



Bankruptcy During the COVID-19 Crisis

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As a result of the Covid-19 pandemic, the executive orders implemented to address the public health emergency have closed non-essential businesses and changed the way essential businesses must operate. In an effort to provide economic relief, the federal government has enacted measures including new emergency leave laws, the CARES Act and the Paycheck Protection Program. Private lenders and creditors have also demonstrated voluntary leniency in debt collection.

While many of these measures help address the immediate financial stress caused by the Covid-19 emergency, they may not be enough for many individuals and businesses. As a result, it is important for those facing significant financial hardship to also understand how the U.S. bankruptcy code can assist them in discharging or reorganizing certain debts and protecting their financial status.

For instance, during these difficult times, individuals (both consumers and business owners) may be tempted to dip into exempt assets like retirement accounts. The bankruptcy code, however, provides certain protections for retirement accounts because it was created to enable consumers and businesses alike to discharge debts and reorganize while still protecting certain essential assets.

A Chapter 13 bankruptcy may be a key tool for consumers who have fallen behind on personal debt obligations, such as car or mortgage payments, due to illness, layoffs or cutbacks as a result of Covid-19. Chapter 13 provides an avenue through which a consumer, pursuant to a court approved plan, may be able to keep current with their monthly obligations while paying back incurred arrearages over time, allowing them an opportunity to get back on their feet. A Chapter 13 bankruptcy plan may also protect debtors even after a foreclosure action has been commenced. Similar protections may be available under Chapter 13 with respect to a threatened car repossession, allowing for restructured payments over time.

A Chapter 7 bankruptcy may also be available to consumers, pursuant to which all unsecured debt can be eliminated; however, the individual filing for bankruptcy must first meet certain “means test” requirements before the debts can be discharged. If a consumer finds themselves unable to pay medical bills or has used unsecured debt to bridge the gap between lost wages and necessary costs of living, a Chapter 7 bankruptcy may be the best option. Significantly, any funds received via the CARES Act will not be attributed as income to a bankruptcy debtor for these “means test” requirements (which also apply to Chapter 13).

Chapter 11 and Subchapter V “small business” cases are primarily used by businesses, including sole proprietors, partnerships, limited liability companies and corporations. A Chapter 11 is frequently referred to as a “reorganization” bankruptcy, allowing a Debtor to assume or reject leases and reorganize debt. A small business case is defined as a case with a "small business debtor." 11 U.S.C. § 101(51C). Determination of whether a debtor is a "small business debtor" requires application of a two-part test. First, the debtor must be engaged in commercial or business activities (other than primarily owning or operating real property) with total non-contingent liquidated secured and unsecured debts of \$2,566,050 or less. Second, the debtor's case must be one in which the U.S. trustee has not appointed a creditors' committee, or the court has determined the creditors' committee is insufficiently active and representative to provide oversight of the debtor. 11 U.S.C. § 101(51D). The CARES Act temporarily increases the debt threshold for filing for relief under Subchapter V of Chapter 11 of the Bankruptcy Code from \$2,725,625 of debt to \$7,500,000. The eligibility threshold will revert to \$2,725,625 after one year.

Please don't hesitate to contact us with any questions. You can also visit our website's Newsroom for information on other new legislation in response to Covid-19.

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