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**Oct. 13, 2020, 1:30-3:00 p.m.**

## ABI: Bankruptcy Issues Related to PPP Loans and Other Pandemic Governmental Lending Programs

Hon. Daniel P. Collins; U.S. Bankruptcy Court (D. Ariz.)
Tiffany Payne Geyer; BakerHostetler LLP
Andrew C. Helman; Murray Plumb & Murray
Thomas J. Salerno; Stinson LLP

# Educational Materials


# ABI: Bankruptcy Issues Related to PPP Loans and Other Pandemic Governmental Lending Programs

# Presenters:

**The Honorable Daniel P. Collins**
*United States Bankruptcy Court, District of Arizona*

**Tiffany Payne Geyer**
*BakerHostetler, LLP*

**Andrew C. Helman**
*Murray Plumb & Murray*

**Thomas J. Salerno**
*Stinson, LLP*

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## Debtor Eligibility Under the Paycheck Protection Program and Permitted Uses of Funds

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## March 27, 2020
## Coronavirus Aid, Relief, and Economic Security Act (CARES) Act'' becomes law

$2.2 trillion in funds for families, businesses and workers intended to provide broad economic relief during the pandemic

$376.5 B devoted to small business protections: EIDL Program ($10.652 B); PPP ($349 B); and Subsidies for Certain Other Small Business Loan Payments ($17 B)



## April 24, 2020
## SBA promulgates rule debtors are ineligible for the PPP

**PPP Application, Question 1:**

Is the applicant or any owner of the applicant presently **suspended, debarred**, proposed for debarment, declared ineligible, voluntarily excluded from participation in this transaction by any federal department or agency, **or presently involved in any bankruptcy**?

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## *What are the causes for Suspension or Debarment?*

Commission of fraud, embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, tax evasion, violating Federal criminal laws, receiving stolen property, an unfair trade practice

https://www.gsa.gov/policy-regulations/policy/acquisition-policy/office-of-acquisition-policy/gsa-acq-policy-integrity-workforce/suspension-debarment-division/suspension-debarment/frequently-asked-questions-suspension-debarment



# *Wait- what?!?*

How did honest but unfortunate debtors get lumped into the category of those who have committed fraud… embezzlement… theft… forgery… bribery… tax evasion… ???

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# Case Study:

# St. Alexius Hospital

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## The Case of St. Alexius Hospital

- Serves economically depressed area in St. Louis, MO; annual median household income is less than $33,000
- Open since 1869
- Emergency department, ICU, and radiology, cardiology, therapy, and psychiatric services as well as a senior care center
- Employs over 350 people.
- High portion of uninsured patients and Medicare/Medicaid patients
- Closure “would be devastating… both from a patient health and economic perspective.”
- Chapter 11 Trustee was appointed

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## The Case of St. Alexius Hospital

- Attempted to apply for PPP on May 4 at 10:49pm
- Checked the "yes" box on the PPP application
- Seven minutes later… at 10:56pm– **DENIED!** ("Unfortunately your business is not eligible for the Paycheck Protection Program through U.S. Bank at this time").

***Three Count Adversary Proceeding filed on May 6***

**Count I – Preliminary and Permanent Injunctive Relief (Fed. R. Bankr. P. 7065)**
**Count II – Declaratory Judgment (28 U.S.C. § 2201 and Fed. R. Bankr. P. 7001(9))**
**Count III - 11 U.S.C. § 525(a)**



## *Anxiety provoking days in May…*

May 6: Adversary filed
May 7: Hearing held
May 8: TRO awarded, further hearing to consider preliminary injunction scheduled May 21.
May 8 – May 12: Frantically reapplying for PPP; system repeatedly crashes, cannot save applications in progress, uploading documents takes hours, on telephone with helpful US Bank representative, application finally uploaded

*Approximately 48 hours prior to hearing to consider injunctive relief, St Alexius received $5,105,971; immediately placed in a DIP account.*

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# Overview of PPP Litigation and Case Outcomes

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# The Legal Issues

- Section 525 of the Bankruptcy Code
- Section 706 of the Administrative Procedures Act (5 U.S.C. § 706)
- Judicial Power to Enjoin SBA



# Did SBA Violate 11 U.S.C. § 525?

"[A] governmental unit may not deny, revoke, suspend, or refuse to renew a **license, permit, charter, franchise, or other similar grant** to [or] discriminate with respect to such a grant against . . . a person that is or has been a debtor under this title . . ., solely because such bankrupt or debtor is or has been a debtor under this title[.]"

11 U.S.C. § 525(a) (emphasis added)

# Did SBA Violate the APA?

Courts review agency action and "shall"

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; …

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right[.]

5 U.S.C. § 706



# Do Courts Have Power to Enjoin SBA?

In the performance of, and with respect to, the functions, powers, and duties vested in [her] by this chapter the Administrator may—

(1) sue and be sued … but no attachment, injunction, garnishment, or other similar process, mesne or final, shall be issued against the Administrator or [her] property[.]

15 U.S.C. § 634(b)(1)

## Three Issues and 48 Cases

- 48 adversary proceedings filed v. SBA
- 18 cases had PI or TRO granted (2 granted and then flipped)
- 20 cases had PI or TRO denied by the bankruptcy court
- 4 cases TRO/PI never decided and case disposed of or stalled out
- 2 cases – unclear outcomes



## Three Issues and 48 Cases, continued

- 24 cases have been dismissed or closed
- 4 have motions to dismiss pending
- 15 are on appeal at some level (including recommitment of 2 consolidated APs to the bankruptcy court)
- 4 are otherwise pending in some capacity
- 1 has a docket that is unclear

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# Three Early Decisions That Shaped Litigation

- *Hidalgo Cty. Emergency Svc. Foundation v. Carranza*, Adv. No. 20-2006 (Bankr. S.D. Tex. Apr. 24, 2020)
- *Cosi, Inc. v. SBA*, Adv. No. 20-50591 (Bankr. D. Del. May 14. 2020)
- *Roman Catholic Church of the Archdiocese of Santa Fe v. SBA/Carranza*, Adv. No. 20-1026 (Bankr. D. N.M. May 1, 2020)



# Three Later Decisions Reflecting Litigation Outcomes

- *Penobscot Valley Hospital v. Carranza*, Adv. No. 20-1005 (Bankr. D. Me. June 3, 2020), consolidated with *Calais Regional Hospital v. Carranza*, Adv. No. 20-1006 (Bankr. D. Me. June 3, 2020)
- *Springfield Hospital, Inc. v. Carranza*, Adv. No. 20-1003 (Bankr. D. Vt. June 22, 2020)
- Alaska Urological Institute, P.C. v. SBA, Case No. 3:20-cv-00170-SLG (D. Ak. Aug. 20, 2020)

# Strategies to Get PPP Without Litigation

- Apply for PPP, get the money, and then file – this is ok with SBA
- Dismiss the C11, apply, get the money, reinstate the case – SBA does not object. *In re Blue Ice Investments, LLC*, Case No. 2:20-bk-02208-DPC (Bankr. D. Ariz.)
- Dismiss the C11, apply, get the money, file a new case – SBA does not object. *In re Eastern Niagara Hospital, Inc.*, Case No. 19-12342-CLB (Bankr. W.D.N.Y.); *In re Jack Cty. Hosp. Dist.*, Case No. 20-40858 (Bankr. N.D. Tex.)



## How Much Did This Litigation Cost Debtors and Creditors?

## What if SBA Had Adopted a Rule Mandating Certain Terms for a DIP/364 Order Instead?

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# Current Legislative Outlook and Debt Forgiveness Going Forward



## Congress To The Rescue?
## Not so fast….

- PPP Program expired August 8, 2020, leaving pending litigation in its wake.
- **FEAR NOT!** S. 4321 ("**NEW BILL**") introduced July 27, 2020! Another $1-2.5 Trillion into the hopper (hey, in for a penny, in for a pound)
  - Primary Sponsors: Marco (R-FL) and Collins (R-ME)
- Looked to be "fast tracked"…until it wasn't!
- On again, off again, on again…quite a rollercoaster!

- **Current Status:** "***07/27/2020 READ TWICE AND REFERRED TO THE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP. ACTION BY: SENATE 2019 FD S.B. 4321 (NS).***" (Bill tacking for S. 4321, 116th Cong. (2020)).

  - "Committees" are where bills go to wither and die….

# Progress On New Bill?

- Good News/Bad News….
- **Good News:** There is active work right now on New Bill! (Yeah! Crowd claps appreciatively….)
- **Bad News:** The Senate version of the New Bill is the subject of the ABI Article. There is apparently a House version which would only allow critical access hospitals to participate on post-petition financing aspects (Hey, all animals are equal, some are just more equal than others!).
- It is not yet clear which, if either, will survive.



# The New Bill (Assuming Senate Version Survives) Giveth And Taketh Away!

- Step in the right direction! **Allows PPP Loans to be made as post-petition financing** (crowd roars its approval!). *See* Salerno, ***Proposed Extension Of The PPP Loan Program: A Nice First Step…*** (*ABI Journal* September 2020) ("***ABI Article***")
- So what's not to love? Devil's always in the details!
- **Two (2) Issues:**
  - **ISSUE ONE:** "Dueling" Super-Priority Administrative Expenses Status and its implications in the case
    - Interestingly, not an oversight! Divide and conquer?
  - **ISSUE TWO:** SBA Still Has Discretion Re. "Sound Value" Gating Determination

# Forgive Us Our Debts—Next Battleground?

- The "Holy Grail" of a PPP? Forgiveness—it's FREE MONEY!
- Bankruptcy as "default" that would preclude forgiveness?
  - Say it ain't so! Yeah…*See* Barlow, ***A New Challenge For Debtors Who Received PPP Loans Under The Cares Act***, ABI COVID-19 Resources (July 30, 2020)
  - "But that's not in the CARES Act!" Grow up….
  - How about one step removed—cross default for Section 7(a) other loans?



# Timing Is Everything!

- **So, you are finally getting ready to fill out your application for PPP loan forgiveness.**
  - Know this---the average PPP loan forgiveness application took folks over 5 tries to get everything their friendly Banker wanted. Their efforts notwithstanding, no releases/forgiveness have yet been granted!
- **If SBA drags its bureaucratic feet—can the Bankruptcy Court decide?**
  - Jurisdiction? "Arbitrary and capricious" *Chevron* review? 525? 502(c)?
  - Same arguments as much of pending litigation—different packaging!
- **Implications on plan confirmation pending forgiveness process**
  - Still a claim that has to be dealt with?
  - Feasibility issues if not forgiven?
  - Escrow payments?

