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Small Business Disaster Relief and Restructuring

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ABSTRACT. To assist small businesses in the wake of an exogenous shock, Congress should consider implementing a system of lending that models the financing provided to small business debtors in a bankruptcy proceeding. Such a system would be more targeted, effective, and fair than traditional government loans, but less stigmatizing than bankruptcy.

INTRODUCTION

Small businesses are central to the economic health of the United States. Their survival following disaster is therefore essential to economic recovery. Small businesses employ nearly half of all American workers[1] and create two out of every three new jobs.[2] They also provide life and vibrancy to their local communities, encouraging economic activity and other beneficial community interactions.[3]

Due in part to their size, which necessarily limits capitalization and the capacity to spread risk, small businesses are particularly susceptible to exogenous shocks, such as natural disasters, international conflict, and domestic turmoil.[4]

1. *See* Off. of Advoc., *2020 Small Business Profile*, U.S. SMALL BUS. ADMIN. (2020), https://cdn.advocacy.sba.gov/wp-content/uploads/2020/06/04144224/2020-Small-Business-Economic-Profile-US.pdf [https://perma.cc/GV7M-6GA7].
2. *See* Brian Head, Off. of Advoc., *Small Business Facts*, U.S. SMALL BUS. ADMIN. (Sept. 1, 2017), https://advocacy.sba.gov/2017/09/01/small-business-job-creation [https://perma.cc/F5NT-M76U].
3. *See* Susan S. Kuo & Benjamin Means, *Corporate Social Responsibility After Disaster*, 89 WASH. U. L. REV. 973, 977 (2012) ("Locally owned businesses play a critical role in long-term disaster recovery, not only because they are motivated to reinvest in their own communities, but because the investments have social and economic significance.").
4. For example, many small-business owners were adversely affected by the protests following the killing of George Floyd in the spring and early summer of 2020. *See* Nellie Bowles,

The Federal Emergency Management Agency (FEMA) has reported that up to 40% of small businesses never reopen after a major disaster.[5] The impact of natural disasters can fall heavily on small businesses and continue to be felt for years.[6]

Protecting small businesses from natural disasters is at the forefront of public-policy considerations. However, the best way to help small businesses recover from disasters is not readily apparent, especially not in the heat of the crisis. This is due, in part, to the fact that small businesses, while similar in many respects, are extremely diverse in terms of size, industry, financial health, resources, and growth prospects.[7] Although all are "small," the prevailing definition of small businesses includes sole proprietorships and companies with up to 1,500 employees or $41.5 million in annual receipts.[8] As a result, government responses to exogenous shocks can easily miss the mark, particularly when they attempt to assist not only small businesses, but also large corporations and individuals.[9] After all, policymakers have a duty to evaluate their approaches and expend public resources in a way that accomplishes the most good and does the least harm.

The congressional response to help small businesses in the wake of the COVID-19 pandemic, exemplified by the Payment Protection Plan (PPP),

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Businesses Trying to Rebound After Unrest Face a Challenge: Not Enough Insurance, N.Y. TIMES (Nov. 9, 2020), https://www.nytimes.com/2020/11/09/business/small-business-insurance-unrest-kenosha.html [https://perma.cc/2ZLQ-GN8Y].

5. *See* Fed. Emergency Mgmt. Agency, *Ready Business: Hurricane Toolkit*, U.S. DEP'T HOMELAND SEC. (Apr. 7, 2020), https://www.ready.gov/sites/default/files/2020-04/ready_business_hurricane-toolkit.pdf [https://perma.cc/3JCN-QRMN].

6. *See, e.g.*, DANIEL J. ALESCH, JAMES N. HOLLY, ELLIOTT MITTLER & ROBERT NAGY, ORGANIZATIONS AT RISK: WHAT HAPPENS WHEN SMALL BUSINESSES AND NOT-FOR-PROFITS ENCOUNTER NATURAL DISASTERS 8-9 (2001), http://www.chamberofecocommerce.com/images/Organizations_at_Risk.pdf [https://perma.cc/C5Q5-LCBG] (examining small businesses in the wake of the Northridge earthquake in 1994 and concluding that most businesses did not fail immediately after the adverse event but struggled to recover for years before succumbing to closure); Tomoko Hiramatsu & Maria I. Marshall, *The Long-Term Impact of Disaster Loans: The Case of Small Businesses After Hurricane Katrina*, 10 SUSTAINABILITY 1, 12 (2018) (noting that "many small businesses in Mississippi were still at the stage of trying to recover from the disaster even eight years after Hurricane Katrina").

7. *See, e.g.*, Ryan Decker, John Haltiwanger, Ron Jarmin & Javier Miranda, *The Role of Entrepreneurship in US Job Creation and Economic Dynamism*, 28 J. ECON. PERSPS. 3, 5 (2014); Erik Hurst & Benjamin Wild Pugsley, *What Do Small Businesses Do?*, *in* BROOKINGS PAPERS ON ECONOMIC ACTIVITY 73, 74-76 (Fall 2021), https://www.brookings.edu/wp-content/uploads/2011/09/2011b_bpea_hurst.pdf [https://perma.cc/GVQ5-7UQR].

8. *See* 13 C.F.R. § 121.201 (2021).

9. For example, advocates of providing disaster relief for small businesses caution against disaster responses that could undermine small businesses' recovery, such as providing free food or building materials in a way that puts local grocery stores or hardware stores out of business. *See* Kuo & Means, *supra* note 3, at 1007.

missed the mark by providing costly relief that failed to reach the firms that needed it most and limiting the use of relief funds in ways that prejudiced many small businesses. This Essay proposes an alternative federal response to future exogeneous shocks. That alternative approach uses the structure of a forgivable loan, incorporating principles of bankruptcy protection to encourage a more efficient use of funds while simultaneously avoiding the stigma associated with a bankruptcy filing. Part I provides a brief summary of the PPP, focusing primarily on the weaknesses of the program. Part II describes how a bankruptcy filing can help small businesses reorganize and preserve owner equity while acknowledging the limited perceived utility of bankruptcy for many small-business owners. Finally, Part III suggests an alternative approach that would combine the advantages of the PPP and bankruptcy protection, while avoiding many of their disadvantages.

I. THE PAYMENT PROTECTION PLAN

The COVID-19 pandemic, which disrupted the normal operation of most American businesses from the spring of 2020 well into 2021, is a striking example of an exogenous shock that dramatically affected small businesses. There are important lessons to learn from the government programs that succeeded and failed in their efforts to provide assistance to small businesses as part of a larger response. In particular, this Essay analyzes the efficacy of the PPP, the most visible element of the government's effort to aid small businesses affected by the global pandemic.

In the early days of the pandemic, federal, state, and local governments responded by encouraging social distancing.[10] Although prohibiting large meetings and shutting down gathering places were necessary to protect public health, these measures threatened the economy, particularly for small businesses.[11] In some ways, the pandemic was no different from other exogenous shocks. Hurricanes, floods, fires, and even riots may require businesses to cease normal operations to protect the health and safety of their customers and workers. Small businesses often suffer from short-term revenue loss after natural disasters, in addition to incurring costs from building and equipment damage caused by storms, loss of electricity, or looting. But the COVID-19 shutdown was

10. For a history of social distancing as a policy response to pandemic, see Eric Lipton & Jennifer Steinhauer, *The Untold Story of the Birth of Social Distancing*, N.Y. TIMES (Apr. 22, 2020), https://www.nytimes.com/2020/04/22/us/politics/social-distancing-coronavirus.html [https://perma.cc/HX94-N4DN].

