



Paycheck Protection Program: Access to PPP Loans for Chapter 11 Debtors



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The CARES Act and Bankruptcy: Consonance & Dissonance



CARES Act & Bankruptcy

- The Coronavirus Aid, Relief, and Economic Security Act, H.R. 748 (“CARES Act”) extended lifelines to small businesses suffering economic distress from COVID-19, including the Paycheck Protection Program (PPP), and expanded eligibility for the Small Business Reorganization Act.
- The question for today: Can businesses avail themselves of both forms of relief? Congress has been silent on the subject, but the Small Business Administration (SBA) has made clear that, in its view, companies involved in a bankruptcy proceeding are ineligible for PPP funds.

CARES Act & Bankruptcy

- In today's webinar, we will:
 - Provide an overview of applicable law
 - Provide an update on challenges to the SBA's position
 - Examine arguments that have worked and not worked
 - Explore strategies for accessing PPP funds despite the SBA bar in the event that the PPP program re-opens
 - Highlight the benefits of accessing PPP funds in bankruptcy
 - Discuss recently proposed legislation that may provide a new path forward for small business seeking to leverage the PPP as a reorganization asset

The New, New Small Business Reorganization Act



Small Business Reorganization Act (SBRA)

- The SBRA, codified in Subchapter 5 of Chapter 11 of the Bankruptcy Code (11 U.S.C. §§ 1181 - 1195), went into effect February 19, 2020.
 - Courts have held that qualified debtors with pre-existing cases may elect treatment under the SBRA. *See In re Progressive Solutions, Inc.*, 2020 WL 975464 (Bankr. C.D. Cal, Feb. 21, 2020).
- SBRA, as enacted, applied only to Debtors with noncontingent, liquidated debts of \$2,725,625 or less.
- Key distinctions from traditional reorganizations:
 - Debtor retains possession and a trustee is appointed
 - Only the debtor may file a plan and must generally do so within 90 (as opposed to 180) days
 - No requirement to pay administrative claims on Effective Date (may spread over 3 -5 years)
 - No absolute priority rule
 - No separate disclosure statement requirement
 - No creditors' committee unless ordered by the Court
 - No quarterly UST fees

Expanded Subchapter 5

- The CARES Act expanded eligibility for Subchapter 5 by raising the applicable debt ceiling to \$7,500,000.
- The increased debt limit only applies to cases filed on or within one year after March 27, 2020.
 - As a result, although pre-SBRA/CARES debtors with \$2,725,625 or less in debts may still elect Subchapter 5 treatment after filing, pre-SBRA/CARES debtors with higher debts may not.
- The debt limit for all new Subchapter 5 filers reverts back to \$2,725,625 on March 27, 2021.

The Paycheck Protection Program (PPP)



PPP - Legislative Intent

- The CARES Act was intended to provide stimulus to the struggling economy by distributing approximately \$2.3 trillion to various industries, programs, companies, and individuals.
- The CARES Act temporarily added a new program (PPP) to the SBA's pre-existing 7(a) loan program. 15 U.S.C. § 636(a).
- PPP provides economic relief to small businesses nationwide who are adversely impacted by COVID-19.

