

COVID-19 Closed My Business. Can I Still Reorganize in Bankruptcy?

Written By **Lance P. Martin** (lpm@wardandsmith.com)

May 6, 2020



We previously informed you that if you are a small business that needed to file bankruptcy to save your company, then you may be able to take advantage of Subchapter V of Chapter 11 of the Bankruptcy Code.

The new subsection, which took effect in February, creates a more streamlined and less expensive Chapter 11 reorganization path for small business debtors. It applies to a person or business entity "engaged in commercial or business activities."

But what if you're closed and not engaged in any commercial or business activity? Is it too late to seek relief in bankruptcy? The issue is important because the coronavirus -- and the efforts to contain it -- have caused many businesses to cease operations and lay off or furlough employees. The lights are off, the doors are locked, and the business may not have seen revenue for some time.

According to a bankruptcy judge in South Carolina, a shuttered small business can still seek relief under the new Subchapter V.

In a decision on April 27, the judge ruled that Subchapter V does not require a small business debtor be currently engaged in commercial or business activity when it seeks relief. Bankruptcy remains available for a defunct or mothballed business.

In the South Carolina case, the debtor was an individual – Charles Wright. He had owned two businesses that went under in 2018. As a result, he was saddled with considerable personal debt related to those companies – presumably under guaranty obligations. So in February 2020, he filed his own Subchapter V case.

An individual can be a small business debtor if he or she meets the eligibility requirements. The debtor must be engaged in commercial activity and total debts -- secured and unsecured – must be less than \$2,725,625. (That amount was increased to \$7,500,000 for one year under the CARES Act.) At least half of those debts must come from business activity.

Mr. Wright's debts qualified him, but the United States Trustee objected to him proceeding under Subchapter V because he was not engaged in commercial or business activity. After all, his businesses had ceased operations in 2018 and their attempts to reorganize had failed – resulting in dismissals in 2019 and asset liquidation to benefit secured creditors. Surely there was no longer any business activity by Mr. Wright?

The judge disagreed. She held that Subchapter V is not restricted to a person who at the time of filing of the petition is presently engaged in commercial or business activities and who expects to continue in those same activities under a plan of reorganization. She further concluded that Mr. Wright was engaged in business activity by addressing residual business debt.

This decision is the ruling of one bankruptcy court and it is not binding on all others.

Nevertheless, it provides some hope for small businesses who – shuttered by the economic fallout from the coronavirus – thought it was too late to use bankruptcy to resurrect their companies or resolve their residual debt.

--

© 2020 Ward and Smith, P.A. For further information regarding the issues described above, please contact Lance P. Martin.

This article is not intended to give, and should not be relied upon for, legal advice in any particular circumstance or fact situation. No action should be taken in reliance upon the information contained in this article without obtaining the advice of an attorney.

We are your established legal network with offices in Asheville, Greenville, New Bern, Raleigh, and Wilmington, NC.