11. *See* Robert Fairlie, *The Impact of COVID-19 on Small Business Owners: Evidence from the First Three Months After Widespread Social-Distancing Restrictions*, 29 J. ECON. & MGMT. STRATEGY 727, 727-28 (2020).

substantially farther reaching and longer lasting than most disasters in living memory, resulting in a loss of revenue that was especially dramatic and persistent.[12] For many small- and medium-sized enterprises, the government's social-distancing policy had an unprecedented effect.[13]

Policymakers quickly realized that small businesses needed the government's assistance to cope with the consequences of the pandemic.[14] Leaving small businesses to their own devices was likely to have severe consequences for the larger

12. *See, e.g.*, Alexander W. Bartik, Marianne Bertrand, Zoe Cullen, Edward L. Glaeser, Michael Luca, & Christopher Stanton, *The Impact of COVID-19 on Small Business Outcomes and Expectations*, 117 PROC. NAT'L ACAD. SCI. 17656, 17656 (2020); Andy Medici, *Uneven Recovery: 35% of Small Businesses Might Not Survive the Summer, Survey Finds*, BUS. J. (June 4, 2021, 1:17 PM EDT) (reporting on a survey in which 57% of small-business owners recorded half or less than half of pre-COVID-19 revenues); *Small Business Pulse Survey*, U.S. CENSUS BUREAU, https://portal.census.gov/pulse/data/#weekly [https://perma.cc/6GJV-3UG2] (reporting weekly survey responses to questions regarding the impact of COVID-19 on revenues, employees, hours, and expectations).

13. Bartik et al., *supra* note 12, at 17657 (projecting a "scale of job dislocation that could be larger than anything America has experienced since the Great Depression").

14. *See, e.g.*, Press Release, John Curtis, U.S. Rep., U.S. House Comm. on Small Bus., Curtis Speaks at House Small Business Hearing: "Small Business Will Save Us" (Apr. 23, 2020), https://curtis.house.gov/press-releases/curtis-speaks-at-house-small-business-hearing-small-businesses-will-save-us [https://perma.cc/5KCB-UTPJ] ("Businesses throughout my community need more help, and now. This bill we will vote on later today is critical to delivering resources to the parts of the country and economy that are currently on life support."); Press Release, Nydia M. Velázquez, U.S. Rep., U.S. House Small Bus. Comm. Chairwoman, Chairwoman Velázquez on March Jobs Report (Apr. 3, 2020), https://smallbusiness.house.gov/news/documentsingle.aspx?DocumentID=3233 [https://perma.cc/X5F5-CTP4] ("Few have borne the economic brunt of this crisis as painfully as the small business owners that line our Main Streets and fuel our economy. Now, these companies are facing gut-wrenching decisions over how to protect the health and safety of their employees and customers while also making payroll, paying rent, and keeping the business afloat."); U.S. HOUSE COMM. ON FIN. SERVS., COMMITTEE PRIORITIES INCLUDED IN H.R. 748, THE CARES ACT (2020), https://financialservices.house.gov/uploadedfiles/priorities_included_in_h.r._748__the_cares_act.pdf [https://perma.cc/RY3G-D8YY] (providing "increased bankruptcy protections for . . . small businesses"; "loan forgiveness to small businesses for expenses related to utilities, rent, interest on mortgages, and payroll. Struggling small businesses will have access to funds to cover their immediate costs"; and "oversight, transparency and accountability of Federal aid intended to support . . . businesses").

economy.[15] Based on research conducted by the Federal Reserve,[16] it seemed inevitable that a substantial number of small businesses would be forced to lay off their employees or close entirely.

Indeed, the initial shutdowns in March of 2020 produced the largest spike in unemployment claims observed since the Great Depression.[17] Significant numbers of small businesses temporarily closed due to the pandemic, reducing their staffs and suffering staggering losses in revenue.[18] More disturbing, minority business owners experienced a much larger drop in revenue than average, even after controlling for industry variations.[19]

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15. *See 2020 Report on Employer Firms: Small Business Credit Survey*, FED. RSRV. BANKS 5 (2020), https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2020/2020-sbcs-employer-firms-report [https://perma.cc/4JH4-9CE9] (reporting survey results from small businesses responding to a hypothetical two-month revenue loss). In this survey, which was conducted in 2019, nearly half (47%) of small businesses reported that they would simply use the owner's personal funds to stay in business, with smaller amounts indicating they would reduce salaries (37%), take out additional debt (34%), lay off employees (33%), downsize operations (30%), and defer expenses and/or payments (29%). A further 17% of respondents indicated they would close or sell their business.

16. *See id.*

17. *See* Rakesh Kochhar, *Unemployment Rose Higher in Three Months of COVID-19 Than It Did in Two Years of the Great Recession*, PEW RSCH. CTR. (June 11, 2020), https://www.pewresearch.org/fact-tank/2020/06/11/unemployment-rose-higher-in-three-months-of-covid-19-than-it-did-in-two-years-of-the-great-recession [https://perma.cc/H8D6-XFX7]; *see also Civilian Unemployment*, U.S. BUREAU LAB. STATS., https://www.bls.gov/charts/employment-situation/civilian-unemployment.htm [https://perma.cc/HH8M-87ZY] (providing a graphical demonstration of historic unemployment rates in which the spike observed in 2020 is clearly visible).

18. *See* Bartik et al., *supra* note 12, at 17656 (2020), https://www.pnas.org/content/pnas/117/30/17656.full.pdf [https://perma.cc/5ETL-UJW6] (reporting that 43% of small businesses temporarily closed and businesses collectively reduced employment by 39%); John Eric Humphries, Christopher Neilson & Gabriel Ulyssea, *The Evolving Impacts of COVID-19 on Small Businesses Since the CARES Act* 2 (Cowles Found. Discussion Paper No. 2230, 2020), https://ssrn.com/abstract=3584745 [https://perma.cc/GS2N-8QZK] (reporting that 59% of small-business survey respondents had laid off workers by March 30 and 46% believed their business would not recover within two years by April 20); Robert W. Fairlie, *The Impact of COVID-19 on Small Business Owners: Evidence of Early-Stage Losses from the April 2020 Current Population Survey* 1 (Nat'l Bureau of Econ. Rsch., Working Paper No. 27309, 2020), https://www.nber.org/system/files/working_papers/w27309/w27309.pdf [https://perma.cc/WJ6W-W9CZ] (reporting that the number of working business owners dropped 22% from February to April of 2020).

19. Black Americans experienced the largest losses, with an absolute 41% drop in business owners, and a 35% drop when controlling for national industry distribution. Fairlie, *supra* note 18, at 7. The study also found that minority-owned and female-owned small businesses were significantly less likely to be deemed essential, placing them at higher risk of losses due to COVID-19. *Id.* at 8.

Faced with widespread business closures and potential large-scale unemployment, Congress decided to act. In considering different responses, lawmakers hoped to encourage ongoing employment by small businesses to minimize the effect of long-term unemployment on the economy.[20] This determination was largely informed by the lessons of the 2008 recession. Lawmakers feared that unemployment caused by the pandemic could persist long-term, even after the worst effects of the pandemic had receded.[21] Congress sought to incentivize small businesses to retain employees on the payroll by providing loans that could be forgiven if used primarily for that purpose.[22] This program came to be known as the Paycheck Protection Program (PPP).

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20. *See, e.g.*, 166 CONG. REC. H1820 (daily ed. Mar. 27, 2020) (statement of Rep. Neal) ("We also fought to include provisions to shore up the financial health of small business and other struggling employers. . . . [E]mployers who take action to keep their employees on the payroll should be rewarded."); *see also* Letter from Marco Rubio, Chairman, Senate Comm. on Small Bus. & Entrepreneurship, et al., to Steven Mnuchin, Sec'y of the Treasury, U.S. Dep't of the Treasury & Jovita Carranza, Adm'r, U.S. Small Bus. Admin. (Mar. 30, 2020), https://www.rubio.senate.gov/public/_cache/files/6efb771d-da31-4b00-aba1-e6fb428bd1ba/8EF8F376311973C53773AEC96F534D79.3.30.20-final-cares-act-implementation-letter.pdf [https://perma.cc/NP89-RCSC] ("It is critical that . . . relief is disbursed to small businesses as quickly as possible to help ensure that no small businesses are forced to choose between solvency and retaining their employees during this uncertain time."); Ron Johnson, Opinion, *How to Fix the Paycheck Protection Program*, WALL ST. J. (May 31, 2020, 3:44 PM ET), https://www.wsj.com/articles/how-to-fix-the-paycheck-protection-program-11590954296 [https://perma.cc/TQ72-ALKN] ("The [Paycheck Protection Program]'s primary objective, as stated by its sponsors, was to provide financial support to employees by keeping them connected to their employers, regardless of whether there was work for them to perform. This helped accomplish a corollary goal of reducing the number of people seeking unemployment benefits.").