PPP - Loan Basics

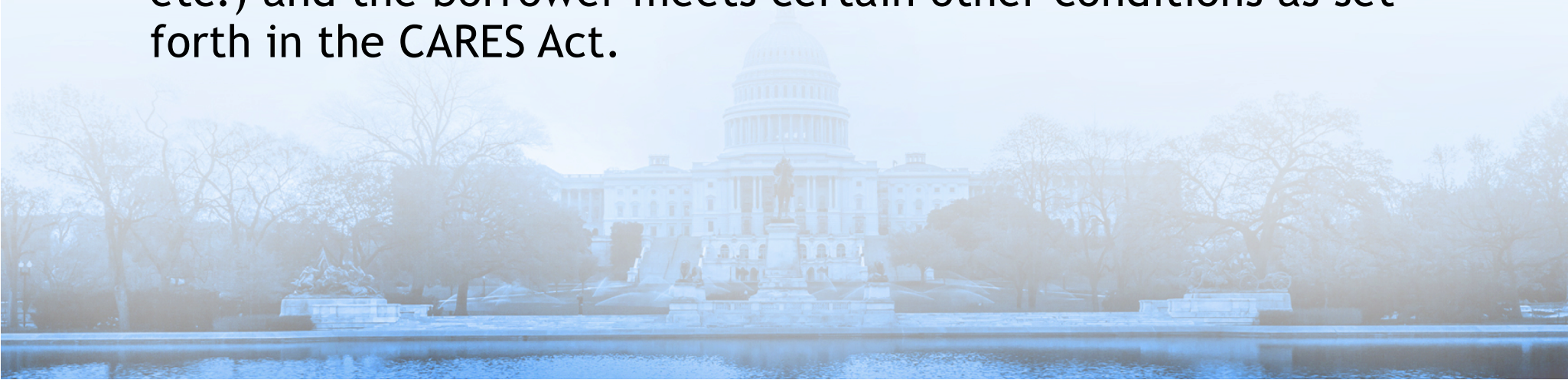
- Congress authorized up to \$349 billion in the first round of PPP, plus additional appropriations pursuant to the PPP Flexibility Act.
- PPP allows lenders to give federally guaranteed loans to small businesses to cover payroll and other approved expenses during the period of February 15, 2020 through December 31, 2020 (as amended by the PPP Flexibility Act). In addition to payroll, borrowers can use PPP for payments of interest on mortgages, rent, utilities, and interest on other debt.
- The CARES Act ***significantly expanded*** upon eligibility requirements compared to prior SBA loan 7(a) loan programs. This was done intentionally by Congress in order to help distribute funds quickly without doing an upfront eligibility analysis.

PPP - Eligibility Criteria & Mechanics

- In general, businesses with 500 or less employees are eligible for PPP loans.
- Unlike prior SBA loan programs, no collateral or personal guarantees are required to receive a PPP loan.
- There is no requirement that the borrower show it cannot obtain credit elsewhere.
- Neither the SBA nor lenders may charge any fees for the PPP loan.
- The loan has very favorable terms; it matures in 2 years (or 5 under the PPP Flex Act) and carries an interest rate of 1%.

PPP - Loan Forgiveness

- Most importantly, the PPP loan may be fully forgiven if the funds are used for authorized purposes (payroll, rent, utilities, etc.) and the borrower meets certain other conditions as set forth in the CARES Act.



The SBA Bankruptcy Bar



CARES Act Borrower Requirements

- The CARES Act requires borrowers are required to certify in good-faith that:
 - Economic uncertainty makes the loan necessary to sustain operations
 - Funds will be used to retain workers or other approved purposes
 - The borrower has no pending duplicative application
 - The borrower has not received federal SBA funds from 2/15/20 - 12/31/2020 for the same purpose
- The CARES Act does not impose any certification or other requirement relating to bankruptcy in order to qualify for PPP.
- The borrower (not the lender or the SBA) determines its own eligibility at the application phase (need for speed).

SBA Rulemaking Authority

- The CARES Act grants the SBA emergency rule making authority and charges the SBA to issue regulations to carry out the PPP program.
- To date, the SBA has issued 24 interim rules and 51 FAQs interpreting the PPP program.



Limits to agency rule making

- Pursuant to the Administrative Procedures Act, agencies such as the SBA are not permitted to promulgate rules or regulations that *conflict with* or *change* the law passed by Congress.
- *But See Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), establishing the two-part test applied by a court reviewing agency action, that is highly deferential to government agencies.

Administrative Procedures Act (“APA”)

- The APA directs reviewing courts to “compel agency action unlawfully withheld or unreasonably delayed” and to “hold unlawful and set aside agency action, findings, and conclusions” that are:
 - (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;
 - (B) contrary to constitutional right, power, privilege, or immunity;
 - (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; . . .

