⁰

In the District of Delaware, as of 28 April 2020, all visitors to the Bankruptcy Court, including litigants and attorneys, must wear a mask or face covering when in public areas of the Court and when interacting with the Court's staff.¹¹ Additionally, Court hearings that are not considered time sensitive have been continued to a later, to be determined date; the rescheduled date will be decided by the presiding judge, but in no event can it occur before 18 May 2020. All Court hearings occurring before 18 May 2020 will be held telephonically and/or by video conference unless otherwise ordered by the presiding judge. The method for submitting evidence for telephonic and/or video conference Court hearings held before 18 May 2020 will be determined by the presiding judge on a case-by-case basis.¹²

In the Southern District of Texas, all hearings will be conducted electronically until further notice. Hearings may be held either by the judge assigned to the case, or by any other bankruptcy judge. Notice of chapter 13 panel hearings will take place through a notice posted by the chapter 13 trustees on the trustee's website. Unless otherwise ordered, 'chapter 13 panel hearings will only be heard if there is a statutorily imposed deadline for the conduct of the hearing', and the trustees 'will post a hearing calendar that contains only matters with statutorily imposed deadlines'.¹³

Other adjustments to court rules and procedures

Some Courts have made adjustments that may have a more substantive effect on creditors and debtors alike. For instance, on 9 April 2020, the United States Bankruptcy Court for the Southern District of New York issued General Order M-545, which provides that for individual chapter 7, 11, 12, and 13 cases, an original signature is no longer necessary to electronically file a document bearing that signature, subject to the fulfillment of certain conditions. Additionally, creditors providing temporary suspensions of mortgage

payments to debtors are required to file a Notice of Temporary Forbearance, which is attached as an addendum to General Order M-545. Similar creditor-debtor communications regarding forbearance during the forbearance period do not violate the automatic stay. The additional protections afforded by General Order M-545 will remain in effect until 1 July 2020.¹⁴

Some judges have also approved temporary case management procedures designed to ease administrative burdens and decrease debtor costs. For example, in *In re CraftWorks Parents, LLC, et al.*, Judge Brendan Shannon of the United States Bankruptcy Court for the District of Delaware issued an order that (1) permits the debtors to reject executory contracts and unexpired leases via email, (2) encourages parties who desire a lifting of the automatic stay to first contact the debtors to seek a consensual agreement, (3) delays any hearings on non-urgent lift-stay motions until at least 30 April 2020, (4) encourages all parties-in-interest to address outstanding disputes via stipulation, and (5) requires all hearings to be heard telephonically until further notice.¹⁵ In addition, Judge Kevin Huennekens of the United States Bankruptcy Court for the Eastern District of Virginia in *In Re Pier 1 Imports, Inc.*, agreed to the temporary suspension of all proceedings and deadlines while explicitly authorising the temporary deferment of all rent payments due by a debtor to its creditor landlords.¹⁶

Conclusion

In light of the tremendous economic upheaval caused by the COVID-19 pandemic, the number of bankruptcy filings in the US will likely continue to rise months ahead. The CARES Act provides interim specific relief to debtors and creates a backdrop by which courts can provide additional flexibility during the bankruptcy process. But it is conceivable that the Federal and State governments will need to take additional measures to assist debtors, creditors, and the Courts in handling the continuing wave of filings directly or proximately resulting from the dramatic effects of COVID-19.

Notes

- 10 Telephonic 341 meeting of creditors during Covid-19 Emergency: Instructions for Testifying Debtors and Counsel, Office of the United States Trustee, E.D.N.Y., <<https://www.nyeb.uscourts.gov/sites/nyeb/files/Covid-19-General-Instructions.pdf>>, last visited 8 April 2020.
- 11 *In Re: Use of Face Mask/Coverings In Public Areas of the District And Bankruptcy Courts*, Standing Order, Bankr. D. Del., 28 April 2020.
- 12 *In Re: Second Amended Order Governing the Conduct of Hearings Due to Coronavirus Disease 2019 (COVID-19)*, Bankr. D. Del., 20 April 2020.
- 13 *In Re: Adoption of Contingency Plan to Address Possible Public Health Limitations on Court Operations*, Bankr. S.D. Tex., 9 March 2020.
- 14 General Order M-543, Bankr. S.D.N.Y., 9 April 2020.
- 15 Order (I) Establishing Temporary Procedures and (II) Granting Related Relief, *In re CraftWorks Parent, LLC, et al.*, Case No. 20-10475 (Bankr. D. Del., 30 March 2020).
- 16 Order Granting (I) Relief Related to the Interim Budget, (II) Temporarily Adjourning Certain Motions and Applications for Payments, and (III) Granting Related Relief Motion to Approve, *In re Pier 1 Imports, Inc.*, Case No. 20-30805-KRH (Bankr. D. E Va., 6 April 2020).

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