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# Legislative Update

BY THOMAS J. SALERNO

# Proposed Extension of the PPP Loan Program: A Nice First Step….

**Editor's Note:** *ABI launched its Coronavirus Resources for Bankruptcy Professionals website (abi.org/covid19), which aggregates information for bankruptcy professionals to assist clients and provide guidance due to the fallout from the COVID-19 pandemic.*

*"So near, and yet so far."*
*— Lord Tennyson (1833)*

**Thomas J. Salerno**
*Stinson LLP; Phoenix*

*Thomas Salerno is a partner with Stinson LLP in Phoenix.*

As COVID-19 continues to wreak havoc on the world economy, at press time Congress is slowly grinding toward yet another extension of the unprecedented Payroll Protection Program Second Draw Loan bill, introduced on July 27, 2020. S. 4321 (the "proposed PPP III legislation") has become mired in partisan politics that is the hallmark of our age, but some version is likely to pass. After months of stunningly unnecessary litigation and convoluted legal machinations forced on debtors by the Small Business Administration (SBA)[1] in their dogmatic defense of the now infamous April 24, 2020, rule that categorically denied debtors in bankruptcy from accessing the PPP loans on the basis that debtors "present an unacceptably high risk of an unauthorized use of funds or non-repayment of unforgiven loans,"[2] the proposed PPP III legislation effectuates a stunning reversal of course and acknowledges (finally) that the SBA will grudgingly allow debtors (while still somewhat slimy) to access PPP III loans.[3]

The proposed PPP III legislation is certainly a step in the right direction. However, there are at least two aspects that merit further attention. The bankruptcy provisions are found in § 116 of the proposed PPP III legislation and are set forth below for ease of reference. Bottom line: In this author's opinion, there are two fixes Congress should consider making to the proposed PPP III legislation.

## Issue One: "Dueling" Super-Priority Administrative Expenses Will Wreak Havoc on Traditional Financing Negotiations

### Law of Unintended (or Perhaps Intended) Consequences

One of two things is true with respect to the proposed PPP III legislation: It either was written by people with no experience in chapter 11 cases, or it was written by people very knowledgeable in chapter 11 cases. If the former, then there are unintended consequences to the proposed PPP III legislation. If the latter, it is perhaps a clever tactic to give the SBA plausible deniability in keeping these loans out of debtors' hands in all events.

1. *Dueling Super-Priority Administrative-Expense Claims:* Section 116(a) of the proposed PPP IIII legislation essentially states that if this PPP loan is made post-filing as a DIP loan under § 364 of the Bankruptcy Code, it will have super-priority administrative-expense priority if it is not forgiven. While on its face this may not seem an unusual protection, it will create material difficulties for debtors attempting to negotiate first-day orders and financing arrangements in chapter 11 cases.

Anyone who has ever had to negotiate cash collateral, trade credit or a DIP loan at the outset of a case knows that super-priority administrative-expense priority is precisely what the other (traditional) lenders in the capital structure will seek and demand as part of cash-collateral use, or as part of ordinary DIP financing.[4] From a pure timing perspective, the PPP loans (intended as short-term "band aids") will not likely occur before more traditional uses of cash collateral, trade term negotiations or DIP financing are negotiated and approved. Hence, this super-priority administrative-expense spot will already be taken up by the other creditors in the capital structure.

As such, debtors will face a choice: either (1) go with a PPP loan as the sole source of DIP financing (and not seek to use cash collateral —

1 *See* Thomas J. Salerno, "Reports of a 'Debtor Bar' for PPP Loans Have Been 'Exaggerated,'" *ABI News & Analysis* (July 2, 2020). ("SBA Tango Article"), *available at* abi-org.s3.amazonaws.com/Newsroom/ABI_Brief/SBATangoArticle.pdf. *See also* David M. Barlow, "A New Challenge For Debtors Who Received PPP Loans Under the CARES Act," *ABI News & Analysis* (July 30, 2020) (unless otherwise specified, all links in this article were last visited on Aug. 11, 2020).

2 *See* Thomas J. Salerno & Christopher Simpson, "This DIP Loan Should Be Brought to You by Someone Who CARES! (or, 'You Can't Get There from Here'): A Plea for Rationality: Part Two 1/2," XXXVIX *ABI Journal* 6, 8-9, 58-62, June 2020, *available at* abi.org/abi-journal. Ironically, under some circumstances even convicted felons are eligible to receive PPP Loans. *See* Appellee's Petition for Rehearing *En Banc* Filed in the Hildago Cnty. Emergency Serv. Found., *appeal filed* Aug. 6, 2020 (Case No. 20-40368) (Document 00515519357).

3 Of course, there are other slimy PPP loan borrowers (besides convicted felons) who are not in bankruptcy, and they had access to the PPP Loans unfettered by this debtor bar. *See, e.g.*, "Man Spent PPP Funds on Hotels, Jewelry and $318,497 Lamborghini, Authorities Say," CNN (July 28, 2020), *available at* cnn.com/2020/07/28/us/ppp-funds-miami-lamborghini-trnd. A 29-year-old Miami man received nearly $4 million in PPP loans and decided that the best way to reinvigorate the economy was to spend the funds furiously on the local economy. Nothing helps ease the stress of a pandemic like a cobalt blue Lambo.

4 *See* § 507(b) of the Bankruptcy Code, which states in pertinent part:
If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(2) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, *then such creditor's claim under such subsection shall have priority over every other claim allowance under such subsection.*

not really an option in a chapter 11 case); or (2) forgo a PPP loan because it will put the debtor into conflict with the traditional lenders in the case (who will likely object, because lenders are entitled to super-priority administrative-expense priority if adequate protection proves inadequate). It creates a battle of the super-priority administrative claims. As they said in *Highlander*: "There can be only one!"[5]

2. *Congress Giveth and Taketh Away:* While the proposed PPP III legislation states that a lender cannot block a PPP DIP loan based on a "no further indebtedness" loan clause or prior cash-collateral use order,[6] that does not make obtaining cash-collateral use and adequate-protection rights by the debtor easier; indeed, it makes it tougher. Lenders will argue (and with some justification) that the ability of the debtor to "prime" the § 507(b) protections given as part of cash-collateral use with a subsequent PPP loan is prejudicial to the lender and its rights in the cash collateral. Accordingly, they really are not protections at all.[7] Moreover, it is highly unlikely that the PPP loan (at best intended to be a near-term bandage, bridge-type of financial assistance) will be sufficient to carry any type of restructuring process.[8]

3. *Intentional Choice?* Was this an intentional part of the proposed PPP III legislation? In fact, it was. According to a knowledgeable person involved in the proposed PPP III legislation, the thought process was that by giving the SBA the first bite at the administrative-expense-priority apple, the inherently unscrupulous debtors (my words, not my source) will be kept in check by the other creditors who do not want to risk having the PPP loan (if not forgiven) go to the front of that line. In other words, the other creditors will keep the debtor "honest." While that is one way to deal with these inherently unscrupulous debtors, it will likely result in debtors forgoing the PPP loans altogether because they will create serious negotiating issues at the outset of the cases with the traditional lenders in the capital structure.[9]

4. *Win/Win for the SBA?* If Congress (and the SBA) is only now grudgingly acknowledging that its prior dogmatic positions are resulting in PPP loans entering bankruptcy cases anyway (albeit as general unsecured claims, as a result of the "SBA Tango"[10]), this provision in the proposed PPP III legislation as a practical matter may well act to effectively keep the PPP loans outside the reach of debtors if attempted as a DIP loan. The SBA will now be able to say (with an appropriate straight face): "Hey, we gave you what you wanted (availability of PPP loans in bankruptcy), and it's not our fault if the other lenders in the case insist that they also are entitled to a super-priority administrative-expense priority.[11] Choose your poison, debtor. We never wanted you to have these to start with!"

### Proposed Resolution

If Congress really wants to help here, the better approach would be for any post-filing PPP loan to be afforded general administrative-expense priority under § 503(b)(1), not super-priority administrative expense under the Proposed PPP III Legislation's revisions to Bankruptcy Code § 364(g)(1). This would be like post-filing trade credit, for example.

## Issue Two: SBA Still Has Discretion to Make PPP Loans Based on "Sound Value"

### What's Not in the Proposed Legislation that Needs to Be?

The PPP loans are part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act and are administered by the SBA under § 7(a) of the Small Business Act.[12] One of the issues spawning the litigation surrounding whether the SBA could systemically exclude debtors from the PPP loans, in addition to the SBA's rule-making authority, is a determination by the SBA under the Small Business Act that making the PPP loan was of "sound value."

As previously discussed, the SBA has publicly stated that it does not believe that debtors are honest. If the SBA retains the discretion to deny PPP III loans on the basis of "sound value" under § 7(a), it does not require a crystal ball to foresee that the SBA can certainly state that PPP III Loans are not of "sound value" — hence, notwithstanding this legislative exercise, these loans will still not be approved.

### Proposed Resolution[13]

Once again, if Congress really wants to help here, the proposed PPP III legislation should amend the Small Business Act as follows:

> PAYCHECK PROTECTION PROGRAM LOANS TO DEBTORS ARE OF SOUND VALUE. — Section 7(a)(6) of the Small Business Act (15 U.S.C. 636(a)(6)) is amended—
>
> (1) in paragraph 6(B), by striking "and" at the end;
>
> (2) in paragraph 6(C), by striking the period at the end and inserting "; and"; and
>
> (3) by adding at the end the following:

5 *Highlander* (1986), *available at* en.wikipedia.org/wiki/Highlander_(film).

6 The proposed language for changes to § 364(g)(2) states: "The trustee may incur debt described in paragraph (1) notwithstanding any provision in a contract, prior order authorizing the trustee to incur debt under this section, *prior order authorizing the trustee to use cash collateral under section 363*, or applicable law that prohibits the debtor from incurring additional debt."

7 In fact, it is likely there will be a prior cash-collateral use order (since a cash-collateral use order, either by agreement or otherwise, will generally be a "first-day" order in order for any ongoing business to keep operating). Accordingly, if the first-day order is entered giving the cash-collateral lienholder the § 507(b) protections, and then the debtor seeks a PPP loan, which, if granted, "primes" (as a matter of law) the super-priority administrative expense of the lender, doesn't that violate law-of-the-case doctrine? Regardless of the prohibition on "other indebtedness" restrictions, the proposed PPP legislation says nothing about the preclusion of a default provision in a cash-collateral/DIP loan agreement if the protections afforded the cash-collateral/DIP lender's § 507(b) protections are impaired. Can the bankruptcy court's PPP loan-approval order retroactively change the rights of the lender in the prior cash-collateral use order?

8 I also recognize that the SBA rejoinder here is simple: "Just be a good debtor and use the money like you said you would use it, and it will be forgiven. No problem!" That, of course, ignores that forgiveness happens at such future time, and cash-collateral use (and negotiations) happen immediately. It also ignores the dynamic that the SBA, with whatever the "regulation *du jour*" it puts out in the future, can (as it has) change the rules of the game on forgiveness, thereby making ultimate forgiveness less certain, even if the money is used as directed. This leads to yet more uncertainty, and — wait for it — more litigation!

9 The proposed PPP III legislation's grant of a super-priority administrative expense is mandatory in its scope; it is not likely possible that the courts can "subordinate" the PPP loan's super-priority administrative-expense position if the legislation is enacted in its current form. While it is possible that the other lenders will adjust to this "line-cutting" by the SBA, at the outset of chapter 11 cases the dynamics are fraught with uncertainty. The last thing a debtor looking to keep its doors open, employees paid and lights on needs is yet another hurdle by the SBA.