21. *See, e.g.*, Letter from Tammy Baldwin, U.S. Sen., to Mitch McConnell, S. Majority Leader & Charles Schumer, S. Democratic Leader (Apr. 22, 2020), https://www.baldwin.senate.gov/imo/media/doc/2020%204%2022%20Baldwin,%20Wyden,%20Van%20Hollen,%20Bennet,%20Booker%20Subsidized%20Jobs1.pdf [https://perma.cc/8N9U-BM7U] ("While reopening the economy is dependent on the spread and risk of the virus, we must prepare for more lasting impacts on the job market. . . . This national subsidized employment proposal is informed by the successful programs that states were able to get up and running quickly during the Great Recession to place individuals in a wage-paying job."); Press Release, Don Beyer, U.S. Rep., Vice Chair Beyer on UI Claims: Congress Needs to Tie Ongoing Support to Economic Conditions (Apr. 9, 2020), https://www.jec.senate.gov/public/index.cfm/democrats/2020/4/vice-chair-beyer-on-ui-claims-congress-needs-to-tie-ongoing-support-to-economic-conditions [https://perma.cc/9S5L-WYHU] ("This is a catastrophe. Nearly 17 million Americans have lost their jobs and they likely won't find another one until the contagion is under control—and that may be a long way off.").

22. *See* 166 CONG. REC. H1732, H1819 (daily ed. Mar. 27, 2020) (statement of Rep. Brady) ("For small businesses, we offer fully guaranteed loans . . . with the promise that if you keep your workers on payroll, that portion of the loan will be forgiven."); *see also* U.S. SENATE COMM. ON SMALL BUS. & ENTREPRENEURSHIP, THE SMALL BUSINESS OWNER'S GUIDE TO THE CARES ACT 2 (2020) ("If employers maintain their payroll, the loans would be forgiven, which would help workers remain employed, as well as help affected small businesses and our economy

The PPP enabled eligible applicants to borrow up to 2.5 times their monthly payroll, up to a maximum of 10 million dollars.[23] Unlike other Small Business Administration (SBA) loans, the PPP did not require collateral or personal guarantees for loan approval. Furthermore, borrowers could be eligible for forgiveness of their loans, so long as during the eight- to twenty-four-week covered period following loan disbursement, the business maintained the same number of employees and compensation, spending at least 60% of the loan proceeds on payroll costs.[24] Financial institutions approved by the SBA made the PPP loans and administered the program, but the loans were guaranteed by the federal government.[25] Although the SBA has engaged in other guaranteed-lending programs in the past, the size and scope of the PPP was unprecedented.[26]

Many businesses took advantage of the PPP. An estimate published by the SBA in June of 2020 reported that as many as 84% of all small-business

snap-back quicker after the crisis."); Tom Cotton, *SBA Paycheck Protection Loan Program Overview*, SENATOR TOM COTTON ARK. 7 (2020), https://www.cotton.senate.gov/imo/media/doc/Tom%20Cotton-Paycheck%20Protection%20Program.pdf [https://perma.cc/FG3H-SLCQ] ("The purpose of the Paycheck Protection Program is to help you retain your employees, at their current base pay. If you keep all of your employees, the entirety of the loan will be forgiven. If you still lay off employees, the forgiveness will be reduced by the percent decrease in the number of employees.").

23. Monthly payroll was determined by averaging payroll numbers prior to February of 2020. Repayment was deferred for six months, with interest accruing at 1%, and loans maturing after two years. Loans issued after June 5, 2020, have a maturity of five years. *First Draw PPP Loan: Loan Details*, U.S. SMALL BUS. ADMIN., https://www.sba.gov/funding-programs/loans/covid-19-relief-options/paycheck-protection-program/first-draw-ppp-loan#section-header-2 [https://perma.cc/2EVM-CHVQ].

24. *See PPP Loan Forgiveness: First Draw PPP Loan Forgiveness Terms*, U.S. SMALL BUS. ADMIN., https://www.sba.gov/funding-programs/loans/covid-19-relief-options/paycheck-protection-program/ppp-loan-forgiveness#section-header-0 [https://perma.cc/59S9-AANP].

25. *See Paycheck Protection Program (PPP) Information Sheet: Lenders*, U.S. DEP'T TREASURY, https://home.treasury.gov/system/files/136/PPP%20Lender%20Information%20Fact%20Sheet.pdf [https://perma.cc/KG9L-MNJ5].

26. For example, the 7(a) program, the Small Business Administration's (SBA's) most common loan program, also provides loans through financial institutions but guaranteed by the federal government, with a maximum loan of $5 million per recipient. *See 7(a) Loans*, U.S. SMALL BUS. ADMIN., https://www.sba.gov/funding-programs/loans/7a-loans [https://perma.cc/KFY7-JJUG]. This program has guaranteed between $10 billion and $20 billion per year since 2010. *See* Isil Erel & Jack Libersohn, *Does FinTech Substitute for Banks? Evidence from the Paycheck Protection Program* 2 n.3 (Nat'l Bureau of Econ. Rsch., Working Paper No. 27659, 2020), https://www.nber.org/system/files/working_papers/w27659/w27659.pdf [https://perma.cc/5QZ3-MUPT]. The dramatically larger scope of the PPP led the SBA to approve a number of nontraditional lenders specializing in financial technology to distribute funds alongside traditional banks. *Id.* at 2.

employees were supported by the PPP.[27] The amount of funds approved for disbursement steadily grew over the summer of 2020 and into 2021.[28] By August 2021, the SBA had distributed over $790 billion of PPP funds.[29] Later distributions of PPP funds introduced additional restrictions regarding the number of employees, and also required applicants to demonstrate at least a 25% reduction in gross receipts between comparable quarters in 2019 and 2020.[30]

The relief provided by the PPP was not equally distributed across small businesses. Especially for the initial distribution of PPP funds, firms with an outstanding lending relationship with SBA lenders had a significantly better chance of receiving funds. The program's first-come, first-served nature meant that businesses without preexisting relationships were often left out in the cold. Businesses owned by women and minorities—groups who were less likely on average to have preexisting banking relationships—were therefore less likely to receive PPP assistance.[31] PPP fund distribution was also criticized as inequitable for funding companies based on the size of their payroll, rather than the amount of their apparent need.[32] Certain recipients of PPP funds—such as Ruth's Chris and Shake Shack—are hard to describe as "small" businesses, despite apparently

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27. *See* U.S. SMALL BUS. ADMIN., PAYCHECK PROTECTION PROGRAM (PPP) REPORT 4 (July 2020), https://www.sba.gov/sites/default/files/2020-07/PPP%20Results%20-%20Sunday%20FINAL.pdf [https://perma.cc/DG49-QW85].

28. The Coronavirus Aid, Relief, and Economic Security (CARES) Act, which introduced the PPP, initially set aside $349 billion in PPP funds, distributed on a first-come, first-served basis. *See* Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, 134 Stat. 281 (2020). Congress then approved additional funds as the pandemic effects continued. *See* Paycheck Protection Program and Health Care Enhancement Act, Pub. L. No. 116-139, 134 Stat. 620 (2020).