Chevron deference

- **Step one**
- A court must determine whether Congress expressed intent in the statute and, if so, whether or not the statute's intent is ambiguous.
- If the intent of Congress is unambiguous, or clearly stated, then the inquiry must end. Agencies must carry out the clearly expressed intent of Congress.
- If, however, the intent of Congress is unclear, or if the statute lacks direct language on a specific point, then a federal court must decide whether the agency interpretation is based on a permissible construction of the statute—one that is not arbitrary or capricious or obviously contrary to the statute.
- **Step two**
- In examining the agency's reasonable construction, a court must assess whether the decision of Congress to leave an ambiguity, or fail to include express language on a specific point, was done explicitly or implicitly.
- If the decision of Congress was explicit, then the agency's regulations are binding on federal courts unless those regulations are arbitrary, capricious, or manifestly contrary to statute.
- If the decision of Congress was implicit, then so long as the agency's interpretation is reasonable, a federal court cannot substitute its own statutory construction superior to the agency's construction.

PPP Timeline

- **March 27, 2020** - CARES Act signed into law, \$349 billion allocated to PPP
- **April 2, 2020** - First Interim Final Rule
- **April 2, 2020** - Release of first PPP Borrower and Lender Applications
- **April 16, 2020** - PPP program runs out of funding, SBA closes E-tran system

PPP Timeline

- **April 24, 2020** - SBA releases Interim Final Rule regarding “Promissory Notes, Authorizations, Affiliation, and Eligibility”
- **April 24, 2020** - PPP and Health Care Enhancement Act signed into law; provides an additional \$310 billion in PPP funds
- **June 5, 2020** - PPP Flexibility Act signed into law; extends the “covered period” through the end of the year and makes additional borrower friendly program changes
- **August 8, 2020** - PPP program closes to new applications
- **Now** - new legislation?

First Interim Final Rule (“FIFR”)

- On April 2, 2020, the SBA released a FIFR providing guidance on the eligibility requirements to receive a loan under PPP.
- It adopts the ineligibility standards set forth in section 120.110, title 13 of the Code of Federal Regulations ("CFR 120.110"), as further described in SBA's Standard Operating Procedure 50-10, Subpart B, Chapter 2 ("SOP 50-10").
 - See FIFR, 2(c) ("Businesses that are not eligible for PPP loans are identified in 13 CFR 120.110 and further described further in SBA's Standard Operating Procedure").

The April 2 FIFR

- The SOP 50-10 provides that a “Small Business Applicant” must, among other things: be an operating business; be organized for profit; be located in the United States; be small (as defined by the SBA); and demonstrate the need for the desired credit. See SOP 50-10, pg. 85.
- The SOP 50-10 also provides that businesses listed in CFR 120.110 are not eligible for a SBA loan.
- Bankrupt debtors are not listed as an ineligible business in CFR 120.110.

Release of PPP Application

- On April 2, 2020, the SBA also release an application that purported to disqualify bankruptcy debtors from participation in PPP, despite no such prohibition in the CARES Act.
- Application question 1: “Is the Applicant or any owner of the Applicant presently . . . Involved in any bankruptcy?”
- The Application form advises that if Question 1 is answered “Yes,” then the “loan will not be approved.”
- Further, SBA issued the PPP Lender Application, which states that the PPP loan cannot be approved unless the applicant certifies that neither the applicant nor any owner is presently involved in bankruptcy.

In re Hidalgo: Debtor Challenges the SBA

- On April 22, 2020, Hidalgo County Emergency Service Foundation, a Chapter 11 Debtor in the Southern District of Texas filed an adversary proceeding to enjoin the SBA from enforcing the PPP's application's bankruptcy bar based on section 525 of the Bankruptcy Code and the absence of statutory authority or rulemaking. *In re Hidalgo Cty. Emergency Serv. Found.*, Adv. Pro. No. 20-02006.
- On April 24, 2020, the SBA filed an opposition (a) contesting the applicability of section 525, (b) pointing to an Interim Final Rule issued the same day formalizing the bankruptcy bar.