10 *See* "SBA Tango" article, *supra* n.1.

11 To paraphrase (and with apologies to) Orson Welles, "[W]hile all super-priority administrative expenses may be equal, some are more equal than others."

12 15 U.S.C. § 636(a)(6).

13 Credit for this proposed legislative fix goes to **Andrew C. Helman** (Murray Plumb & Murray; Portland, Maine), whose tireless advocacy on these issues has advanced the ball on this significantly.

*continued on page 77*

## Legislative Update: Proposed Extension of the PPP Loan Program

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"(D) any covered loan under section 7(a)(36) of the Small Business Act (15 U.S.C. 636(a)(36)) to a person who is a debtor in a case under title 11 of the United States Code shall be of sound value to the same extent as a covered loan made to a person who is not a debtor in a case under title 11 of the United States Code, and the status of a person as a debtor in a case under title 11 shall not make such person ineligible to obtain a covered loan under section 7(a)(36) of the Small Business Act (15 U.S.C. 636(a)(36)) or to obtain forgiveness with respect to such covered loan."

This takes the discretion away from the SBA based solely on the status of the potential borrower being in a bankruptcy proceeding, and it avoids the next round of potential litigation. The proposed PPP III legislation is a good first effort. Now Congress needs to fine-tune it so we can all get back to the business of restructuring.

### Text of the Proposed Legislation

SEC. 116. BANKRUPTCY PROVISIONS.

(a) IN GENERAL. — Section 364 of title 11, United States Code, is amended by adding at the end the following:

"(g)(1) The court, after notice and a hearing, may authorize a debtor in possession or a trustee that is authorized to operate the business of the debtor under section 1183, 1184, 1203, 1204, or 1304 of this title to obtain a loan under section 7(a)(36) of the Small Business Act (15 U.S.C. 636(a)(36)), and such loan shall be treated as a debt to the extent the loan is not forgiven under section 1106 of the CARES Act (15 U.S.C. 9005) with priority equal to a claim of the kind specified in subsection (c)(1) of this section.

"(2) The trustee may incur debt described in paragraph (1) notwithstanding any provision in a contract, prior order authorizing the trustee to incur debt under this section, prior order authorizing the trustee to use cash collateral under section 363, or applicable law that prohibits the debtor from incurring additional debt.

"(3) The court shall hold a hearing within 7 days after the filing and service of the motion to obtain a loan described in paragraph (1)."

(b) ALLOWANCE OF ADMINISTRATIVE EXPENSES.—Section 503(b) of title 11, United States Code, is amended —

(1) in paragraph (8)(B), by striking "and" at the end;

(2) in paragraph (9), by striking the period at the end and inserting "; and"; and

(3) by adding at the end the following:

"(10) any debt incurred under section 364(g)(1) of this title."

(c) CONFIRMATION OF PLAN FOR REORGANIZATION. — Section 1191 of title 11, United States Code, is amended by adding at the end the following:

"(f) SPECIAL PROVISION RELATED TO COVID–19 PANDEMIC.— Notwithstanding section 1129(a)(9)(A) of this title and subsection (e) of this section, a plan that provides for payment of a claim of a kind specified in section 503(b)(10) of this title may be confirmed under subsection (b) of this section if the plan proposes to make payments on account of such claim when due under the terms of the loan giving rise to such claim."

(d) CONFIRMATION OF PLAN FOR FAMILY FARMERS AND FISHERMEN.— Section 1225 of title 11, United States Code, is amended by adding at the end the following:

"(d) Notwithstanding section 1222(a)(2) of this title and subsection (b)(1) of this section, a plan that provides for payment of a claim of a kind specified in section 503(b)(10) of this title may be confirmed if the plan proposes to make payments on account of such claim when due under the terms of the loan giving rise to such claim."

(e) CONFIRMATION OF PLAN FOR INDIVIDUALS. — Section 1325 of title 11, United States Code, is amended by adding at the end the following:

"(d) Notwithstanding section 1322(a)(2) of this title and subsection (b)(1) of this section, a plan that provides for payment of a claim of a kind specified in section 503(b)(10) of this title may be confirmed if the plan proposes to make payments on account of such claim when due under the terms of the loan giving rise to such claim." abi

# Legislative Update

BY THOMAS J. SALERNO AND CHRISTOPHER SIMPSON[1]

# This DIP Loan Should Be Brought to You by Someone Who CARES! (or, "You Can't Get There from Here")

## *A Plea for Rationality: Part Two 1/2*[2]

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***Christopher Simpson***
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*Thomas Salerno and Christopher Simpson are partners with Stinson LLP in Phoenix.*

**Editor's Note:** *ABI recently launched its Coronovirus Resources for Bankruptcy Professionals website (abi.org/covid19), which aggregates information for bankruptcy professionals to assist clients and provide guidance due to the fallout from the COVID-19 pandemic. An updated version of this article will be available on the site.*

*"If the law supposes that, the law is an ass — an idiot!"*
*Charles Dickens, Oliver Twist (1838)*[3]

Let's be candid: $349 billion just does not go as far as it used to. In just two short weeks, the entire allocation for small business loans under the landmark CARES Act[4] Payroll Protection Program (PPP),[5] part of the single-largest government stimulus package in U.S. history, was completely exhausted by the onslaught of distressed businesses (the "PPP I Loans").[6] The result of this eye-popping phenomenon was that the government passed "PPP II: The Sequel,"[7] authorizing yet another $310 billion in PPP loan availability (the "PPP II Loans").[8]

The lending institutions that will actually make these PPP loans (and the lawyers that both sue and represent them) rejoiced.[9] Distressed small businesses, aghast at being too slow on the draw (or perhaps lacking clout at their banking institutions to get a PPP I Loan), breathed a collective sigh of relief, but perhaps for naught: It is anticipated that the PPP II Loans will soon be exhausted.[10] Like the never-ending *Rambo* franchise, are PPP III, IV and V Loans perhaps on the horizon?[11] And as the sun rises in the east and sets in the west, where there is money fraud soon follows in its wake.[12]

On April 1, 2020, when the PPP I Loan program was introduced, the authors wrote "This DIP Loan Brought to You by Someone Who CARES! (Or, 'I'm from the Government and I'm Here to Help You'), Part One" ("April 1 article").[13] In that

1 The authors are part of a multidisciplinary Coronavirus Task Force at Stinson LLP. The opinions herein are the authors' alone and do not represent the opinions of Stinson LLP or its clients. The authors further wish to thank the members of ABI's Business Reorganization Committee listserve group, who have so graciously provided real-time orders, pleadings and analysis (thereby serving as an informal and important vetting panel).

2 This article is a further update of the article "This DIP Loan Should Be Brought to You by Someone Who CARES! (or, You Can't Get There from Here: A Plea for Rationality, Part Two," published by ABI on April 27, 2020, written by Thomas Salerno, Gerald Weidner, Chris Simpson and Susan Ebner (the "April 27 Article"), *available at* connect.abi.org/l/107412/2020-04-27/4jv57x.

3 Mr. Bumble, the beleaguered spouse of a domineering wife, after being told in court that "the law supposes that your wife acts under your direction."

4 For a more in-depth and expanded analysis of the CARES Act, *see* Susan Warshaw Ebner, Gerald D. Weidner, Jessica C. Wheeler, Zachary M. Sheahan, Thomas J. Salerno, Christopher C. Simpson, Matthew C. Tews, Audrey A. Fenske, Judith Araujo & Patrick J. Respeliers, "Coronavirus Aid, Relief and Economic Security (CARES) Act Signed into Law: Overview of Key Provisions," Stinson Client Alert (March 30, 2020). *See also* Force Majeure and the Coronavirus (COVID-19); DoD Issues Class Deviation and Guidance to Implement CARES Act Relief for DoD Contractors under Section 3610; New Paycheck Protection Program FAQs Released; SBA Issues New Guidance on Paycheck Protection Program.

5 PPP loans were intended to help small businesses fund certain payroll, loan interest, rent and utility expenses. The act required the Treasury Secretary and Small Business Administration (SBA) to implement regulations for the application and administration of the PPP, which would include loan terms and conditions, interest rates, underwriting standards and the SBA guarantee percentage. While the PPP provisions suggest that the guarantee percentage will be 100 percent and the SBA will reimburse lenders for any forgiven loan amounts, the final guarantee percentage was to be established by regulation.

6 To the extent that there is any doubt that this pandemic has had a material and far-reaching immediate adverse impact on the economy, one need look no further than the stunning $59 billion in net losses posted for the first quarter of 2020. *See* Paul R. La Monica, "Buffett's Berkshire Hathaway Reports Nearly $50 Billion Loss," CNN Business (May 2, 2020). If Warren Buffett cannot make money, no one can make money! *See also* "Great Depression-Like U.S. Job Losses, Unemployment Rate Expected in April," ABI Newsroom (May 8, 2020); Anneken Tappe, "Record 20.5 Million American Jobs Lost in April. Unemployment Rate Soars to 14.7%," CNN Business (May 8, 2020), *available at* cnn.com/2020/05/08/economy/april-jobs-report-2020-coronavirus/index.html (largest monthly loss since 1939, which effectively wipes out job gains in the last 10 years); "U.S. Airlines Burn Through $10 Billion a Month as Traffic Plummets," ABI Newsroom (May 6, 2020); "Wave of U.S. Bankruptcies Builds Toward Worst Run in Many Years," Bloomberg News (May 7, 2020) ("Everyone's distressed watch list has become so big that it doesn't even make sense to call it a watch list — it's everyone," said Derek Pitts, head of debt advisory and restructuring at PJ Solomon, which tracks the financial well-being of hundreds of companies using a color code. "You turn page after page and it's all red. It's a sea of red."). Moreover, Congress is being urged to authorize the appointment of more bankruptcy judges due to concerns of the bankruptcy court system becoming "overwhelmed." *See* Jonathan Randles, "Congress Urged to Bolster Nation's Bankruptcy Courts," *Wall St. J.* (May 8, 2020), *available at* wsj.com/articles/congress-urged-to-bolster-nations-bankruptcy-courts-11588964028 (35 legal scholars who comprise Large Corporations Committee of Bankruptcy and COVID-19 Working Group in letter to House and Senate leaders, detailing anticipated $500 billion in anticipated defaults of $1.5 trillion in outstanding debt on leveraged loan market, and stating that country should anticipate "surge in bankruptcies over the next 18 months").

7 The Payroll Protection Program and Health Care Enhancement Act was passed on April 23, 2020.

8 The legislation also includes $75 billion in health care industry loans and grants, plus $2 billion for the SBA's increased administrative costs ("Health Care Program"). More on this later. The figures are by any measure staggering. The Congressional Budget Office announced on April 24, 2020, that the federal budget deficit will be $3.7 trillion for fiscal year 2020. This will make it the largest deficit as a share of the economy since World War II.

