

New covid-19 relief legislation amends Bankruptcy Code



A brief guide to what you need to know

By GEORGE H. SINGER



In response to the continuing crises brought on by the covid-19 pandemic, Congress recently passed the Consolidated Appropriations Act, 2021 (CAA). The legislation signed into law by the president on December 27, 2020 is one of the longest bills (5,593 pages) and largest spending measures ever enacted. The CAA contains among its provisions a number of amendments to the United States Bankruptcy Code, 11 U.S.C. §§101 *et seq.*, all of which became immediately effective upon being signed into law. Most of the changes are temporary and sunset on either the first or second anniversary of enactment. The amendments to the Bankruptcy Code are briefly summarized in this article.

■ **Property Not Considered Property of the Estate (11 U.S.C. §541).** Section 541 of the Bankruptcy Code defines—very broadly—what constitutes property included in the estate of a debtor in a bankruptcy case. Section 541(b) also defines what is *not* property of the estate and thereby excluded from administration in bankruptcy.

The CAA adds a new subsection 541(b)(11). The amendment excludes federal coronavirus relief payments (“recovery rebates made under section 6428 of the Internal Revenue Code of 1986,” a provision created by the CARES Act signed into law on March 27, 2020¹) from the estate. Such payments are not recoverable by creditors or a Chapter 7 bankruptcy trustee. This amendment has a one-year sunset.

■ **Chapter 13 Plan Default Relief (11 U.S.C. §1328).** Chapter 13 of the Bankruptcy Code provides individual debtors who have regular income with the opportunity to reorganize their debt by providing partial payment to unsecured creditors under a plan and to preserve their possession of their residence by making regular payments to the mortgage lender.

The CAA amends section 1328 of the Bankruptcy Code to help Chapter 13 debtors retain their discharge under a confirmed plan even if the debtor has missed up to three monthly payments due on a residential mortgage. The debtor must demonstrate causation—namely that the defaults were attributable to a material financial hardship due, directly or indirectly, to the covid-19 pandemic. The missing mortgage payments must still be paid, but the debtor would not lose the benefits of the discharge for other debt. This amendment has a one-year sunset.

■ **Additional Protection from Discriminatory Treatment (11 U.S.C. §525).** Section 525 of the Bankruptcy Code is designed to protect debtors from discriminatory treatment by governmental entities or private employers on the grounds that they have been a debtor in bankruptcy.

The CAA adds a new subsection 525(d) to provide that debtors are similarly protected from discrimination based on receipt of CARES Act assistance in the form of mortgage debt forbearance, mortgage debt payment assistance, or eviction relief. This amendment has a one-year sunset.

■ **Claims Process for CARES Act Forbearance Claims (11 U.S.C. §§501, 502).** Sections 501 and 502 of the Bankruptcy Code address the filing and allowance of claims in bankruptcy cases. The CARES Act mandates that certain mortgage lenders forbear from exercising their rights on federally backed mortgage loans. These forbearance periods can be as long as 12 months, which can create complications in Chapter 13 bankruptcy cases. At the end of the forbearance period, the debtor is required to pay the deferred mortgage payments in a lump sum.

The CAA amends section 501 and 502 of the Bankruptcy Code to establish a process by which creditors may file proofs of claim for amounts lost due to forbearance periods mandated by the CARES Act. The new relief legislation imposes requirements for such claims, including that any such forbearance claim shall be timely filed if filed before the 120th day after the expiration of the forced forbearance period. As such, servicers may file proofs of claim even if the claims bar date has passed. These amendments have a one-year sunset.

■ **Ability to Modify Confirmed Chapter 13 Plans (11 U.S.C. §1329).** Section 1329 of the Bankruptcy Code contains provisions that allow a debtor to modify his or her plan after confirmation. The CAA amends section 1329 of the Bankruptcy Code to allow a debtor to modify a Chapter 13 plan to account for CARES Act forbearance proofs of claim that are filed by a creditor in the case during the extended period. If the debtor fails to modify his or her plan to address the deferred mortgage payments, the court (on its own motion), the U.S. Trustee, the Chapter 13 trustee, or any party in interest may move the court for such a modification. This amendment has a one-year sunset.