29. *PPP Data*, U.S. SMALL BUS. ADMIN. (Aug. 15, 2021), https://www.sba.gov/funding-programs/loans/covid-19-relief-options/paycheck-protection-program/ppp-data [https://perma.cc/7Z8X-UXPU].

30. *Top Line Overview of Second Draw PPP Loans*, U.S. SMALL BUS. ADMIN. (Jan. 13, 2021), https://www.sba.gov/sites/default/files/2021-01/Top-line%20Overview%20of%20Second%20Draw%20PPP%20%281.8.2021%29-508.pdf [https://perma.cc/468S-KNZZ].

31. *See* Megan Cerullo, *Up to 90% of Minority and Women Owners Shut Out of Paycheck Protection Program, Experts Fear*, CBS NEWS (Apr. 22, 2020, 3:48 PM), https://www.cbsnews.com/news/women-minority-business-owners-paycheck-protection-program-loans [https://perma.cc/Z2V7-SDBG]; *see also* FED. RSRV. BANKS, *supra* note 15, at 9 (noting that non-Hispanic white owners were significantly more likely to use banks than Hispanic or Black owners).

32. *See, e.g*, Amanda Fischer, *Did the Paycheck Protection Program Work for Small Businesses Across the United States?*, WASH. CTR. FOR EQUITABLE GROWTH (July 15, 2020), https://equitablegrowth.org/did-the-paycheck-protection-program-work-for-small-businesses-across-the-united-states [https://perma.cc/VUT3-KBF3] (citing academic findings that firms were more likely to receive a PPP loan if they were located in areas with better employment outcomes, fewer infections and deaths from COVID-19, and less social distancing).

satisfying program criteria.[33] Yet these larger businesses received a proportionately higher amount of funding, despite having access to wider resources than the typical small business struggling with the impacts of COVID-19.[34]

In the initial distribution of PPP funds, recipients were not required to demonstrate need apart from certifying that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations."[35] This may have been due in large part to the prevailing uncertainty regarding the pandemic's length, severity, and geographical spread. For many businesses, particularly in industries such as construction, real estate, finance, and information and technology,[36] the shutdowns in the spring of 2020 were only temporary. Many of these businesses were quickly designated as essential within their respective jurisdictions and were accordingly permitted to continue operating. These industries experienced a smaller reduction in their workforces and less disruption to their revenues, along with lower rates of closure.[37] Nevertheless, many

33. These two companies each received tens of millions of dollars in PPP loans, as did other publicly traded companies. Some subsequently returned the funds in response to public outcry. *See* Inti Pacheco & Theo Francis, *Public Companies Got $500 Million in Small Business Loans*, WALL ST. J. (Apr. 22, 2020, 6:27 PM), https://www.wsj.com/articles/these-are-the-public-companies-that-got-small-business-loans-11587493742 [https://perma.cc/E6QL-B5GS].

34. *See* Stacy Cowley & Ella Koeze, *1 Percent of P.P.P. Borrowers Got over One-Quarter of the Loan Money*, N.Y. TIMES (Mar. 16, 2021), https://www.nytimes.com/2020/12/02/business/paycheck-protection-program-coronavirus.html [https://perma.cc/M7SS-4MWL] (reporting on detailed loan information released by the SBA). The majority of loans were less than $50,000, with the overall average loan size only slightly exceeding $100,000. U.S. SMALL BUS. ADMIN., PAYCHECK PROTECTION PROGRAM (PPP) REPORT 6 (Aug. 8, 2020), https://home.treasury.gov/system/files/136/SBA-Paycheck-Protection-Program-Loan-Report-Round2.pdf [https://perma.cc/LTJ3-SY2R].

35. *Paycheck Protection Program Borrower Application Form Revised June 12, 2020*, U.S. SMALL BUS. ADMIN. https://www.sba.gov/sites/default/files/2020-06/PPP%20Borrower%20Application%20Form%20%28Revised%20June%2012%202020%29-Fillable-508.pdf [https://perma.cc/6Y45-UXBL]. This requirement implicitly presumed that all loans under $2 million would be presumed "necessary." *See* Alan Gassman, *PPP Loan Rules Relaxed by SBA for Loans Under $2,000,000 – Uncertainty Still Abounds for Many*, FORBES (May 14, 2020, 9:25 PM), https://www.forbes.com/sites/alangassman/2020/05/14/ppp-loan-rules-relaxed-by-sba-for-loans-under-2000000uncertainty-still-abounds-for-many [https://perma.cc/C6U2-D2FD].

36. *See* Aaron Klein & Ember Smith, *Explaining the Economic Impact of COVID-19: Core Industries and the Hispanic Workforce*, BROOKINGS INST. (Feb. 5, 2021), https://www.brookings.edu/research/explaining-the-economic-impact-of-covid-19-core-industries-and-the-hispanic-workforce [https://perma.cc/B3JF-V9HP].

37. *See Comparing the Experiences of Essential and Nonessential Businesses During COVID-19*, U.S. BUREAU LAB. STATS. (Mar. 3, 2021), https://www.bls.gov/opub/ted/2021/comparing-the-experiences-of-essential-and-nonessential-businesses-during-covid-19.htm [https://perma.cc/QA5D-JY56]; *Small Business Financial Outcomes During the COVID-19 Pandemic*, JPMORGAN CHASE & CO. (July 2020), https://www.jpmorganchase.com/institute/research/small-business/report-small-business-financial-outcomes-during-the-covid-19-pandemic [https://

businesses within these industries applied for PPP funding in its early days out of an abundance of caution, and then used the funds to pad their reserves.[38]

Other businesses that had accepted PPP funds found the restrictions associated with loan forgiveness so onerous as to severely dilute the program's benefits. As modified,[39] the PPP required recipients to use 60% of the funds received for company payroll within twenty-four weeks of disbursement.[40] Some businesses were heavily restricted from operating for all or most of that period, making payroll an unnecessary expense, as opposed to rent and basic utilities. These companies had to manufacture reasons for employees to work in order to obtain their loan forgiveness.[41] In the meantime, federal unemployment assistance made it more lucrative for many low-wage employees to accept unemployment rather than work their normal hours.[42] Employers thus found themselves competing with unemployment benefits to bring workers back to work in businesses that were closed or operating under heavily restricted conditions. On top of all this, many employers had mixed feelings about bringing employees back to conditions in which they might be vulnerable to infection.[43] Some businesses applied

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perma.cc/TXV8-928P] (noting that grocers, considered essential in every locality, experienced growth even while other retail firms experienced contraction); Fairlie, *supra* note 11, at 10.

38. *See* Brook E. Gotberg, *Failure Is Not an Option: The SBRA in the Time of COVID*, 95 AM. BANKR. L.J. 389 (2021), https://ssrn.com/abstract=3836216 [https://perma.cc/32J2-6RM5] (citing interviews with small business owners).

39. *See* Paycheck Protection Program Flexibility Act of 2020, H.R. 7010, 116th Cong. (1st Sess. 2020).

40. *PPP Loan Forgiveness*, U.S. SMALL BUS. ADMIN., https://www.sba.gov/funding-programs/loans/covid-19-relief-options/paycheck-protection-program/ppp-loan-forgiveness [https://perma.cc/SC2H-AU8J].

41. *See, e.g*, Christopher Rugaber, *Many Small Businesses Say Loans Won't Get Them to Rehire*, ASSOCIATED PRESS (Apr. 22, 2020), https://apnews.com/article/small-business-virus-outbreak-us-news-ap-top-news-oh-state-wire-380b07b9292ea7ae4d382f091d99bf10 [https://perma.cc/H8KV-33S8] (reporting on businesses' reaction to employment requirements).