9 Banks allegedly made $10 billion in fees (*see* "Small Business Rescue Earned Banks $10 Billion in Fees," NPR, April 22, 2020 (the "NPR Report")), and spurred class actions alleging that the banks preferred larger businesses such that the money was not on a first-come, first-served basis. *See* "Chase and Other Banks Shuffled Paycheck Protection Program Small Business Applications, Lawsuit Says," *USA Today*, April 20, 2020. *See also* "New York Attorney General Asks Major Banks to Clarify Handling of Small Business Loans," Reuters Business (May 4, 2020).

10 *See* "Senate OKs $408B More Virus Relief for Small Biz, Hospitals," *Law360* (April 21, 2020) (quoting Richard Hunt of the Consumer Bankers Association). Hence, by the time this article appears, it is distinctly possible that the PPP II Loans will also be exhausted. *See also* Albert-Deitch, "PPP Round 2: Chaos and Confusion Again," *Inc.* (May 6, 2020).

article, the authors asserted that the PPP I Loans would be most effectively used as post-petition financing to distressed small businesses in bankruptcy. Certainly, one might assume (or perhaps hope) that Congress anticipated such a utilization, given that the same CARES Act that increased the debt limits to allow access to the Small Business Bankruptcy Act of 2019 (SBRA), with its simplified structures to help small businesses navigate the sometimes-unwieldy chapter 11 reorganization process, also authorized the PPP Loans. By increasing the debt limits for the SBRA, one would hope that Congress understood that the PPP Loans would be utilized by this increased constituency for the SBRA.

It seems evident that a small business might need to access bankruptcy protection to prevent permanent destruction by an unruly creditor during this pandemic, thereby furthering the legislative purpose to preserve small businesses. Should these PPP Loans be used for payroll and other approved costs, they will be forgiven under the terms of the CARES Act. The Small Business Administration (SBA) therefore not only guarantees the PPP Loans, but will also pay the lenders making such loans if and when they are forgiven.

Since the April 27 article came out, there have been real-time developments in this rapidly evolving area of bankruptcy. While every effort has been made to be as accurate as possible, it is possible that the authors may have missed certain cases in their overview of the law as it is developing. ABI has established a collection point for COVID-19-related matters that is a good source of underlying documents and related material.

## Just Say "No" to Bankruptcy!

While it is undisputed that nothing in the CARES Act itself precludes debtors in bankruptcy proceedings from accessing the PPP Loans, the SBA has publicly and unequivocally stated (on its approved application forms and otherwise[14]) that the pendency of a bankruptcy proceeding will result in the automatic denial of a PPP Loan.[15] The lenders making these loans (the "§ 7(a) Lenders," as the PPP Loans are made under § 7(a) of the Small Business Act), therefore, make the pendency of a bankruptcy proceeding an automatic disqualification factor.[16] As set forth in the SBA's April 24, 2020, guidelines (the "April 24 Guidelines"):

> 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 non-repayment of unforgiven loans. In addition, the Bankruptcy Code

11 Of course, there is no certainty that the federal government will keep the Treasury tap open indefinitely. *See* Anne Sraders, "Goldman Sachs Doubts There Will Be a Round 3 of PPP Loans for Small Businesses," *Fortune* (May 5, 2020) (Goldman Sachs analysts believe that the federal government might use a combination of tax credits/deductions and other means to help prop up small businesses). On May 12, 2020, House Democrats introduced new COVID-19 stimulus legislation to inject another $3 trillion into the economy. *See* Clare Foran, Manu Raju & Haley Byrd, "Democrats Unveil $3 Trillion Covid Relief Package and Plan to Vote This Week," CNN (May 12, 2020), *available at* cnn.com/2020/05/12/politics/3-trillion-aid-package-democrats-house/index.html (with monies earmarked for more direct payments to taxpayers as well as funds for state and local governments, "Senate Republican leaders warned Pelosi that the new bill is dead on arrival even before it was formally unveiled"). *See also* Aaron Gregg & Erica Werner, "SBA Slashes Disaster-Loan Limit from $2 Million to $150,000, Shuts Out Nearly All New Applicants," *Washington Post* (May 7, 2020), *available at* washingtonpost.com/business/2020/05/07/sba-disaster-loans (SBA limiting EIDL grants to $150,000 based on overwhelming demand and shortage of funds).

12 The PPP Loan bonanza is no exception. *See* "Two Charged with Stimulus Fraud," Dep't of Justice (Rhode Island) (May 5, 2020) (announcing indictment of two individuals for submitting false PPP Loan application); "Justice Department Eyes Fraud in Lending Program for Small Businesses Hit by Coronavirus Crisis," ABI Newsroom (May 6, 2020) (Justice Department revealing "multiple ongoing investigations" of fraud related to PPP Loan program).

13 *See* Thomas J. Salerno, Gerald Weidner, Christopher Simpson & Susan Ebner, "This DIP Loan Brought to You by Someone Who CARES!," Harvard Law School Bankruptcy Roundtable (April 14, 2020), *available at* blogs.harvard.edu/bankruptcyroundtable/2020/04/14/this-dip-loan-brought-to-you-by-someone-who-cares.

14 The approved form of loan application was taken, understandably, from the forms of approved pre-CARES Act SBA guaranteed loan applications. One cannot help but wonder whether the bankruptcy questions were vestigial in that they were on pre-CARES Act forms and simply continued.

15 According to the Frequently Asked Questions published by the SBA on April 24, 2020:

> 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. *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 non-repayment 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. (Emphasis added).

16 The private lenders making these loans use the SBA-approved forms and will follow the SBA's regulations and guidance in making the loans. The reason is straightforward: The SBA guarantees these loans, and indeed the CARES Act earmarked billions to have the Treasury actually buy the loans made under this program. Hence, if the SBA takes the position that these loans cannot be made to debtors involved in bankruptcy proceedings, the § 7(a) Lenders that actually make them and that will be looking ultimately to the federal government for payment will take that position so as not to risk impairing their own rights.

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requires that expenses incurred during the pendency of a chapter 11 case be paid in full prior to confirmation of a chapter 11 plan.[17]

For example, in *Pier 1*, the mothball order froze expenses associated with brick-and-mortar store locations while maintaining that the e-commerce business and payments to corresponding vendors be deemed critical to the debtors' e-commerce business. Post-petition payments to landlords, vendors, shippers and suppliers were deferred after the cases had been pending for weeks or months. Ordinarily, if administrative expenses cannot be paid in full, then the debtor is deemed administratively insolvent and the case might be converted to a chapter 7 liquidation, but these are not ordinary times.

This prioritizing of administrative creditors, while possibly acceptable as a short-term fix, will likely face its own resistance as the pandemic continues. For example, in *Toys "R" Us*,[18] the debtors sought to set aside funds to compensate vendors for goods shipped after a certain date, leaving other administrative creditors out of the money. Courts might be hesitant to enforce such a long-term practice that appears to discriminate between administrative-expense-holders, but they may have no other option if they want to avoid a liquidation.

Further, vendors — facing their own challenges in the wake of COVID-19 — might, after any suspension order is lifted, have their own difficulty continuing business, and might be unable to fulfill customer orders even presuming that ongoing trade terms might be successfully negotiated. It would not be surprising to learn that even after a debtor determines that critical-vendor or other post-petition dollars are appropriate to pay a vendor, said vendor is unable to perform based on its own supply chain or other coronavirus-related disruption, whether by shipping delays, cancellation or internal concerns at factories or fulfillment centers because of the implementation of important public health policies to prevent the spread of the virus.

### Conclusion

This mothballing strategy certainly departs from the accepted norm that chapter 11 requires debtors to pay administrative expenses, including landlords and current vendors, in a timely manner. However, the suspension of the cases provides a pause with the hopes that the disruption is short-lived and liquidity may be restored in time and hopefully provide a benefit to stakeholders. The courts, when granting creeping suspension such as in *Modell's* are permitting ongoing uncertainty to stakeholders (such as landlords) as orders are extended monthly. The impact is yet to be determined.

As the pandemic shut down of nonessential businesses in many states might be extended beyond April 30, 2020, it is unclear whether the suspension of cases will delay an inevitable liquidation or provide the anticipated useful extension of support to allow the cases to continue in chapter 11. Of those chapter 11 debtors that survive, the COVID-19 crisis may result in efforts to fast-track funds for critical administrative expenses to employees, professionals and certain vendors in order to keep certain portions of the business (such as online sales) operational, yet leave other creditors (such as landlords and other vendors) out of the money. Such a strategy to further prop up liquidity likely also further reduces or eliminates the possibility of recovery to unsecured creditors, because if such administrative expenses cannot be paid, there is little chance that general unsecured creditors will recover on their claims. abi

17 11 U.S.C. § 365(d)(3), (d)(5), 4 *Collier on Bankruptcy* ¶ 503.03[4] (Richard Levin & Henry J. Sommer eds., 16th ed.) (noting that "ordinary course of business" post-petition administrative expenses "generally are paid when due").

18 *See In re Toys "R" Us Inc.*, Case No. 17-34665 (Bankr. E.D. Va., March 25, 2018) (orders (1) authorizing wind-down of U.S. operations and postponing creditors efforts to collect on administrative claims and (2) establishing dates by which parties holding such administrative claims must file proofs of claim).

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> does not require any person to make a loan or a financial accommodation to a debtor in bankruptcy.[17]

Moreover, the SBA has taken the position that the anti-injunction provisions of the Small Business Act (discussed later in this article) preclude any relief against the SBA in exercising its rule-making functions in administering the PPP Loans and CARES Act. While certain commentators have suggested that the PPP Loans are made pursuant to § 7(a) of the Small Business Act,[18] as such the prohibition on lending to borrowers in bankruptcy cases is implicated. The SBA does not itself lend money; rather, it guarantees loans made by § 7(a) Lenders. Those loans and guarantees are not governed by § 13(3) of the Federal Reserve Act (FRA), so that should not be a roadblock to § 7(a) Lenders providing PPP Loans to insolvent businesses, including bankruptcy debtors, or to the SBA guaranteeing those PPP Loans.[19] FRA § 13(3) comes into play if § 7(a) Lenders want to participate in the federal PPP *Liquidity* (not "*Lending*") Facility (PPPLF), but participation in the PPPLF is not a requirement to being a § 7(a) Lender.[20]

17 Interestingly, the SBA has (most likely inadvertently) approved at least one of the PPP Loans to a chapter 11 debtor (who disclosed the existence of the pending bankruptcy proceeding), which loan was actually funded before the April 24 Guidelines were published. *See In re Mountain States Rosen LLC*, Case No. 20-20111 (Bankr. D. Wy.), and motion to approve DIP financing filed April 21, 2020 (Docket No. 68). The DIP loan-approval motion, which was ostensibly filed at the insistence of the U.S. Trustee, brought greater scrutiny to the PPP Loan application of the debtor, at which time the SBA took the position that it will no longer guarantee the loan if made and ultimately not forgiven. The § 7(a) Lender, caught between the proverbial rock and a hard spot, made a demand on the debtor to return the funds (hence, there is a DIP financing on motion where the DIP lender objects to the approval — strange times indeed). *See* Response of Converse County Bank filed May 11, 2020 (Docket No. 107) (in which the § 7(a) Lender states, "The Bank is aware of a decision from a neighboring jurisdiction approving and confirming a PPP Loan under the circumstances similar to [the debtors], and the Bank finds the rationale for such decision compelling.") Response at 6. It is now likely that the debtor will segregate the money, file a declaratory injunction action that the SBA "no bankruptcy" rule is unlawful, and only then have access to the PPP Loan proceeds.