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11 U.S.C. § 525(a)

- Section 525(a) of the Bankruptcy Code prohibits certain discrimination by the government against a debtor solely based upon its status as a debtor in bankruptcy, specifically with respect to:
 - Licenses;
 - Permits;
 - Franchises;
 - Charters; or
 - Other “similar grant[s]”

April 24, 2020 Update: Interim Final Rule

- Eligibility of Businesses Presently Involved in Bankruptcy Proceedings
 - Will I be approved for a PPP loan if my business is in bankruptcy?
 - No. If the applicant or the owner of the applicant is the debtor in a bankruptcy proceeding, either at the time it submits the application or at any time before the loan is disbursed, the applicant is ineligible to receive a PPP loan. If the applicant or the owner of the applicant becomes the debtor in a bankruptcy proceeding after submitting a PPP application but before the loan is disbursed, it is the applicant's obligation to notify the lender and request cancellation of the application. Failure by the applicant to do so will be regarded as a use of PPP funds for unauthorized purposes.

April 24 Interim Final Rule (cont.)

- The Administrator, in consultation with the Secretary, determined that providing PPP loans to debtors in bankruptcy would present an unacceptably high risk of an unauthorized use of funds or nonrepayment of unforgiven loans.
- In addition, the Bankruptcy Code does not require any person to make a loan or a financial accommodation to a debtor in bankruptcy. The Borrower Application Form for PPP loans (SBA Form 2483), which reflects this restriction in the form of a borrower certification, is a loan program requirement. Lenders may rely on an applicant's representation concerning the applicant's or an owner of the applicant's involvement in a bankruptcy proceeding.
- See 85 Fed. Reg. 23,451.

Hidalgo v. SBA: Round 1 to the Debtor

- On 25 April 2020, Chief Bankruptcy Judge David Jones issued a temporary restraining order allowing a debtor to submit a PPP loan application to any lender with the words “or presently involved in any bankruptcy” stricken from the form.
- The Bankruptcy Court required the SBA to “consider the PPP application and fully implement all aspects of the PPP program with respect to [debtor] without any consideration of the involvement of [debtor] or any owner of [debtor] in any bankruptcy.” *In re Hidalgo Cty. Emergency Serv. Found.*, Adv. Pro. No. 20-02006, Dkt. 18 at 4-5 (Bankr. S.D. Tex. Apr. 25, 2020).
- On May 8, 2020, the Bankruptcy Court extended the temporary restraining order as a preliminary injunction.

Hidalgo v. SBA: Round 2 to the SBA

- On May 11, 2020, the U.S. District Court for the Southern District of Texas stayed the Bankruptcy Court injunction and certified the matter to the U.S. Court of Appeals for the Fifth Circuit.
- On June 22, 2020, the Fifth Circuit vacated the injunction based on language in the Small Business Act providing that “no . . . injunction . . . shall be issued against the Administrator” 15 U.S.C. § 634(b)(1). The Court observed that, “the issue at hand is not the validity or wisdom of the PPP regulations and related statutes, but the ability of a court to enjoin the Administrator.”

Hidalgo v. SBA: Round 3 SBA Haymaker

- On May 14, 2020, while the SBA's appeal was pending (and after the Bankruptcy Court's injunction was stayed by the District Court), the debtor filed a new PPP application. In response to the question of whether it was involved in a bankruptcy, the Debtor answered, "no".
- The loan was approved and the debtor received \$2.5 million.
- On August 15, 2020, the SBA moved for appointment of a Chapter 11 trustee, accusing the debtor of fraud in connection with the PPP application.

Bankruptcy Court Lightning Round



Arkansas

- The U.S. Bankruptcy Court for the Western District of Arkansas denied the debtor's request for a preliminary injunction against the SBA, holding that PPP provided for loans rather than grants and therefore was beyond the ambit of § 525 of the Bankruptcy Code. *In re Dancor Transit, Inc.*, No. 2:20-AP-07024, 2020 WL 4730896, at *10 (Bankr. W.D. Ark. June 22, 2020).