42. *See* Phillip Molnar & Mike Freeman, *Some San Diegans Can Earn More on Unemployment. Why Go Back to Work?*, SAN DIEGO UNION-TRIB. (May 3, 2020), https://www.sandiegouniontribune.com/business/economy/story/2020-05-03/some-san-diegans-can-earn-more-on-unemployment-why-go-back-to-work [https://perma.cc/86ZJ-3MN7].

43. Concerns about workplace spread were exacerbated by fears that employers might be liable for the consequences. *See, e.g*, Julie Creswell, Gillian Friedman & Peter Eavis, *Return-to-Office Plans Are Set in Motion, but Virus Uncertainty Remains*, N.Y. TIMES (Mar. 3, 2021), https://www.nytimes.com/2021/03/03/business/return-to-work-coronavirus.html [https://perma.cc/2K5X-2VMC]; Alexia Elejalde-Ruiz, *If You Get Sick with COVID-19, Is Your Employer Liable? As Businesses Prepare to Reopen, Worker Safety Is a Priority*, CHI. TRIB. (May 4, 2020, 10:25 AM), https://www.chicagotribune.com/coronavirus/ct-coronavirus-employer-liability-workplace-exposure-20200501-dye6husnszchpnpaadiensn2ja-story.html [https://perma.cc/7FT7-8VF6].

for and received funding before they were permitted to open under applicable local regulations, and were accordingly unable to satisfy the initial, more stringent requirements for loan forgiveness.[44]

In sum, the PPP's benefits to small businesses were limited, both because the most vulnerable small businesses had difficulty getting access to loans and because the payroll limitation tied the hands of other small businesses who desperately needed the funding to meet other expenses. Perhaps because of these weaknesses, many small businesses laid off employees throughout 2020 and 2021, leading to spiking unemployment figures.[45] The majority of small businesses experienced a significant decline in sales[46] and were forced to respond by cutting expenses,[47] taking on additional debt,[48] and, in some cases, closing their doors permanently.[49] The PPP did not appear to dramatically improve the survival prospects of most small businesses.[50]

Of course, the PPP was not the only federal program used by small businesses during the COVID-19 pandemic. Many small businesses also applied for and received funding through a separate SBA program, the Economic Injury

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44. *See* Yuka Hayashi, Ruth Simon & Peter Rudegeair, *PPP Small-Business Loans Left Behind Many of America's Neediest Firms*, WALL ST. J. (June 17, 2020, 11:27 AM), https://www.wsj.com/articles/ppp-small-business-loans-left-behind-many-of-americas-neediest-firms-11592407677 [https://perma.cc/B7SD-YVS4].

45. *See* GENE FALK, PAUL D. ROMERO, JAMESON A. CARTER, ISAAC A. NICCHITTA & EMMA C. NYHOF, CONG. RSCH. SERV., R46554, UNEMPLOYMENT RATES DURING THE COVID-19 PANDEMIC (June 15, 2021). The Federal Reserve concluded, based on its 2020 study, that 46% of small businesses reduced their workforce in response to the pandemic. FED. RSRV. BANKS, SMALL BUSINESS CREDIT SURVEY: 2021 REPORT ON EMPLOYER FIRMS 1 (2021). Another study concluded that the PPP had no meaningful impact on the unemployment rate. Raj Chetty, John N. Friedman, Nathaniel Hendren, Michael Stepner & the Opportunity Insights Team, The Economic Impacts of COVID-19: Evidence from a New Public Database Built Using Private Sector Data (Nov. 2020) (unpublished manuscript) (on file with author).

46. *See* FED. RSRV. BANKS, *supra* note 45 at 4 (stating that 81% of firms reported a decrease in sales).

47. *See* Diana Farrell, Chris Wheat, Chi Mac & Bryan Kim, *Small Business Expenses During COVID-19*, JPMORGAN CHASE & CO (Nov. 2020), https://www.jpmorganchase.com/institute/research/small-business/report-small-business-expenses-during-COVID-19 [https://perma.cc/3R7S-8RUM].

48. *See* FED. RSRV. BANKS, *supra* note 45, at 6 (noting that 50% of firms surveyed took out debt to address their financial challenges, and 62% used personal funds to cover business expenses).

49. *See* Anjali Sundaram, *Yelp Data Shows 60% of Business Closures Due to the Coronavirus Pandemic Are Now Permanent*, CNBC (Sept. 16, 2020, 8:32 AM EDT), https://www.cnbc.com/2020/09/16/yelp-data-shows-60percent-of-business-closures-due-to-the-coronavirus-pandemic-are-now-permanent.html [https://perma.cc/4L6Y-82VQ].

50. *See* Robert P. Bartlett III & Adair Morse, *Small Business Survival Capabilities and Policy Effectiveness: Evidence from Oakland* (Nat'l Bureau of Econ. Rsch., Working Paper No. 27629, 2020).

Disaster Loan (EIDL).[51] The EIDL program extends more modest loans[52] directly from the SBA[53] on very favorable terms[54] to small-business owners with dramatically fewer restrictions—albeit without loan forgiveness.[55] Loans over $25,000 require the grant of a security interest in the business's personal property, reflecting an emphasis on repayment.[56]

Federal funding through the PPP and EIDL programs did provide some assistance to small businesses struggling with the effects of the COVID-19 pandemic. However, the PPP largely failed to achieve its goals in providing needed assistance to the most vulnerable businesses, and it was unsustainable as a long-term solution due to its significant expense and potential for waste. As an initial matter, the program was extremely costly,[57] particularly considering that it failed in its ultimate goal of reducing small-business layoffs. The program was also inequitable and ineffective in providing meaningful assistance to businesses that

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51. *See COVID-19 EIDL*, U.S. SMALL BUS. ADMIN. (2021), https://www.sba.gov/funding-programs/loans/covid-19-relief-options/covid-19-economic-injury-disaster-loan [https://perma.cc/4PD9-LT8U].

52. Initially, the Economic Injury Disaster Loan (EIDL) program capped small businesses at six months of operating expenses, with a maximum loan amount of $150,000. On April 6, 2021, in the face of continuing difficulties for small businesses, the maximum loan amount was raised to $500,000. *See* Carmen Reinicke, *The Small Business Administration Is Set to Triple Loan Amounts for Businesses Hurt by COVID*, CNBC (Mar. 24, 2021, 4:19 PM EDT), https://www.cnbc.com/2021/03/24/sba-is-set-to-triple-loan-amounts-for-those-hit-by-covid.html [https://perma.cc/U94E-8L2Z]. Although only a fraction of what was spent on the PPP program, the EIDL had approved an impressive $252 billion of loans by August 2021. U.S. SMALL BUS. ADMIN., DISASTER ASSISTANCE UPDATE: NATIONWIDE COVID EIDL AND TARGETED EIDL ADVANCES (2021).

53. U.S. SMALL BUS. ADMIN., *supra* note 51.

54. Applicants borrow funds at an interest rate of 3.75% (2.75% for nonprofit businesses), to be repaid over a term of up to thirty years. *Id.*

55. *See COVID-19 EIDL*, U.S. SMALL BUS. ADMIN. (2021) [hereinafter U.S. SMALL BUS. ADMIN., *Covid-19 EIDL*], https://www.sba.gov/funding-programs/loans/covid-19-relief-options/covid-19-economic-injury-disaster-loan [https://perma.cc/4PD9-LT8U]. Targeted EIDL Advance funds were available to provide a grant of up to $10,000 to qualified applicants, but this program was limited to businesses in low-income communities. *See Targeted EIDL Advance and Supplemental Targeted Advance*, U.S. SMALL BUS. ADMIN. (2021), https://www.sba.gov/funding-programs/loans/covid-19-relief-options/eidl/targeted-eidl-advance-supplemental-targeted-advance [https://perma.cc/XGG7-BTKT].

56. *See* U.S. SMALL BUS. ADMIN., *Covid-19 EIDL*, *supra* note 55.