18 Section 1102 of the CARES Act amended § 7(a) of the Small Business Act to establish the PPP for covered loans, and the SBA's Interim Final Rule states that § 1102 "temporarily adds a new product, titled the 'Paycheck Protection Program,' to the ... [SBA's] 7(a) Loan Program."

19 Interestingly, the SBA did not raise FRA § 13(3) as a defense to the TRO in *Hidalgo* discussed herein.

20 The PPPLF is an added incentive for private lenders, not a requirement for § 7(a) Lenders to provide PPP Loans to small businesses.

Respectfully, the SBA's position is absurd. Not only is it directly contrary to the very remedial purposes of the CARES Act, but it is also not in the best economic interests of the federal government.[21]

## The Four Hypotheticals

To demonstrate the point that the current SBA position is adverse to the interests of the federal government, allow us to posit four hypotheticals. It is undeniable that more bankruptcy proceedings will come from the economic morass that COVID-19 has wrought, and that a surge in bankruptcy filings is already starting. Hence, these hypotheticals (with the exception of Hypothetical Four) are all actually happening in real time.

- *Hypothetical One:* Borrower files for bankruptcy (either a chapter 11 or an SBRA case),[22] applies to a § 7(a) Lender for a PPP II Loan, and is denied based on the pendency of the bankruptcy proceeding.[23]
- *Hypothetical Two:* Borrower applies for a PPP II Loan and is approved by a § 7(a) Lender, then files a bankruptcy proceeding before the loan is funded. The § 7(a) Lender then promptly withdraws the approval of the PPP II Loan based on the bankruptcy filing. Timing is, indeed, everything.[24]
- *Hypothetical Three:* The unfortunate borrower in Hypothetical Two, realizing its mistake, obtains dismissal of the filed bankruptcy proceeding, then refiles its PPP II Loan application.[25]
- *Hypothetical Four:* The borrower applies for a PPP II Loan, the loan is approved by a § 7(a) Lender, and the PPP II Loan is funded. The borrower then commences a bankruptcy proceeding.[26]

The SBA takes the position that PPP Loans are not available in Hypotheticals One and Two, nor in Hypothetical Three so long as the bankruptcy case is pending, but the SBA would have no issue at all in Hypothetical Four. While one hopes for a legislative solution to this dilemma, it is left to the bankruptcy courts to discern congressional legislative (and political) intent.[27]

## Framing the Legal Arguments

The adversary proceedings to date have taken a fairly unified approach. In summary, here are the legal positions advanced by debtors seeking PPP Loans in chapter 11 cases, and the SBA's positions in responses thereto.

### Debtor's Approach ("You're Not the King of Me")

Debtors have filed adversary proceedings under §§ 105 and 525(a) of the Bankruptcy Code seeking the following: (1) injunctive relief (to force the SBA to take the references to pending bankruptcy cases off the PPP Loan applications) on the bases that such language exceeds the SBA's rule-making authority in that the CARES Act does not require or even reference this; (2) declaratory judgment that the inclusion of the bankruptcy-related questions is unlawful; and that (3) inclusion of this language violates the anti-discrimination provisions of § 525(a)[28]; and (4) the injunctive relief is proper in that, notwithstanding the sovereign immunity and anti-injunction provisions contained in § 634(b)(1) of the Small Business Act, it is abrogated by § 106(a), which provides that notwithstanding sovereign immunity claims, the Bankruptcy Code abrogates it with respect to § 105 relief;[29] and that (5) while the SBA has rule-making authority under the Administrative Procedures Act (APA),[30] that process might not be arbitrary and capricious under APA, 5 U.S.C. § 706(2)(A), (C).[31] Some of the lawsuits also sought *mandamus* against the SBA to require them to consider the PPP Loan applications without consideration of the bankruptcy-related questions.

### The SBA's Position ("It's My Gold, and I Make the Rules")

The SBA's legal arguments are straightforward: (1) Sovereign immunity precludes relief against the SBA, citing the anti-injunction provision of SBA § 634(b)(1); (2) the inclusion of a "no bankruptcy" requirement for PPP Loans

21 It also flies in the face of any notion of fairness or equity. For example, the PPP Loans, while being denied for bankruptcy businesses in desperate need, have been made to a number of public companies, the Los Angeles Lakers and elite private schools (including Harvard University and St. Andrew's Episcopal School). *See* "Private School Attended by Barron Trump to Keep Paycheck Protection Program Loan," CNN Politics (April 30, 2020). Harvard, backed by a $40 billion endowment, defended the nearly $9 million PPP Loan it received. *See* Rick Sobey, "Harvard Under Fire for Accepting More than $8M in Coronavirus Relief Package," *Boston Herald* (April 21, 2020). Of course, if it is fairness one is seeking, perhaps the law is not the place. While a business can be forgiven for aggressively pursuing possibly "free" money, it still creates a public perception of inequity that has broader ramifications. *See, e.g.*, Allison Levitsky & Jeff Gifford, "Phoenix Transportation Company Ordered to Return $10 Million PPP Loan," *Phoenix Bus. J.* (May 8, 2020), *available at* bizjournals.com/phoenix/news/2020/05/08/phoenix-transportation-company-ordered-to-return.html (newly appointed Select Subcommittee on Coronavirus Crisis demanded that publicly traded EVO Transportation & Energy Services return $10 million PPP Loan it applied for and received).

22 All of the hypotheticals assume a restructuring bankruptcy proceeding and not a chapter 7 liquidation.

23 *See In re Andes Indus. Inc.*, Case No. 2:19-bk-14585-PS (Bankr. D. Ariz.); *In re Blue Ice Inv. LLC*, Case No. 2:20-bk-2208-DPC (Bankr. D. Ariz.); *In re Elemental Processing LLC*, Case No. 20-50640-tnw (Bankr. E.D. Ky.); *In re Hidalgo Cnty. Emergency Serv. Found.*, Case No. 19-20497 (Bankr. S.D. Tex.); *In re Roman Catholic Archdiocese of Santa Fe*, Adv. Pro. No. 20-ap-01026 (Bankr. D.N.M. 2020); *In re Calais Reg'l Hosp. Inc.*, Adv. Pro. No. 20-ap-01006 (Bankr. D. Me. 2020); *In re Penobscot Valley Hosp. Inc.*, Adv. Pro. No. 20-ap-01005 (Bankr. D. Me. 2020); *In re Springfield Hosp. Inc.*, Case No. 19-10283 (Bankr. D. Vt. 2019); *In re Dancor Transit Inc.*, (Bankr. W.D. Ark. 2020); *In re Cosi Inc.*, Case No. 20-10417 (Bankr. D. Del. 2020); *In re Asteria Educ. Inc.*, Case No. 20-50169 (Bankr. W.D. Tex.); *In re Trudy's Texas Star Inc.*, Case No. 20-10108 (Bankr. W.D. Tex. 2020); *In re Americore Holdings LLC*, Case No. 19-61608-grs (Bankr. E.D. Ky. 2020); *In re Springfield Med. Care Sys. Inc.*, Case No. 20-01004 (Bankr. D. Vt. 2020); *In re KP Eng'g LP*, Case No. 19-34698 (DRJ) (Bankr. S.D. Tex.) (Docket No. 7) (May 6, 2020); *In re Hartshorne Holdings LLC*, Case No. 20-40133 (Bankr. W.D. Ky.); *In re J -H-J Inc.*, Case No. 19-51367 (Bankr. W.D. La.). Moreover, the Dioceses of Rochester and Buffalo (the "Dioceses"), respectively, both of which have pending chapter 11 cases in the U.S. Bankruptcy Court for the Western District of New York, filed a complaint against the SBA for its unlawful, discriminatory implementation of the PPP against prospective borrowers who are also debtors in bankruptcy. *The Diocese of Rochester, et al. v. SBA, et al.*, Case No. 6:20-dv-06243 EAW, (W.D.N.Y., filed April 20, 2020). In the complaint, the Dioceses allege, among other things, that nothing in the SBA's interim rules authorizes or permits the SBA to exclude debtors in bankruptcy from the PPP loan application process, and that they are businesses that Congress intended would benefit from the PPP to alleviate payroll difficulties. *Id.* at 6.

24 *See Village East Inc.*, Case No. 20:3114-jal (Bankr. W.D. Ky.) (chapter 11); *In re Elemental Processing LLC*, Case No. 20-50640-tnw (Bankr. E.D. Ky.), Doc. No. 124 (May 1, 2020). *In re TooJay's Mgmt. LLC*, Case 20-14792-EPK (Bankr. S.D. Fla.), Doc. No. 2 (April 29, 2020). *See In re TooJay's LLC*, No. 20-14792 (Bankr. S.D. Fla.) (chapter 11), Declaration of Edward Maxwell Piet in Support of the Debtors' Chapter 11 Petitions and First-Day Motions, dated April 30, 2020, at 14 [Dkt. No. 12].

25 *See In re Just Big Stuff Nursery Inc.*, Case No. 10-23984-LMI (Bankr. S.D. Fla.) (chapter 12) (Docket No. 166); *In re Advanced Power Techs. LLC*, Case No. 20-13304-PGH (Bankr. S.D. Fla.) (Docket No. 60). *See also In re Capital Rest. Grp. LLC*, Case 19-65910-wlh (Bankr. N.D. Ga.), Doc. No. 175 (April 22, 2020).

26 TooJays's received a $6.4 million PPP loan, then filed its chapter 11.

27 *See, e.g.*, "Lawmakers in Congress Press for Changes in Small Business Aid Program," ABI Newsroom (May 4, 2020), *available at* abi.org/newsroom/bankruptcy-headlines/lawmakers-in-congress-press-for-changes-in-small-business-aid-program.

28 Since these loans have forgiveness features, they are a grant, not a typical loan, similar to a public housing grant. *See, e.g., In re Stoltz*, 515 F.3d 80, 93 (2d Cir. 2002). There is no underwriting aspect to the PPP loan-application process. *See also* Yuka Hayashi, "Demand for Small-Business Loans Cools," *Wall St. J.* (May 8, 2020) ("Sen. Marco Rubio (R. Fla.), chairman of the Senate small business panel and a main architect of the PPP, said [that] he is pushing [the] Treasury to issue clear guidance on loan forgiveness to allow more flexibility for the 75 percent payroll requirement if businesses rehire employees by June 30. 'We are hearing from a lot of businesses, "We can't do 75 percent in the next eight weeks for a lot of reasons,'" Mr. Rubio said.... 'This loan will be forgivable. This was never designed to be a loan program. It was designed to be almost like a grant program.'").

29 *See, e.g., Ulstein Maritime Ltd. v. United States*, 833 F.2d 1052, 1056-57 (1st Cir. 1987). Section 106 was enacted 20 years after the SBA, so Congress certainly intended for § 106 to abrogate the SBA's sovereign immunity assertions.