California

- The U.S. Bankruptcy Court for the Central District of California denied a debtor's request for a TRO against the SBA. *NAI Capital, Inc. v. Carranza (In re NAI Capital, Inc.)*, Adv. No. 1:20-ap-01051-DS (Bankr. E.D. Cal. May 20, 2020) [Doc. 27].
- Conversely, the U.S. Bankruptcy Court for the Southern District of California granted a preliminary injunction against the SBA on Administrative Procedures Act grounds (and not § 525 grounds). *Vestavia Hills, Ltd. v. U.S. Small Bus. Admin (In re Vestavia Hills, Ltd)*, Adv. No. 20-90073-LA (Bankr. S.D. Cal June 26, 2020) [Doc. 27]

Delaware

- In the *Cosi, Inc.* bankruptcy case, Judge Shannon of the U.S. Bankruptcy Court for the District of Delaware concluded that he lacked authority to enjoin the SBA, despite his dismay with the plight of *Cosi* and disagreement with the SBA's decisions to exclude debtors. *Cosi, Inc. v. U.S. Small Bus. Admin. (In re Cosi, Inc.)*, Adv. Pro. No. 20-50591-BLS, Dkt. 1 at 3, 7 (Bankr. D. Del. Apr. 28, 2020).
- In another case, however, Judge Shannon found that a rugby association debtor could keep a PPP loan it had allegedly applied for prior to its bankruptcy filing—although the timing of the application was disputed by the SBA—and which had been funded while the debtor was “involved in a bankruptcy proceeding.” Judge Shannon distinguished *Cosi* in that the rugby association already had the funds and was not seeking to enjoin the SBA. *In re United States of America Rugby Football Union Ltd.*, 20-10738-BLS (Bankr. D. Del. May 13, 2020) [Doc. 117].

Florida

The Bankruptcy Court for the Middle District of Florida permitted a debtor that applied for a PPP loan while involved in a chapter 11 bankruptcy to keep those funds, despite the debtor's apparent representation on its loan application that it was not a bankruptcy debtor (a disputed fact), finding that the SBA exceeded its authority “[b]y engrafting onto the Paycheck Protection Program a requirement that Congress chose not to insist on” and also acted arbitrarily and capriciously in doing so. *Gateway Radiology Consultants, P.A. v. Carranza (In re Gateway Radiology Consultants, P.A.)*, 20-00330-MGW (Jun. 8, 2020).

Georgia

The U.S Bankruptcy Court for the Northern District of Georgia denied a debtor's request for a preliminary injunction, finding (a) PPP provides for a loan that is not “similar” to other items listed in § 525 of the Bankruptcy Code; and (b) the SBA did not exceed its statutory authority by adopting the bankruptcy bar to ensure loans were of “sound value”. *Henry Anesthesia Assocs., LLC v. Carranza (In re Henry Anesthesia Assocs., LLC)*, Adv. No. 20-06084-LRC (Bankr. N.D. Ga. June 4, 2020) [Doc. 18].

Indiana

- The U.S. Bankruptcy Court for the Southern District of Indiana issued proposed findings and rulings on debtor USA Gymnastics' motion for a preliminary injunction, rejecting the debtors' argument under section 525 of the Bankruptcy Code but agreeing the debtor had a likelihood of success in establishing a violation of Administrative Procedures Act. *USA Gymnastics v. U.S. Small Bus. Admin. (In re USA Gymnastics)*, Adv. No. 20-50055 (Bankr. S.D. Ind. June 12, 2020) [Doc. 20].
- The U.S. District Court agreed, enjoining the SBA from enforcing the bankruptcy bar. *USA Gymnastics v. U.S. Small Bus. Admin. (In re USA Gymnastics)*, No. 18-09108-RLM (S.D. Ind. June 22, 2020).

Kentucky

- The U.S. Bankruptcy Court for the Western District of Kentucky denied a debtor's emergency motion to require its lender to turn over PPP funds for a loan that was approved, but not funded, prior to the debtor's bankruptcy filing. *In re Village East, Inc.*, Case No. 20-31144 (Bankr. W.D. Ky. Apr. 22, 2020).
- The U.S. Bankruptcy Eastern District of Kentucky refused to require a hemp-grower debtor's pre-petition receiver to turn over PPP funds that were funded the day after the petition date. *See In re Elemental Processing, LLC*, Case No. 20-50640 (Bankr. E.D. Ky. May 1, 2020).