57. *See* Raj Chetty, John N. Friedman, Nathaniel Hendren and Michael Stepner, *The Economic Impacts of COVID-19: Evidence from a New Public Database Built Using Private Sector Data*, OPPORTUNITY INSIGHTS (Nov. 2020), https://opportunityinsights.org/wp-content/uploads/2020/05/tracker_paper.pdf [https://perma.cc/642P-X4JD] (estimating that the cost per job saved by the PPP was $377,000).

lacked the customer base to justify retaining employees.[58] The format of the EIDL likely reduced the likelihood of waste as a consequence of emphasizing repayment.[59] But it was also demonstrably less attractive to small businesses concerned about their ability to repay their debt over the long term.[60] Accordingly, the EIDL's more modest goals were muted, insofar as businesses opted for forgivable loans even when they proved less useful due to the restrictions imposed.

II. THE SMALL BUSINESS REORGANIZATION ACT

Government lending programs poured a remarkable amount of public funds into the economy in an effort to forestall soaring unemployment and a likely recession. The effectiveness of this approach remains to be seen and warrants further study. Expanding the use of bankruptcy relief might have provided a more targeted approach by assisting those companies in the greatest need. The bankruptcy laws of the United States allow companies to propose a plan of reorganization that can be confirmed over the objections of creditors, and they permit companies to discharge debts, escape unprofitable contracts, and stay collection efforts during the reorganization.[61] Many predicted that even with additional governmental aid, large and small businesses would widely invoke bankruptcy as a mechanism to stop collection efforts and obtain additional funding.[62] Although this was largely true for big corporations, bankruptcy was not a widely used solution for small businesses.[63]

58. *See, e.g*, Christopher Rugaber, *Many Small Businesses Say Loans Won't Get Them to Rehire*, ABC NEWS (Apr. 22, 2020), https://abcnews.go.com/Business/wireStory/small-businesses-loans-rehire-70285887 [https://perma.cc/BQ36-8JQW] (reporting on businesses' reaction to employment requirements).

59. *See supra* note 56 and accompanying text.

60. This is reflected in the relative popularity of the programs. The EIDL program distributed around $250 billion dollars compared with the PPP's distribution of nearly $800 billion over the same time period. *See Disaster Assistance Update National COVID-19 EIDL*, U.S. SMALL BUS. ADMIN. (Aug. 12, 2021), https://www.sba.gov/sites/default/files/2021-08/COVID-19%20EIDL%20TA%20STA_08.12.2021_Public-508.pdf [https://perma.cc/WU4R-ZU89]; *PPP Data*, U.S. SMALL BUS. ADMIN. (Aug. 15, 2021), https://www.sba.gov/funding-programs/loans/covid-19-relief-options/paycheck-protection-program/ppp-data [https://perma.cc/YX4V-W6FP].

61. *See* 11 U.S.C. §§ 1101-1195 (2018).

62. *See, e.g.*, Mary Williams Walsh, *A Tidal Wave of Bankruptcies Is Coming*, N.Y. TIMES (June 18, 2020), https://www.nytimes.com/2020/06/18/business/corporate-bankruptcy-coronavirus.html [https://perma.cc/5ED3-CKW4].

63. *See* Maria Chutchian, *Bankruptcy Filings Lowest Since 1985 Amid Pandemic Relief*, REUTERS (Aug. 4, 2021), https://www.reuters.com/legal/transactional/bankruptcy-filings-lowest-

A full explanation of this phenomenon has yet to be determined.[64] Uncertainty about the future may have played a large role in delaying bankruptcy filings during the pandemic, along with the lack of liquidity. But this explanation is somewhat unsatisfying, given that large corporations, facing the same uncertainty, filed for bankruptcy in record numbers in 2020,[65] and evidence suggests that liquidity was unusually high during the early days of the pandemic in particular.[66] Another theory might be that small businesses perceived less value in a bankruptcy filing, which is generally viewed as a mechanism to discharge debt, despite other advantages it can provide, such as the automatic stay and oversight of lending. Perhaps a better explanation is that until very recently, bankruptcy was not a particularly useful tool for small businesses seeking to reorganize. Historically, Chapter 11 proceedings were often too costly in terms of time, fees, and sacrifice of owner equity to benefit smaller organizations.[67] Shortly before the pandemic commenced, Congress passed major reforms to the Bankruptcy Code aimed at facilitating small-business reorganization.[68] But despite this felicitous timing, small businesses do not appear to have been sufficiently inspired to take advantage of the new law once the pandemic hit.

The Small Business Reorganization Act (SBRA), which passed in 2019 with an effective date of February 19, 2020, reduced the costs of filing for Chapter 11 bankruptcy (the chapter designated for business reorganization) by creating a

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since-1985-amid-pandemic-relief-2021-08-04 [https://perma.cc/3Y67-CKJK]; Jialan Wang, Jeyul Yang, Benjamin Iverson & Raymond Kluender, Bankruptcy and the COVID-19 Crisis (unpublished manuscript) (on file with author).

64. Some surmise that many small businesses have simply shut down in the face of ongoing uncertainty. *See, e.g.*, Laurence Darmiento, *Bankruptcies Are Way Down During the Pandemic. Here's Why*, L.A. TIMES (Mar. 23, 2021, 6:00 AM PT), https://www.latimes.com/business/story/2021-03-23/covid-19-bankruptcies-pandemic [https://perma.cc/K86U-WFKJ] (also citing the influence of cash pumped into the economy in the form of loans and stimulus checks and the moratorium on foreclosures).

65. *See* Tayyeba Irum & Chris Hudgins, *US Corporate Bankruptcies End 2020 at 10-Year High Amid COVID-19 Pandemic*, S&P GLOB. MKT. INTEL. (Jan. 5, 2021), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-corporate-bankruptcies-end-2020-at-10-year-high-amid-covid-19-pandemic-61973656 [https://perma.cc/FZ48-S6P4].

66. *See* Edith S. Hotchkiss, Greg Nini & David C. Smith, *Corporate Capital Raising During the COVID Crisis* (Nov. 1, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3723001 [https://perma.cc/BG99-U2AN].

67. *See* AM. BANKR. INST., ABI COMMISSION TO STUDY THE REFORM OF CHAPTER 11 277 (2014); NAT'L BANKR. REV. COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 614 (1997); Donald R. Korobkin, *Vulnerability, Survival, and the Problem of Small Business Bankruptcy*, 23 CAP. U. L. REV. 413, 425, 436 (1994).

68. *See* Small Business Reorganization Act of 2019 (SBRA), Pub. L. No. 116-54, 133 Stat. 1079 (codified as amended at 11 U.S.C. §§ 1181-1195 (2018)). The SBRA was passed on August 23, 2019, to take effect on February 19, 2020.

subchapter V with comparably softer restrictions and requirements.[69] For small businesses with debts under roughly $2.7 million, the SBRA reduced administrative paperwork requirements, shortened the timeframe for obtaining a plan of reorganization, and permitted equity owners to retain their interest even while discharging debt over the objection of creditors.[70] These modifications removed the largest perceived drawbacks of Chapter 11 bankruptcy proceedings for small businesses.[71] When the COVID-19 crisis hit, one part of the congressional response in the Coronavirus Aid, Relief, and Economic Security (CARES) Act was to raise the debt limits for qualification under the SBRA to $7.5 million.[72] However, despite these advances and the objective need for relief among small businesses, there was no noticeable increase in bankruptcy filings among small businesses.[73]

The reluctance of small businesses to take advantage of the bankruptcy system may be partially attributable to the stigma surrounding bankruptcy, particularly among consumers and small-business owners.[74] There are also real economic consequences to filing for bankruptcy that principally affect future credit worthiness.[75]

But bankruptcy proceedings provide a wide range of tools for small businesses seeking to overcome a dramatic economic shock. The filing itself invokes

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69. *See generally* Charissa Potts, *Key Facts About the SBRA*, ABI J. 8 (Dec. 2019) (analyzing the impact of the SRBA on small business bankruptcy outcomes).