30 *See* n.32, *infra*, regarding the SBA's position that injunctive relief related to the APA rule-making authority is a non-core proceeding over which the bankruptcy court may only issue reports and recommendations to the district court under 28 U.S.C. § 157(c)(1).

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does not violate § 525 of the Bankruptcy Code because the PPP Loans are not a "license, permit, charter, franchise or other similar grant to ... a person that is or has been a debtor under [the Bankruptcy Code]" — hence § 525 does not preclude discrimination for a loan; (3) the bankruptcy courts have no jurisdiction to issue final injunctive relief as it relates to the SBA's rule-making powers under the APA, as this is, at best, a non-core matter over which the court may only issue a report and recommendation to the district court under 28 U.S.C. § 157(c)(1) and *Stern v. Marshall*;[32] and (4) courts must give substantial deference to an agency's rule-making powers under the Chevron deference[33] principle.[34] Reduced to its essentials, the SBA's approach in denying approval of PPP Loans in bankruptcy seems to be that a PPP Loan applicant must be in financial distress to get the PPP Loan, just not *too much* financial distress.

## Great "PPP Scorecard"

While by no means intended as a definitive outline, and certainly subject to additional decisions daily (not to mention appellate and other review), as of May 12, 2020, it looks like debtors are batting a respectable 600 (9-6) on the injunction field, with numerous matters pending resolution.[35]

Injunctive relief has been granted for (1) Calais (health care facility), (2) Springfield Hospital (hospital),[36] (3) Santa Fe (Catholic archdiocese),[37] (4) Penobscot (hospital), (5) Hidalgo (ambulance services, preliminary injunction),[38] (6) Springfield Medical (health care), (7) KP (engineering services); (8) Hartshorne (coal mining operator); and (9) Organic Power (generator of biogas from organic waste). Injunctive relief has been denied for (1) Breda (two inns/restaurants), (2) Cosi (sandwich chain);[39] (3) Asteria (test-preparation publisher),[40] (4) Trudy's Texas Star (restaurant);[41] (5) JHJ (a grocery store chain);[42] and (6) Abe's Boat Rental (curiously enough, boat rental business).[43] More cases will undoubtedly be filed and forthcoming (at least until all the cash is gone),[44] changing this scorecard perhaps daily.[45]

## "I'm Not a Doctor, but I Play One on TV"

The PPP II Loan program also included $75 billion in grants to health care businesses. Appropriated under the

31 Judge Jones, in granting the preliminary injunction against the SBA on May 8, 2020, held that the "Plaintiff has shown a substantial likelihood of success on the merits on its claim that Jovita Carranza in her capacity as Administrator for the [SBA] has acted in a manner that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," 5 U.S.C. § 706(2)(A), and "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right," 5 U.S.C. § 706(2)(C), and therefore the Court "shall compel agency action unlawfully withheld or unreasonably delayed." 5 U.S.C. § 706(1). Preliminary Injunction at 1 (Docket No. 33).

32 564 U.S. 462 (2011). As to whether the bankruptcy court may exercise core jurisdiction under 28 U.S.C. § 1334(b) over this aspect of the dispute under the APA, under 5 U.S.C. §§ 702 and 703 the bankruptcy court is a court of competent jurisdiction that can address the allegations under 5 U.S.C. § 706. That said, are those "core" disputes over which the court can enter final orders? The authors believe that they are. The SBA's decision to exclude debtors goes to the very heart of case administration because the funds were intended by Congress to replace revenue lost by the shutdowns. Beyond that, however, is the undeniable and fundamental context of the dispute. The only reason that the claims under the APA exist in this context is because of the debtor's status as a debtor in bankruptcy. The SBA's "No Bankruptcy" requirement, which says that the debtor's assertion is arbitrary and capricious and exceeds the SBA's authority and should be set aside under the APA, only affects this plaintiff *because* it is in bankruptcy. The debtors in these cases are not asserting that any other action by the SBA should be set aside — only those actions that specifically affect the plaintiff/debtor solely because it is a debtor in bankruptcy. If the plaintiff were not in bankruptcy and were not subject to the bankruptcy court's jurisdiction, the SBA's "No Bankruptcy" requirement would be wholly irrelevant, and these particular claims would not exist. In fact, there would not even be a case or controversy here but for the existence of the bankruptcy case. Therefore, the bankruptcy lawsuits must necessarily be core proceedings within the purview of 28 U.S.C. § 157(b)(2)(A) (matters concerning administration of estate), (D) (orders in respect to obtaining credit), (E) (orders to turnover estate property, to the extent that PPP can be viewed as a grant and not a loan), and (O) (other proceedings affecting the liquidation of assets of the estate or adjustment of the debtor/creditor relationship).

33 *See* CARES Act, § 1114 (directing SBA with issuing regulations to carry out" the provisions of CARES Act). *Chevron U.S.A. Inc. v. Natural Res. Defense Council Inc.*, 467 U.S. 837 (1984), was a landmark case in which the U.S. Supreme Court set forth the legal test for determining whether to grant deference to a government agency's interpretation of a statute which it administers. The decision articulated a doctrine now known as "*Chevron* deference." The doctrine consists of a two-part test applied by the court, when appropriate, that is highly deferential to government agencies: "whether the agency's answer is based on a *permissible construction* of the statute," so long as Congress has not spoken directly to the precise issue at question (emphasis added).

34 The SBA's rule-making powers have come under attack not only from those that did not obtain PPP loans, but also those that did and are now being asked to repay them. Three technology companies filed suit in a California federal court to block the latest SBA rules meant to steer larger companies away from PPP Loans, and stating that such rules overreach and exceed the SBA's powers. *See Zumasys Inc., et al. v. U.S. Small Bus. Admin., et al.*, Case No. 8:20-cv-00851 (C.D. Cal. 2020); Jon Hill, "Treasury, SBA Sued over PPP Loan Eligibility Guidance," *Law360* (May 5, 2020) (court challenge to new rules that would require these larger companies to repay PPP Loans that would otherwise be forgiven, arguing SBA rules created "bait and switch" situation). The SBA has also flirted with the position that there is no private right of action with respect to the PPP Loan program or the SBA's implementation of it.

35 Cases are being filed and decided now on an almost daily basis, and by no means is this intended to ne an exhaustive list. The courts in the cases in Maine and Vermont are going to move to trials on the merits of the PPP claims in very short order. In Maine, the court set a trial date of May 27 on all claims. In Vermont, the court is using a slightly different approach: It is bifurcating the § 525(a) claim and addressing it first. The parties are required to file declarations with any additional relevant facts on the § 525(a) claim by May 14, 2020, and there is a limited opportunity for further briefing. The court set a trial on that claim for May 22, 2020, but may rule on the merits before that date if there are no factual issues. In a nod to the "new normal," both trials to be held via Zoom.

36 *See* Bill Rochelle, "Two More Judges Rule that Chapter 11 Debtors Are Eligible for PPP Loans," *Rochelle's Daily Wire* (May 5, 2020), *available at* abi.org/newsroom/daily-wire; Bob Herman, "Bankrupt Hospitals Sue Feds for Paycheck Protection Program Loans," *Axios* (May 7, 2020).

37 Judge Thuma not only issued the TRO, but also instructed the SBA to grant the PPP Loan, the failure of which would result in actual and potential punitive damages. *See* n.55, *infra*. A bit of overreach? Perhaps. Message sent? Most definitely! Message received? Likely not. *See also* H. Joseph Acosta, "New Mexico Court Holds that Bankrupt Entities Are Eligible for the Paycheck Protection Program," Dorsey Corporate Restructuring News (May 7, 2020).

38 On May 8, 2020, Judge Jones entered the requested preliminary injunction in *Hidalgo* (Docket No. 33) ("Preliminary Injunction") and doubled down on the position taken in the TRO. He required Jovita Carranza, in her capacity as the SBA Administrator, to file a sworn statement by May 11 "that the SBA will honor any right, guaranty, inducement or other privilege extended to any participating lender in the [PPP] that complies with the preliminary injunction [*i.e.*, considers the PPP Loan application without regard to any pendency of any bankruptcy proceeding]." Preliminary Injunction at 3-4. Failure to file the sworn declaration will subject Ms. Carranza to an OSC and personal appearance. *Id.* The SBA sought an emergency stay pending appeal, which was granted at 5:03 p.m. CDT. *See* Order, Document 7 (S.D. Tex. May 11, 2020). Interestingly, at 4:59 PM CDT, Ms. Carranza submitted her declaration, as required by Judge Jones (Docket 43), in which she stated that she, on the SBA's behalf, would "honor any right, guaranty, inducement, or other privilege extended to any participating lender in the [PPP] that complies with [the court's] preliminary injunction." As of May 13, 2020, the district court has not ruled on the appeal.

39 *See* Rose Krebs, "Bankrupt Cosi Loses Bid to Seek Small Business Virus Funds," *Law360* (April 30, 2020).

40 *See* Giorgio Bovenzi, Matt Ferris, Martha Wyrick & Camie Carlock, "Weathering the Economic Storm: Are PPP Loans and Bankruptcy Reorganizations Mutually Exclusive Options?," Haynes and Boone (May 7, 2020); Daniel M. Anderson, "Bankruptcy Courts Reach Conflicting Results Regarding Legality of Bankruptcy Exclusion in SBA Rules Implementing Paycheck Protection Program," Ice on Fire Insights (May 4, 2020).

41 Oral Ruling, May 8, 2020 (Mott, BJ).

42 Hon. **John W. Kolwe** granted a TRO, but on May 12, 2010, denied the preliminary injunction based largely on Hon. **H. Christopher Mott**'s decision in *Trudy's Texas Star*, citing sovereign immunity and *Chevron* deference issues to find doubt as to ultimate success on the merits.

43 Judge Kolwe, the same judge who denied the TRO in *JHJ*.

44 The SBA, in some (but not all) of the pending cases, has agreed to reserve funds for the debtor's PPP Loan pending a resolution (thereby making the immediate economic injury less of an issue. This was the deal cut in the *Blue Ice* case. Moreover, there are cases in related areas not occurring in a bankruptcy context. In *LIT Ventures LLC v. SBA*, Case No. 2:20-cv-00760-JAD-DJA (D. Nev.), District Judge Jennifer Dorsey denied a request for *mandamus*/TRO requiring the SBA to fund an EIDL (not in a bankruptcy context). *See* Order Denying Emergency Motion or Application and Requiring Ventures to Show Cause Why This Petition Should Not Be Dismissed dated May 5, 2020 (Docket No. 18).