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Louisiana

The U.S. Bankruptcy Court for the Western District of Louisiana denied a Debtors' motion for a preliminary injunction against the SBA. *J-H-J, Inc. et al v. Carranza (In re J-H-J, Inc. et al)*, Adv. No. 20-05014 (W.D. La. May 20, 2020) [Doc. 21] (bench ruling).



Maine

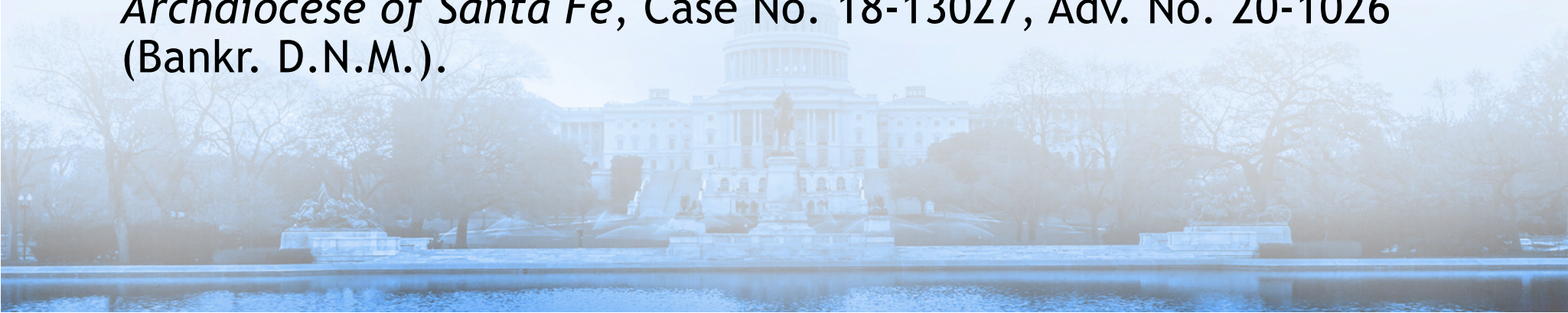
- In the *Penobscot Valley Hospital* bankruptcy case, the U.S. Bankruptcy Court for the District of Maine allowed the debtor's emergency motion for a temporary restraining order, *In re Penobscot Valley Hosp.*, No. 19-10034, 2020 WL 2201943 (Bankr. D. Me. May 1, 2020), but ultimately refused to extend the TRO to a preliminary injunction on grounds that (a) PPP loans were not similar to grants under § 525 of the Bankruptcy Code; and (b) the SBA had not exceeded its rulemaking authority. *In re Penobscot Valley Hosp.*, No. 19-10034, 2020 WL 3032939, at *15 (Bankr. D. Me. June 3, 2020).
- The District Court agreed with the Bankruptcy Court's § 525 analysis but remanded for further consideration of evidence in connection with the SBA's authority under *Chevron*. *Penobscot Valley Hosp. v. Carranza*, No. 1:20-MC-00148-JDL, 2020 WL 4383801 (D. Me. July 31, 2020).



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New Mexico

The U.S. Bankruptcy Court for the District of New Mexico found that the SBA acted unlawfully and exceeded its jurisdiction and authority by excluding debtors from PPP eligibility and that the SBA's bankruptcy exclusion is arbitrary and capricious and violates 11 U.S.C. § 525(a). *In re Roman Catholic Church of the Archdiocese of Santa Fe*, Case No. 18-13027, Adv. No. 20-1026 (Bankr. D.N.M.).



New York

- In the *Diocese of Rochester* bankruptcy case, the U.S. District Court for the Western District of New York withdrew the reference from the Bankruptcy Court because it was unclear the Bankruptcy Court had authority to issue a final decision.
- The District Court entered summary judgment in favor of the SBA on the debtor's claims that it exceeded its authority under the CARES Act and violated § 525(a) of the Bankruptcy Code by excluding debtors in bankruptcy from participation in the PPP. *Diocese of Rochester v. U.S. Small Bus. Admin.*, No. 6:20-CV-06243 EAW, 2020 WL 3071603, at *12 (W.D.N.Y. June 10, 2020).

