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Despite punishing pandemic and friendlier rules, fewer CT biz file for bankruptcy

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Pullman & Comley attorney Irve Goldman said he's surprised more small companies struggling amid the pan aren't taking advantage of a relatively new cheaper and streamlined federal bankruptcy option.

By Matt Pilon

The COVID-19 pandemic has hobbled Connecticut's economy, forcing an estimated 36% of small businesses to close their doors as of December, according to a recent Harvard University analysis.

Amid that turmoil, one might expect bankruptcy filings to be skyrocketing. However, defying predictions from seasoned area attorneys, that hasn't been the case. In fact, the exact opposite has happened and it's got nothing to do with any federal courthouse closures related to the pandemic.

Robert Kaelin

Commercial bankruptcy cases in Connecticut fell nearly 30% in 2020 from the year prior, close to twice the rate of decline nationwide, according to the latest available data from the American Bankruptcy Institute.

An even bigger surprise, given new debtor-friendly rules passed by Congress just months before the novel coronavirus became a known threat, was that Chapter 11 bankruptcy reorganizations — which allow businesses to restructure and discharge debts while retaining control of their operations, as opposed to liquidating assets to repay creditors — were down even more sharply.

Bankruptcy experts say a combination of factors, from government stimulus to creditors' and borrowers' perceptions about the cost and overall burden of bankruptcy reorganization, have all played a role.

The CARES Act last March made far more businesses eligible for a new and less costly form of bankruptcy, but only for a one-year period, which meant many attorneys were forecasting a slew of reorganization filings early in 2021 from businesses that have been in financial trouble but holding on as long as they could.

"I would have said five weeks ago that I think we're going to see a tidal wave of bankruptcies coming in January, February and March, but now you have the new stimulus act and a second round of [Paycheck Protection Program] money," said Robert Kaelin, a partner at law firm Murtha Cullina in Hartford who specializes in bankruptcy and commercial litigation. "PPP saved countless businesses. It really worked."

In Connecticut, more than 64,000 employers shared in $6.7 billion worth of potentially forgivable loans from the PPP program through August, but additional money has flowed into the state since then with the total amount now approaching $8 billion, according to the U.S. Small Business Administration.

The handful of COVID-19 vaccines approved by the U.S. Food and Drug Administration since December have also been key, according to Irve Goldman, an attorney at Pullman & Comley.

The fact that vaccines exist and are said to be effective has engendered additional flexibility in lenders, many of which already granted various forbearance and other relief in 2020.

“I think that in Connecticut the banks and the landlords aren't really putting as much pressure on businesses than they would in normal times,” Goldman said. “I think people can see the end in sight. If they can just hang in there together it’s going to give the business a chance to get back on sound footing.”

While fewer bankruptcies can offer insight into the health of a state’s economy, there are caveats to using such data, particularly in a state like Connecticut, which is not a hub for bankruptcy cases, though attorneys have been working with the court to make local rules more attractive in recent years.

"Most of the larger Chapter 11 filings for well over 10 years have been getting filed in Delaware or the Southern District of New York,” said Kaelin.

While Chapter 11 commercial bankruptcy filings fell in Connecticut from 36 cases in 2019 to just 10 last year — their lowest level since at least 2012 — such filings were up 29% across the country, according to ABI, whose Executive Director Amy Quackenboss also credited government relief programs and lender deferments for the overall decline in commercial bankruptcy filings.

New advantages go largely unused

Recognizing that some small businesses might survive a bankruptcy if not for its high costs and other hurdles, Congress in 2019 passed the Small Business Reorganization Act (SBRA).

The law provides a new avenue for a business to pursue a cheaper, faster form of Chapter 11 bankruptcy, known as “subchapter V,” while still allowing owners to restructure debt and keep control of their company.

The SBRA had just taken effect when the pandemic struck last March, and through the CARES Act, Congress temporarily expanded access to it, making businesses with as much as $7.5 million in debt eligible for subchapter V, up from the new law’s original threshold of $2.5 million.

Attorneys have watched closely, anticipating that the SBRA would generate a wave of bankruptcy reorganizations.

Murtha Cullina’s Kaelin estimates that the cost and length of time needed to complete a subchapter V bankruptcy could be about half that of a normal Chapter 11.

"One of the big drivers behind the [SBRA] was that bankruptcy was becoming too expensive, cumbersome and time-consuming, particularly for medium-sized and smaller businesses," Kaelin said. "They simply cannot absorb the time and the cost like a big national retailer can."

Subchapter V removes key leverage normally held by unsecured creditors in a regular Chapter 11 process. For example, it eliminates a rule that normally allows creditors to block a bankruptcy plan that pays them less than desired, according to Pullman & Comley's Goldman, who sees the SBRA as a game changer for troubled businesses.

"I think it's the most far-reaching bankruptcy reform that the court has seen since the bankruptcy code was enacted in 1978, really," he said.

However, it's seen little use so far, even with the looser eligibility rules set to expire in March, barring additional action by Congress.

A review of federal court filings in Connecticut during the past year reveals just a handful of companies opting for the novel path through Chapter 11, including Chip's Family Restaurant in Southington and Beacon Pharmacy in New Britain.

Owners of both businesses and their attorneys did not respond to requests for comment for this story.

Connecticut is punching beneath its weight so far when it comes to the SBRA. Across the country, there have been more than 1,400 subchapter V filings, heavily concentrated in states like New York, Florida, Texas and California, according to the ABI.

Goldman said the SBRA's temporary $7.5 million debt eligibility limit remains an attractive offering for troubled companies, and he suspects the new law may just have flown under the radar for many.

"It is curious that it hasn't been used as much as I think bankruptcy professionals would have thought," he said. "I just don't think it's widely known that it's available."

Both Kaelin and Goldman believe subchapter V bankruptcies will catch on in the years to come, pandemic or not.

"It really does substantially change the dynamic of how a Chapter 11 works," Goldman said.

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