45 While the authors recognize that it might be tempting to surmise that health care facilities/related operations and churches should get some sort of preferential treatment, the legal principles at stake are the same. Moreover, in one fascinating variation of this morality play, the SBA tried a new tack in defending against an injunction sought outside of bankruptcy. The plaintiffs operated a number of "adult entertainment" businesses (as characterized by the court as "pole dancing" at the "Silk Exotic Gentlemen's Club" in Wisconsin and Las Vegas to be precise). *See* Decision and Order, *Camelot Banquet Rooms Inc. v. SBA and Related Cases*, Case. No. 20-C-0601 (ED Wis.) (Docket No. 28). The SBA took the position that PPP Loans were not available to businesses that present "live performances of a prurient sexual nature" in violation of a 1996 SBA regulation. The district court found that the performances were legal and expressions protected under the First Amendment. Accordingly, the SBA could not use the regulation to deny the plaintiffs the PPP Loans. In essence, since the CARES Act provided no such prohibition, the SBA by regulation could not add a requirement not already in the statute. The authors wonder if the dancers were also armed whether the court might have found the performances covered under both the First and Second Amendments, but that is academic. In any event, a "pole dancing" business can get a PPP, just not a "pole dancing" operation in chapter 11.

Payroll Protection Program and Health Care Enhancements Act (PPP-HCE Act), this is intended to replenish the Public Health and Social Services Emergency Fund established by the CARES Act (the "HCE Funds").[46] The HCE Funds may be used for building temporary structures, leasing property, supplies and equipment, increased workforce and trainings, emergency operation centers, retrofitting facilities, and surge capacity. Moreover, the HCE Funds may not be used to reimburse expenses or losses that have been reimbursed from other sources or that other sources are obligated to reimburse.

Hospitals seeking HCE Funds must submit an application to the Department of Health and Human Services (HHS) that includes a statement justifying the hospital's need for the payment. On their face, these HCE Funds appear to be grants, as there is no provision in the PPP-HCE Act for repayment.[47] They are grants to health care providers to reimburse them for expenses or lost revenue attributable to coronavirus.[48] There is no prohibition in this provision of the PPP-HCE Act on hospitals that are debtors in bankruptcy receiving funds.[49]

Accordingly, the PPP-HCE Act creating the HCE Funds program looks a lot like the PPP Loan program. While the authors are unaware whether there are any cases in which the HHS will take the position taken by the SBA in the PPP Loan cases automatically disqualifying hospitals in bankruptcy cases, the same legal and economic principles set forth herein would apply, perhaps even more so as the PPP-HCE Act and funds thereunder are expressly (absent fraud) a grant. Hence, the prohibition against nondiscrimination in § 525(a) of the Bankruptcy Code would seem even more applicable.[50]

## Your Tax Dollars at Work?

No disrespect is intended to the federal government in this article, but frankly, what are you thinking? The world economy is reeling, and we are all making our way in uncharted seas. The foregoing notwithstanding, the SBA's position in the first three hypotheticals earlier in this article is directly contrary to the economic interests of the federal treasury (and derivatively all of us as taxpayers). This is true for at least three reasons.

First, insolvency is not an issue here. All of these borrowers will, at a bare minimum, have material liquidity issues (which is one test for insolvency: the inability to pay debts as they come due). That is the very reason for the PPP Loans and the CARES Act, so making "insolvency" an issue in the matter of PPP Loans is a contradiction in terms. Borrowers need the PPP Loans because they are insolvent.

Second, the April 24 guidelines notwithstanding, this is not a "credit risk" issue. These "loans" will be forgiven, assuming that the proceeds are used for their intended purposes (and borrowers must certify that that is what the loan proceeds will be used for). Hence, is it really even a "loan" in that sense?[51] Moreover, and as pointed out by Hon. **David Jones** in *Hidalgo*, as well as the courts in *Calais*, *Penobscot*, *Springfield Hospital* and *Santa Fe*, there is nothing in the CARES Act that references creditworthiness or excludes borrowers in bankruptcy from being considered.[52]

For the same reasons, the § 7(a) Lenders do not have any creditworthiness considerations for the PPP Loan borrowers, since the "loans" (whether forgiven or not) are backed by the full faith and credit of the federal government. There is no underwriting being done here;[53] it is simply processing paperwork.[54] Hence, "credit risk" here is a red herring and ought not be identified as a consideration at all. Even assuming, *arguendo*, the SBA had wide latitude in its rule-making authority, why would it withhold the PPP Loans from the sizeable portion of the American public that needs them the most? As stated by Hon. **David Thuma** in the *Santa Fe* decision, rule-making authority does not mean that it can be exercised in an arbitrary and capricious manner.[55]

46 Division B, Title I of the PPP-HCE Act defines eligible entities as Medicare- or Medicaid-enrolled suppliers and providers (including hospitals) that provide diagnoses, testing or care for individuals with possible or actual cases of COVID-19.

47 The CARES Act specifies that funds from the Public Health and Social Services Emergency Fund are "for necessary expenses to reimburse, through grants or other mechanisms, eligible health care providers for health care-related expenses or lost revenues that are attributable to coronavirus." The PPP-HCE Act similarly states that the HCE Funds are to be expended "for necessary expenses to reimburse, through grants or other mechanisms, eligible health care providers for health care-related expenses, or lost revenues that are attributable to coronavirus." While there are specific purposes for which the HCE Funds must be used and terms/conditions that providers receiving the funds must agree to abide by, neither the CARES Act nor the PPP-HCE Act contain any provisions allowing or requiring repayment of the funds if the funds are not used for designated purposes. Both acts do require providers to submit reports and maintain documentation specified by the HHS to verify that the funds are used in compliance with the specified terms and conditions, but there is no provision allowing for or requiring repayment if health care providers fail to abide by these requirements. Further, the HHS website confirms that funds initially paid out of the Public Health and Social Services Emergency Fund are "payments, not loans, to health care providers, and will not need to be repaid." *See* "CARES Act Provider Relief Fund," HHS, *available at* hhs.gov/coronavirus/cares-act-provider-relief-fund/index.html.

48 The only circumstance under which repayment appears to be contemplated is if a hospital receives HCE Funds as part of an automatic distribution and affirmatively decides that it will not agree to the terms and conditions for acceptance and use of the HCE Funds. In this instance, the hospital may reject the HCE Funds by completing the HHS attestation form (*available at* covid19.linkhealth.com/#/step/1) and returning the funds to HHS. This must be done within 45 days (extended from the initial 30 days) of receiving the HCE Funds. Of course, if in a later audit the HHS determines that a hospital used HCE Funds improperly or falsified data in required reports, the HHS could seek to recoup the HCE Funds through civil or criminal enforcement actions, but that would be on an individual basis based on the facts and circumstances of each case rather than as part of a widespread repayment program.

49 Provided that the hospitals are operating in chapter 11 and not liquidations. Given the limitations on how the funds can be used and the requirement to submit a statement justifying the hospital's need for payment, it would be very difficult for a hospital that is closed down and in liquidation and does not intend to operate in the near future to qualify for these funds.

50 While the HHS may argue that there is certainly more of an "underwriting" aspect to the HCE Funds (given the specificity required in the application process), in the end it is a distinction without difference as it relates to the legal analysis, since these are not "loans"; these are explicitly grants. Hence, absent obtaining the HCE Funds under false pretenses, they are not required to be repaid.

51 Judge Jones, presiding over the *Hidalgo* case, was the first to grant a TRO on April 25, 2020 (Dkt. No. 18), in an adversary proceeding wherein the debtor sought an injunction against the SBA on the basis that disqualifying bankruptcy debtors for PPP Loan relief exceeds the SBA's authority under the CARES Act. At oral argument on April 24, 2020, Judge Jones pointed out that the PPP is not really a loan program, but rather a conditional grant. What commercial loan anywhere, anytime, is forgivable only if you use it to pay payroll? None, of course. Moreover, Judge Jones noted that there is nothing in the CARES Act creating the PPP Loan program that addresses qualifications for the "loan," nor is there any mention of "creditworthiness." It is instead a "support program." All the borrower needs to do is make the certification about its COVID-19 impact, send the documents, and it is approved. Judge Jones called "frivolous" the SBA's argument that creditworthiness is a requirement. *See* Transcript of Hearing at pp. 28-29 ("*Hidalgo* Tr.").

52 *See* Jonathan Randles, "Bankrupt Companies Shut Out of Stimulus Money," *Wall St. J.* (April 25, 2020), *available at* wsj.com/articles/bankrupt-companies-shut-out-of-stimulus-money-11587812400.

53 As observed in *Hidalgo*:

> Judge Jones: "In fact, there really is no underwriting that's done, right? I mean, aren't the [§ 7(a) Lenders] authorized to simply accept what's on the form and act just on the form, and so long as they rely on the form, then they are protected; isn't that the way it works?"
> SBA Counsel: "From the interim rule I've read, yes…."
> * * *
> Judge Jones: "…And in fact there really isn't an underwriting function.... In fact, let's be practical. The entire intent of the [PPP] is for people not to pay this back. It's a way of getting money from the government to people that are being harmed. And as long as they use it in the right way, they don't have to pay it back."

*Hidalgo* Tr. at 16-17, 22-23.

54 And arguably a lucrative undertaking at that. It has been reported that the § 7(a) Lenders have earned $10 billion in fees to process this paperwork. *See* NPR Report. That is, frankly, understandable: The number of borrowers alone is enough to overwhelm the staff of any § 7(a) Lender, itself operating under the social distancing and shelter-in-place types of orders occurring throughout the U.S.

55 Judge Thuma held that the "Defendant's inexplicable and highhanded decision to rewrite the PPP's eligibility requirements in this way was arbitrary and capricious, beyond its statutory authority, and in violation of 11 U.S.C.§ 525(a). By a separate final judgment, the Court will grant [the] Plaintiff the relief it requests. If [the] Defendant's actions result in [the] Plaintiff not obtaining the $900,000 it requested, [the] Plaintiff may file an adversary proceeding for compensatory and, if appropriate, punitive damages."

*continued on page 62*

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Third, and perhaps most importantly, the SBA's position is directly contrary to its economic interests. In Hypotheticals One and Two, if the PPP Loan is made as post-petition financing, it is, at a minimum, legally entitled to administrative-expense priority in the bankruptcy proceeding (assuming that it is not simply forgiven under the terms of the CARES Act).[56]

Conversely, by insisting that borrowers dismiss their bankruptcies (as in Hypothetical Three), then refile the bankruptcy once the PPP Loan is funded,[57] or wait until the PPP Loan is funded, then file for bankruptcy (as in Hypothetical Four), both of which would presumably pass muster under the SBA rules and regulations (as borrowers are not required to waive any rights to file bankruptcy as a condition to getting the PPP Loans[58]), the SBA puts itself in the position of entering the bankruptcy proceeding as a general unsecured creditor. It also puts form over substance, since it requires (as in the case of *Advanced Power* discussed herein) a dismissal, then a refiling after obtaining a PPP Loan. Of course, that means (absent fraud and forgiveness) that the PPP Loan would be subject to being discharged or having its recovery otherwise subject to *pro rata* dilution and recovery. Indeed, if the SBA is truly concerned about "the unacceptable high risk of ... non-repayment of unforgiven loans" as set forth in the April 24 guidelines, these PPP Loans should absolutely be made in bankruptcy cases, not outside of them.