■ **Temporary Debt Limit Increase for Small Business Cases Not Extended.** Congress previously amended the Bankruptcy Code to create subchapter V of Chapter 11, which became effective on February 19, 2020, to address challenges faced by “small business debtors” in Chapter 11 cases.² An otherwise eligible debtor with non-contingent, liquidated debts not exceeding \$2,725,625 could avail itself of more streamlined relief under Chapter 11 of the Bankruptcy Code. The CARES Act raised the subchapter V debt

limit for eligibility to \$7,500,000 to allow more business debtors to avail themselves of this relief. However, the increased debt limit was enacted with a sunset date of March 27, 2021. Congress, perhaps as an oversight, did not extend the sunset date in the CAA so, in the absence of an extension in future legislation, the recently enacted small debtor bankruptcy provisions will be available to a much smaller universe of businesses.

■ **Small Businesses May Now Qualify for PPP Loans (11 U.S.C. §364).** The Paycheck Protection Program (PPP) was established under the CARES Act to allow eligible businesses to obtain guaranteed loans administered by the Small Business Administration (SBA). Under the PPP, eligible businesses may obtain loans to cover certain expenses that may be forgiven if the proceeds are used to cover allowable expenses and certain conditions are satisfied. While the CARES Act was silent on the issue of excluding companies in bankruptcy from receiving PPP loans, the SBA promulgated rules denying bankruptcy small businesses access to PPP loans. Litigation of the issue around the country ensued almost immediately after the passage of the Cares Act, and a significant number of courts upheld the SBA’s determination.³

The CAA amends section 364 of the Bankruptcy Code to provide that bankruptcy courts may now authorize small business debtors to obtain a loan under the PPP. However, the new legislation on this issue is *not effective until* the date on which the SBA Administrator submits to the Director of the Executive Office for the United States Trustee a written determination that corporate debtors are eligible for CARES Act funding. In other words, the new statute seemingly delegates to the SBA administrator the discretion to approve PPP loans in future bankruptcy cases.

Provided that such eligibility is determined, the changes to Section 364 contemplate that a business debtor may file a motion with the bankruptcy court to obtain CARES Act funding and the court is required to hold a hearing within seven days. If the court authorizes the loan, it can do so on a final basis and, to the extent not forgiven, the loan will be treated as a priority claim ahead of other administrative expenses under sections 503(b) and 507 of the Bankruptcy Code. A plan

may be confirmed, however, if it proposes to make payments when due under the terms of the loan. Debtors in bankruptcy cases existing prior to the effective date of the CAA are not grandfathered and eligible for funding. This amendment has a two-year sunset.

■ **Extended Time to Perform under Unexpired Leases of Nonresidential Real Property (11 U.S.C. §365).** Section 365(d)(3) of the Bankruptcy Code requires a tenant in bankruptcy to continue to timely perform its obligations under an unexpired lease of nonresidential real property.

The CAA amends section 365(d)(3) to provide that debtors in “subchapter V small business chapter 11 bankruptcy cases” may obtain an additional 60-day delay (120 days total) to pay rent if the debtor can demonstrate that it has experienced and is continuing to experience a material financial hardship, directly or indirectly, as a result of the covid-19 pandemic. The amendment provides that any claim arising from such extension (i.e. rent deferral) shall be treated as an administrative priority expense for purposes of confirmation of a subchapter V small business plan. However, unlike other administrative expense claims (which are typically required to be paid on the effective date of the plan), debtors are allowed to repay the delayed administrative rent over time (rather than in a lump sum) under their plan. This amendment sunsets two years after enactment, but the provisions will continue to apply to any subchapter V small business Chapter 11 bankruptcy case commenced before the sunset date.