70. *See* William L. Norton III & James B. Bailey, *The Pros and Cons of the Small Business Reorganization Act of 2019*, 36 EMORY BANKR. DEVS. J. 383, 383-87 (2020).

71. *See, e.g.*, Rob Landry, Feature, *SBRA: Eligibility, Governance and Oversight*, Dec. 2019 ABI J. 28, 28.

72. *See* Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, 134 Stat. 281, 310-11 (2020) (codified as amended at 15 U.S.C. §§ 9001-9141 (2018)).

73. *See Annual Bankruptcy Filings Fall 29.7 Percent*, U.S. CTS. (Jan. 28, 2021), https://www.uscourts.gov/news/2021/01/28/annual-bankruptcy-filings-fall-297-percent [https://perma.cc/HP7L-H376] (reporting that business filings dropped from 22,780 in 2019 to 21,655 in 2020); *Subchapter V Cases by Month*, AM. BANKR. INST. (July 29, 2021), https://app.powerbi.com [https://perma.cc/JL6J-G6LS] (reporting an average of under 150 subchapter V cases filed per month nationwide).

74. *See* Gotberg, *supra* note 38 (manuscript at 5-6).

75. *See* David K. Musto, *What Happens When Information Leaves a Market? Evidence from Postbankruptcy Consumers*, 77 J. BUS. 725, 727 (2004) (discussing the impact of a bankruptcy flag, which remains on consumer credit reports for 10 years). Interestingly, one study concluded that although consumer credit typically declines after bankruptcy by nearly $20,000 on average, 65% of the ex-ante lowest-quality borrowers experienced an increase in the amount of credit available to them. *See* Ethan Cohen-Cole, Burcu Duygan-Bump & Judit Montoriol-Garriga, *Who Gets Credit After Bankruptcy and Why? An Information Channel*, 37 J. BANKING & FIN. 5101, 5102 (2013).

an automatic stay, halting all efforts by creditors to collect against the debtor.[76] In particular, it renders void any act to repossess collateral, foreclose on collateral already possessed, or continue an eviction.[77] This provides a "breathing spell" for the debtor to make determinations regarding what to do next.[78] Debtors may also stretch out payments on secured assets, sell assets free and clear of any liens, and reject unprofitable contracts and leases.[79] When acting as a "debtor in possession" (DIP) of the bankruptcy estate, a company may also take on additional debt in bankruptcy through what are commonly referred to as "DIP loans."[80] DIP lenders, who are frequently preexisting creditors or insiders of the debtor, benefit from the bankruptcy system's transparency and the assurance of priority in repayment, even while other obligations are restructured or discharged.[81]

Although the primary purpose of a Chapter 11 filing is not for businesses to obtain a "fresh start,"[82] but rather to reorganize debts to maximize future economic viability, filers may also obtain a discharge of debts. Under the classic Chapter 11 model, discharge is obtained by proposing a plan of repayment to which creditors consent, and all debts outside the plan of repayment are discharged upon the bankruptcy court's confirmation of the plan.[83] Outstanding unsecured debts, damages arising from rejection of contracts and leases, and cure amounts on secured obligations may all be discounted and paid out over time. Under subchapter V of the Chapter 11, enacted through the SBRA, small-business debtors need not obtain creditors' consent to a plan and may instead obtain a discharge of outstanding debts upon a showing that they have used all disposable income to repay debts for a period of three to five years.[84]

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76. *See* 11 U.S.C. § 362(a) (2018).

77. *See id.*

78. *See* H.R. REP. NO. 95-595, at 340 (1977).

79. *See* 11 U.S.C. §§ 363, 365, 1129(a)(9) (2018).

80. *See* Sandeep Dahiya, Kose John, Manju Puri & Gabriel Ramirez, *Debtor-in-Possession Financing and Bankruptcy Resolution: Empirical Evidence*, 69 J. FIN. ECON. 259 (2003) (describing and evaluating DIP-financing options).

81. *See id.* at 263. Research indicates that debtors are also greatly benefitted by the existing of DIP lending, which corresponds with more successful outcomes in reduced time. *Id.* at 279.

82. There is no such thing as a "fresh start" for businesses, at least insofar as that term applies to Chapter 7. A Chapter 7 liquidation for a business results in the termination of that business. A personal-bankruptcy filing under Chapter 7 is frequently referred to as a "fresh start" as the debtor is permitted to keep all postpetition assets in addition to statutorily defined exempt property.

83. *See* 11 U.S.C. § 1141 (2018) (describing the effect of plan confirmation).

84. *See id.* § 1191. Under this "cramdown" scenario, discharge will not take place until all plan payments have been made, similar to the standard in Chapter 13.

These advantages are available in bankruptcy by virtue of federal laws that override state rights and remedies, which typically protect the property interests of creditors. Bankruptcy laws allow debtors to maximize the going-concern value of their businesses by restructuring their outstanding obligations. By limiting creditor rights to a quick recovery, the law permits insolvent debtors to look ahead to a future of productivity. However, by virtue of being associated with the term "bankruptcy," a Chapter 11 filing may be ineffective as a disaster-relief mechanism, for the simple reason that many business owners would rather fail than file for bankruptcy, with its accompanying social stigma.[85]

III. THE SMALL BUSINESS RELIEF AND RESTRUCTURING ACT: AN ALTERNATIVE APPROACH

This Essay proposes a hybrid approach to disaster relief that incorporates bankruptcy principles, but avoids the stigma associated with bankruptcy filings, by structuring relief as a forgivable loan – similar to what Congress offered under the PPP.[86] This proposal is more targeted than the relief offered by the PPP, and it also takes into account the challenges faced by business owners who personally guaranteed their business debts by providing temporary relief from collective actions. In addition, this proposal avoids the stigma of a bankruptcy filing, encouraging a broader uptake among small-business owners, similar to that observed with use of the PPP and the EIDL. A tentative title for such a proposal might be the Small Business Relief and Restructuring Act (the Act).

The Act would provide relief for small businesses, administered at the federal level, to be triggered upon the declaration of an emergency within that business's federal district. Similar to applications for SBA loans, qualifying businesses would need to apply for this relief by filling out an attestation regarding their size, past experience with federal-benefit programs, and anticipated need. Furthermore, within a designated period, businesses would need to provide additional documentation demonstrating how their revenues have been affected by the disaster.

After satisfactorily demonstrating qualification for the program, small-business beneficiaries would be entitled to a general stay of collection proceedings, modeled after the automatic stay of the Bankruptcy Code, preventing evictions, foreclosures, repossessions, and the like for a predesignated period of six months, to be expanded if the business demonstrates that disaster conditions

85. *See* Gotberg, *supra* note 38.

86. This approach is not intended to undermine other worthy efforts to overcome unproductive levels of stigma by promoting greater information and combating misinformation about the costs and benefits of bankruptcy.

have continued beyond that timeframe. This targeted relief could take the place of broader moratoria on foreclosures and repossessions for businesses in the aftermath of an exogenous shock, although these policies may still be desirable for individual consumers.[87] The stay would extend to personal guarantees applying to any outstanding business debts.[88] During this period of stay relief, creditors affected by the stay could request compensation to protect their interest in a debtor's assets. Qualification for and the amount of compensation would be determined based on the creditor's sworn affidavit of loss caused by the stay, and it would be drawn from loans granted to the debtor through the program.[89]

In addition to the benefit of the six-month stay on collection efforts, businesses taking part in the Act's restructuring program would qualify for loans to be administered directly by the SBA, similar to the EIDL program currently in place.[90] Depending on the perceived risk, such loans could require the grant of

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87. During the COVID-19 pandemic, the government at both state and federal levels invoked a plethora of restrictions on foreclosures and evictions, which appear to have effectively paused foreclosures in the short term, and may reduce the total number of foreclosures provoked by the crisis, thanks in part to the increase in home prices and corresponding rise in home equity. *See* Shaina Mishkin, *There Probably Won't Be a Post-Covid Wave of Foreclosures. Here's Why.*, BARRON'S (Mar. 3, 2021, 9:08 AM ET), https://www.barrons.com/articles/there-probably-wont-be-a-post-covid-wave-of-foreclosures-heres-why-51614717019 [https://perma.cc/HZD7-36MP].