Ohio

The U.S. Bankruptcy Court for the Northern District of Ohio granted a debtor's request for a preliminary injunction against the SBA because the loan application was filed before the SBA's regulations were issued, constituting an impermissible retroactive rulemaking. *Weather King Heating & Air, Inc. v. U.S. Small Bus. Admin. (In re Weather King Heating & Air, Inc.)*, Adv. No. 20-05023 (N.D. Ohio May 22, 2020) [Doc. 26].

Tennessee

The U.S. Bankruptcy Court for the Western District of Tennessee granted the debtor a preliminary injunction against the SBA, noting that in light of “the unprecedented[ed] nature of the PPP and the circumstances underlying its enactment, there is no reason to assume that Congress intended to cede to Defendant discretion to exclude bankruptcy debtors from the PPP. Rather, a review of the CARES Act in its entirety shows the opposite.” *In re Skefos*, No. 19-29718-L, 2020 WL 2893413, at *11 (Bankr. W.D. Tenn. June 2, 2020).

Texas

The U.S. Bankruptcy Court for the Western District of Texas denied a debtor's request for a temporary restraining order in the Asteria Education, Inc. bankruptcy case. *See In re Asteria Educ., Inc.*, Case No. 20-50169 (Bankr. W.D. Tex. Apr. 30, 2020).



Vermont

The U.S. Bankruptcy Court for the District of Vermont granted a Debtor's request for a temporary restraining order against the SBA. *Springfield Hospital, Inc. v. Carranza (In re Springfield Hospital, Inc)*, Adv. No. 20-1003 (Bankr. D. Vt.) [Doc. 19] ("Plaintiff shall be authorized to submit a PPP application to a participating lender of its choosing - and a participating lender may consider any pending application of the Plaintiff - with the words 'or presently involved in any bankruptcy' stricken from the official form of application").

Wisconsin

The U.S. Bankruptcy Court for the Eastern District of Wisconsin denied a debtor's request for a preliminary injunction, holding that the "SBA promptly promulgated emergency rules consistent with both the CARES Act and the agency's other preexisting, statutory obligations." *Schuessler v. United States Small Bus. Admin. (In re Schuessler)*, No. AP 20-02065-BHL, 2020 WL 2621186, at *13 (Bankr. E.D. Wis. May 22, 2020).

Skirting the Scuffle



Practice Pointer

- The PPP program is not currently accepting applications (the program closed on August 8, 2020). But recently proposed legislation may allow the program to open again in the future.
- The following slides discuss strategies to consider in the event that the PPP program opens again and begins accepting new applications.



Voluntary Dismissal

- Some debtors have avoided or freed themselves from entanglement with the SBA by voluntarily dismissing their bankruptcy cases, applying for PPP loans, and then re-filing petitions after receiving funding.
- This approach has had mixed success, *compare*:
 - In re iThrive Health, LLC, No. 19-25413 (Bankr. D. Md.) (court allowed debtor's motion to dismiss case to seek PPP funds), *with*
 - *In re Calais Regional Hosp.*, No. 19-10486 (Bankr. D. Me.) (debtor withdrew motion to dismiss following multiple objections seeking to place conditions on dismissal).

Prepetition vs. Postpetition PPP

- Debtors who apply for and receive PPP funds prior to the petition date will be able to schedule the loan unsecured.
- Conversely, in the event a debtor presses for authority to apply for and receive PPP funds post-petition, the loan will require bankruptcy court approval and be entitled to priority as an administrative expense of the estate. *See* 11 U.S.C. § 364(b).
- In view of this distinction, a loan to a debtor in chapter 11 may be sounder than a loan to a distressed business not in chapter 11.

Proposed Legislation

- Senator Mark Rubio (R-FL) and Senator Susan Collins (R-ME) have proposed legislation, the *Continuing Small Business Recovery and Paycheck Protection Program Act*, that would expressly open the doors of PPP to debtors in bankruptcy.
- The proposed legislation would, among other things, provide post-petition PPP loans with super-priority administrative expense status under section 364 of the Bankruptcy Code (to the extent the loans are not forgiven).
- It would also allow for PPP second draw loans, expand permissible use of funds to include PPE and adaptive investments, and expand eligibility to certain 501(c)(6)'s.



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Questions or Follow-up?

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