■ **Extended Time to Assume or Reject Unexpired Leases of Nonresidential Real Estate (11 U.S.C. §365).** Section 365(d)(4) of the Bankruptcy Code currently provides that an unexpired lease of nonresidential real estate is deemed rejected unless it is assumed by the debtor within 120 days following the entry of the order for relief.

The CAA amends section 365(d)(4) to afford additional time for a Chapter 11 debtor to assume, assume and assign, or reject its nonresidential real property leases to 210 days. Because the bankruptcy court already had the ability under existing law to increase section 365(d)(4)'s period by 90 days, this means that a debtor under an unexpired lease of nonresidential real property can potentially

obtain up to 300 days to decide whether to assume or reject the lease. This amendment also sunsets two years after enactment, but the provisions will continue to apply to any subchapter V small business Chapter 11 bankruptcy case commenced before the sunset date.

■ **Reduced Exposure for Landlords and Suppliers from Otherwise Recoverable Preferential Transfers (11 U.S.C. §547).** Section 547 of the Bankruptcy Code allows avoidance and recovery of so-called preferential transfer payments—late payments made by a debtor to its creditors shortly before the bankruptcy filing on outstanding debt.

The CAA amends section 547 to insulate deferred payments made by a debtor pursuant to an amended arrangement made after March 13, 2020, from being recovered from commercial landlords (i.e. rental arrearages) and suppliers of goods and services (late invoice payments). However, such payments are sheltered only to the extent such deferred payments do not include any fees, penalties, or interest in an amount greater than the fees, penalties, or interest the debtor would otherwise have owed the creditor without the deferral. The legislation removes the risk of payment “clawback” for certain landlords and suppliers that work with their tenants and customers during this unprecedented time. Significantly, however, the payments sheltered from avoidance under the CAA include only those that have been paid under executory contracts (as defined in section 365 of the Bankruptcy Code) that deferred the payment otherwise due. In other words, payments that are simply received late, but not pursuant to an amended agreement, would not appear to be protected by the CAA. This amendment sunsets two years after enactment, but the provisions will continue to apply to any bankruptcy case commenced before the sunset date.

■ **Limited Relief from Termination of Utility Services (11 U.S.C. §366).** Section 366 of the Bankruptcy Code regulates the alteration, refusal to provide, or termination of utility services to a debtor in a bankruptcy case. The CAA amends section 366 to preclude a utility from terminating services to an individual debtor (even if the debtor fails to furnish a security deposit), so long as the debtor pays the utility for any services provided dur-

ing the 20-day period beginning on the date of the bankruptcy filing and thereafter makes timely payments for services provided during the bankruptcy case. This amendment has a one-year sunset.

■ **Subrogation and Customs Duties (11 U.S.C. §507).** Section 507(d) of the Bankruptcy Code prevents subrogation with respect to certain claims entitled to priority under the Bankruptcy Code. The CAA amends section 507(d) to provide that a party that pays the United States government a customs duty on behalf of an importer is subrogated to the government's priority status for customs duties. The provision benefits forwarders and customs brokers that frequently pay the government for customs duties on behalf of their importer clients.

Conclusion

As the economic fallout of the pandemic continues, Congress will be pressed to address ways to provide additional relief for struggling families and businesses. President-elect Biden has in fact called the CAA a “down payment” on recovery.⁴ So further legislation, including changes to the Bankruptcy Code, may very well be enacted in 2021. ▲

Notes

¹ *The Coronavirus Aid, Relief and Economic Security Act*, S. 3548.

² *The Small Business Reorganization Act of 2019* (creating 11 U.S.C. §§1181-1195, known as “subchapter V”).

³ See, e.g., *USF Federal Credit Union v. Gateway Radiology Consultants, P.A.*, 2020 WL 7579338 (11th Cir. 12/22/2020).

⁴ ‘Biden Endorses \$908 Billion Covid Relief Plan as ‘Down Payment,’ *Washington Post* (12/3/2020).

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