88. These personal guarantees may be one factor currently discouraging small businesses from filing for bankruptcy under Chapter 11. Although a bankruptcy filing invokes the automatic stay for a debtor, it does nothing to save a separate entity from collection efforts. Accordingly, in the case of personal guarantees, small-business owners might be required to file for bankruptcy themselves to obtain full protection, with consequences for their personal credit. For a discussion of the heavy burden personal guarantees has placed on small-business owners during the COVID-19 pandemic, see generally Ruth Simon & Heather Haddon, *Small-Business Owners Feel Weight of Personal Debt Guarantees*, WALL ST. J. (Apr. 4, 2021, 11:07 PM ET), https://www.wsj.com/articles/small-business-owners-personal-debt-guarantees-coronavirus-pandemic-11617555245?page=1 [https://perma.cc/M7FK-7E6V], which describes the extent and impact of personal guarantees for business debts during the pandemic.

89. The small-business debtor would have the opportunity to refute or challenge the creditor's affidavit, with administrative hearings on the issue conducted as necessary. The analysis would likely generally follow the principles embodied by the adequate-protection analysis commonly found in bankruptcy proceedings. *See generally* Steven C. Krause & Andrew Zatz, *Recent Developments in Adequate Protection Under Section 361*, *in* NORTON ANNUAL SURVEY OF BANKRUPTCY LAW 557 (2012 ed.) (explaining the term and where it is referenced in the bankruptcy code).

90. Research suggests that direct loans do better than loan guarantees at targeting cash-poor borrowers with good projects, and that loan guarantees lower average business quality and increase the risk of bankruptcy. *See* Wenli Li, *Government Loan, Guarantee, and Grant Programs: An Evaluation*, 84 ECON. Q. 25, 49 (1998). Having direct loans may also facilitate loan forgiveness down the road, although it is possible that structuring the loans as direct loans may create complications in government budgetary accounting. *Id.*

security in business assets. Loan amounts would be determined primarily as a function of the company's operating budget for one to three years, although flexibility would permit a larger or smaller loan depending on the purpose of the loan. Loans would be offered for the purpose of maintaining normal operations during a period of exogenous shock or for altering or reorganizing operations in the face of such a shock, but not for facilitating liquidation of the business. These loans would also be fully forgivable upon the loan recipients' demonstration that they had successfully returned to profitability and had faithfully dedicated all disposable income (income not otherwise dedicated to operating costs) to repayment of the loan for three years. This standard would mirror that required for a nonconsensual discharge under subchapter V of Chapter 11.[91] Firms that failed to return to productivity would not receive loan forgiveness, permitting the SBA to stand as a creditor with equal footing to others in the event of the firm liquidation. In the event that the SBA obtained a security interest, that interest would be fully enforceable in cases where the company did not qualify for loan forgiveness. In cases where the company had been sold or transferred to another entity, loan forgiveness would not be available, and the SBA's rights would be fully enforceable against the purchaser.

Qualification for the loan and for loan forgiveness would be overseen by a plan administrator operating through the SBA. This administrator would be a disinterested third party, not a federal employee. These private individuals would function similarly to trustees in the bankruptcy system, particularly like the role envisioned for the subchapter V trustee.[92] Most individuals filling this role would be trained in small-business finances. They might also be trained turnaround managers, specialized consultants trained to initiate corrective measures to guide a struggling firm through a financial crisis.[93] As circumstances change for the business, the plan administrator would permit or deny requests for modification in terms and ultimately determine whether loan forgiveness is warranted. Officers would generally be overseen by government officials, likely through the SBA or even the Department of Justice.[94]

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91. *See* 11 U.S.C. § 1191 (2018).

92. *See* Katherine Rea, *There's a New Trustee in Town: Examining the Role of Reorganization Trustees in Light of the New Subchapter V Standing Trustee*, Dec. 2019 ABI J. 36, 68. This role has not been fully developed, with ongoing uncertainty regarding the exact parameters of a trustee's duties. Statutorily, they are laid out in 11 U.S.C. § 1183 (2018).

93. *See* William B. Fredenberger, Astrid Lipp & Hugh J. Watson, *Information Requirements of Turnaround Managers at the Beginning of Engagements*, 13 J. MGMT. INFO. SYS. 167, 168 (1997).

94. The Department of Justice is a likely candidate for overseeing plan administrators, insofar as it currently oversees the U.S. Trustee Program in bankruptcy cases, where a bankruptcy trustee fulfills a similar role. *See U.S. Trustee Program*, U.S. DEP'T JUST. https://www.justice.gov/ust [https://perma.cc/2SBD-TGVL].

In short, without forcing small businesses to acknowledge a bankruptcy filing, the Act would allow for designated bankruptcy-like relief, with its balance of transparency for creditors and relief for filers. Creditors would benefit from the loan and in cases where the debtor qualifies for loan forgiveness, they would be paid in full. The role of trustee and judge in the bankruptcy court would be collapsed into the position of a plan administrator. This would reduce overall program costs and ensure a more tailored, need-based approach, along with ongoing oversight in cases like the COVID-19 pandemic where disaster conditions linger, and relief must be ongoing. This program would not replace full bankruptcy proceedings, which some borrowers might find necessary, but it would substantially assist companies struggling with external shocks who might not need or desire the full protections of a bankruptcy filing. It would also serve as a method to preserve preexisting debtor/creditor relationships, including landlord/tenant relationships, during a period in which both are under significant pressure due to exogenous forces. The program would combat unnecessary economic loss by providing short-term liquidity to enable small businesses to remain current on their obligations despite interrupted revenue and the introduction of additional costs.

By basing loan forgiveness on a can-pay system of repayment, the program would differ from the more uniform approach of the PPP and allow for alternative criteria for forgiveness from companies that do not hire outside employees, or who could not meaningfully benefit the economy by increasing or even maintaining payroll. As such, the proposed Act would more effectively target a broader cross-section of small-business owners. By limiting loan forgiveness to those organizations who successfully used the loan to return to productivity, it would also incentivize businesses to repay current creditors and return to normal operations. This approach could disrupt or discourage private negotiations, instead incentivizing debtors to repay other creditors and not the SBA loan. However, the fact that it would be limited to disaster scenarios likely to affect both creditors and debtors makes this result neutral or even desirable.

The Small Business Relief and Restructuring Act, or another program like it, would work best if established well in advance of eventual future disasters, to facilitate smooth administration and to ensure practitioners who advise small businesses are aware of its existence. Indeed, now may be a better time to act than ever, given that passage of such a program may be more politically feasible in the immediate aftermath of a significant disaster, such as the recent COVID-19 pandemic, than it would be in times of prosperity. With memories of the pandemic still fresh and shutdown-related hardships still lingering, policymakers are more likely to view such measures as a priority. As time goes on and other stories dominate the news, legislation for responding to disasters may lose its timeliness and relevance.

CONCLUSION

The COVID-19 pandemic was not the first crisis to shock small businesses, and it will not be the last. Our government will need to respond to similar disasters in the future. This Essay proposes an alternative approach to providing relief for small businesses in the wake of exogenous shocks, one that melds the benefits of easy financing with the accountability, oversight, and gatekeeping of the bankruptcy court, but that avoids the stigma of bankruptcy. Such an approach is essential for ensuring the ongoing viability of small businesses, the lifeblood of the U.S. economy.

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