Why is this in the economic interest of the federal government (or taxpayers)?[59]

### A Rational Approach, Please

The COVID-19 pandemic and its economic fallout are creating enough economic, legal and personal challenges. It is time for the federal government to stop asserting positions that only harm the very constituency that the CARES Act was intended to assist, create burdens on an already stressed court system, and create additional fees, costs and delays for borrowers in bankruptcy. Given the speed with which the PPP I Loans and very likely the PPP II Loans have been and will be exhausted by desperate small businesses trying to keep their heads above this rising tide, the SBA's continued insistence on the position that bankruptcy is an automatic disqualifying event for PPP Loans may well freeze out this group of borrowers just by the delay in adjudication of the issue.

It is worth remembering that the SBRA and PPP are complementary tools to accomplish the same goal: Save small businesses from an unprecedented and costly collapse. Small businesses generate an estimated 44 percent of all U.S. economic activity.[60] The widespread loss of small businesses would therefore be devastating to the economy.[61] During this unprecedented pandemic, the PPP and SBRA could (and should) be coordinated tools to accomplish a joint goal of the CARES Act and SBRA: Save small businesses from devastating collapses.

For small businesses, the actions of one creditor are often enough to cripple the business. During this time of forced shutdowns and the economic aftermath, a small business may need to quickly access bankruptcy protection in order to prevent garnishment of its payroll account, the seizure of essential equipment or a landlord lockout. Each of these events will likely result in a small business's permanent closure during this pandemic. As many creditors and landlords are also under pressure, creditors might feel compelled to take collection actions. It would be a fatal policy misstep to "tie the hands" of small businesses by restricting their access to bankruptcy protection at a time when small businesses need this protection the most.

Many small businesses (especially those whose operations are shut down by shelter-in-place ordinances) are struggling to survive. Some small businesses may receive enough support through the PPP Loans to survive. For others, the PPP Loan is only enough to keep the business going for a few weeks until it can reopen and begin generating revenue again. If the PPP's goal is to help small businesses survive economic hardships caused by the COVID-19 pandemic through funding payroll costs, rent, interest and utilities during the initial shelter-in-place period, then it is illogical to require those businesses to give up the benefits of reorganization in bankruptcy (which may enable these businesses to effectuate larger changes to their capital structures to emerge as more viable business enterprises that are hopefully around long after the PPP is of mere historical interest and gone).

Resolution of this issue is critical for the borrowers that need these funds and need them immediately. A rational approach is sorely in order. In the words of Judge Jones at the April 24, 2020, *Hidalgo* hearing, "But this can't be what Congress intended. This can't be the way we are supposed to treat our fellow man in this time. It's inconceivable to me that this distinction (between a borrower in bankruptcy and one not in bankruptcy) could be drawn."[62]

Wise words indeed. abi

56 *See* § 364(a) of the Bankruptcy Code.

57 Both the *Big Stuff Nursery* and *Advanced Power* cases were expressly dismissed "without prejudice." *Advanced Power* dismissed its chapter 11 and obtained its PPP Loan, then reinstated its chapter 11 case a week later.

58 Nor would such requirements likely be enforceable as a matter of violation of public policy in any event.

59 One has to wonder who precisely is making the decisions at the SBA regarding the positions it has taken related to the PPP Loan program (both in bankruptcy proceedings and out). The SBA Inspector General, in a report issued on May 8, 2020, conceded that the SBA did not follow several congressional mandates in implementing its huge loan program designed to keep businesses afloat during the coronavirus pandemic, including failing to issue guidance that prioritized underserved communities. It found, among other things, that the SBA's rules and regulations in administering the PPP requiring borrowers to use the majority of their loan funds on payroll costs to receive full forgiveness, even though the CARES Act passed by Congress didn't mandate any specific amount be dedicated for payroll expenses, was counter to the purpose of the CARES Act. Many small businesses objected to this measure, including owners of restaurants, hair salons and other businesses who have been forced to close and who say they needed the money more for overhead costs, including rent. *See* Amara Omeokwe, "SBA Veered from Guidelines on Small-Business Loans, Report Says," *Wall St. J.* (May 8, 2020) (reporting on SBA Inspector General Report issued May 8, 2020, issued in response to requests by Sens. Chuck Schumer and Sherrod Brown).

60 "Small Businesses Generate 44 Percent of U.S. Economic Activity," U.S. Small Business Admin., Office of Advocacy, Press Release No. 19-1 ADV, *available at* advocacy.sba.gov/2019/01/30/small-businesses-generate-44-percent-of-u-s-economic-activity.

61 *Id.* According to the release, "nominal small business GDP measured $5.9 trillion in 2014, the most recent year for which small business GDP data are available."

62 *Hidalgo* Tr. at 32.

# Reports of The "Debtor Bar" For PPP Loans is "Exaggerated"

**Thomas J. Salerno**
**Stinson, LLP**
**July 2, 2020**

"The report of my death was an exaggeration."
Mark Twain
June 2, 1897

In my learned colleague Bill Rochelle's June 24 *Daily Wire*, the headline blares "**Fifth Circuit Bars Debtors from Receiving 'PPP' Loans Under the CARES Act".** Bill's headline is not unique—many law firm blogs have reported the same thing. As my good colleague acknowledged, the headline (while certainly eye catching, and as headlines are wont to do) fails to tell the whole story. As reported accurately by Bill Rochelle: "In record time, the Fifth Circuit granted a direct appeal and reversed the bankruptcy court on June 22, ruling that the Small Business Act bars the bankruptcy court from entering an injunction that requires the Small Business Administration to grant a so-called PPP loan to a company in bankruptcy. " While the Paycheck Protection Program ("**PPP**") expired on June 30, that very night the Senate introduced legislation to extend it another six weeks as there is a whopping undisbursed $130 billion still left in the federal giveaway grab bag (the House, as of this writing, has not yet acted on it). *See* "$130 Billion Left At Paycheck Program Deadline, But Senate Acts To Extend It", *New York Times* (June 30, 2020). The House voted to approve the extension to August 8 on July 1.

The June 22, 2020 three-page decision by the Fifth Circuit did not hold that debtors were barred from the PPP Loan program, nor did the Fifth Circuit give judicial blessing to the now infamous April 24, 2020 regulation promulgated by the Small Business Administration ("**SBA**") that automatically disqualified debtors from participation in the PPP (the "**SBA Bankruptcy Rule**"). Rather, the court ruled on the very narrow issue of whether the bankruptcy court in *Hidalgo* (the first court in the country to issue the injunction at issue) could enjoin the SBA. As stated by the Fifth Circuit: "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, whether in regard to the PPP or any other circumstance. Because, under well-established Fifth Circuit law, the bankruptcy court exceeded its authority when it issued an injunction against the SBA Administrator, we VACATE its preliminary injunction." *Hidalgo Community Emergency Service Foundation v. Carranza*, No. 20-40368 (June 22, 2020) (Docket No. 0051546181).

As set forth in **"This DIP Loan Should Be Brought To You By Someone Who CARES! (Or, "You Can't Get There from Here"): A Plea For Rationality Part 2 ½"**, *ABI Journal* (June 2020), injunctive relief was an early procedural mechanism used to force the SBA to strike the SBA Bankruptcy Rule from the approval process for debtor's applying for PPP loans.

Debtor's counsel are nothing if not adaptable! Many astute counsel foresaw the issues with injunctive relief (including the requirement to show irreparable harm as well as the potential arguments regarding the anti-injunction provisions of the law governing the SBA), and abandoned the injunctive relief portions of the adversary proceedings that were filed post-*Hidalgo*. In its place, debtors instead are now seeking declaratory relief seeking an adjudication that the SBA Bankruptcy Rule is discriminatory in violation of Bankruptcy Code §525, and the SBA Bankruptcy Rule is arbitrary and capricious under the Administrative Procedures Act (although apparently it is not a legal basis to invalidate an administrative rule if it is simply counter to common sense or runs contrary to the economic interests of taxpayers, who are the ultimate source of such funds…but I digress). Same destination, different route.

Moreover, there is still also available the new dance sensation sweeping the bankruptcy world, the "**SBA Tango**"! It's that whimsical, exciting, time consuming and costly charade that the SBA makes needy borrowers perform in order to sidestep the SBA's dogged irrationality. It's like the old Westerns where

an outlaw makes someone "dance" by shooting at their feet. The SBA Tango is as simple as it is stunningly unnecessary. It comes in two variations, the "two step" or the "three step". The **two step** is where the borrower gets the PPP loans first, then files bankruptcy (which the SBA has absolutely no issue with at all, even though any PPP Loan if not forgiven will be treated as a general unsecured claim). The somewhat more convoluted is the **three step**, where debtors are turned down for the PPP Loan based on the SBA Bankruptcy Rule. In this shuffle, the bankruptcy courts allow a quick dismissal of the pending case (thereby magically "curing" the dogmatic disqualification), thereby allowing the now former debtors to get the PPP Loan (because the "magic box" about being in bankruptcy is no longer checked). Once the loan is obtained, the climactic third step is done when the bankruptcy case get reinstated. Interestingly, the SBA is fine with that as well. Either of these dances can be done with or without a long stem rose in your mouth.

It is no surprise that the House voted to extend the PPP in line with the Senate vote. The money was already budgeted, so what's another $130 billion or so in deficit? All those politicians will be out of office and retired before the country's taxpayers have to pay this tab anyway! With a new round of spikes in COVID infections and renewed business shutdowns in many states, extending was the logical thing to do at this point ("in for a penny, in for a pound" as they say). Nonetheless, this whole dynamic will always be a head scratching footnote when the history of the economic challenges of COVID 19 is written.

Until the money runs out, let's keep on dancing, ladies and gentlemen.

AMERICAN BANKRUPTCY INSTITUTE

## A New Challenge for Debtors Who Received PPP Loans Under the CARES Act[1]

*Written by:*
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*"I keep going to a lot of places and ending up somewhere I've already been."*
— Don Draper in "Mad Men"

The CARES Act and corresponding paycheck protection program (PPP) provisions continue to provide fertile ground for discourse concerning policy implications and legislative intent amid an unprecedented pandemic. In the early months of implementing the CARES Act's PPP provisions, the bankruptcy world was particularly fraught with such debate.[2] Courts across the country grappled with the SBA's authority to enforce rules prohibiting access to the $659 billion of relief afforded to small businesses solely based on their status as debtors in bankruptcy.

Although that phase of litigation appears to have concluded, debtors who received PPP loans and are now seeking loan forgiveness may need to clear a new hurdle. Specifically, lenders of the PPP loans may refuse to process a borrower's application for loan forgiveness because the applicant's filing of bankruptcy constituted a default under the terms contained in the PPP loans. Despite going to a lot of places and engaging in what has affectionately been referred to by one commentator as the "SBA Tango,"[3] debtors may end up somewhere they have already been: in front of a bankruptcy court seeking the relief necessary to have their PPP loan forgiven.

### A New Hypothetical Challenge

Consider the following hypothetical: A small business applies for and receives a PPP loan. The small business uses the funds for approved purposes under the PPP provisions and would otherwise be entitled to forgiveness. Faced with continued financial problems caused by the pandemic, the small business files for bankruptcy and subsequently applies for loan forgiveness. The lender refuses to process the loan-forgiveness application because the loan defines an event of default to include the filing of a bankruptcy petition.

Now, the debtor, who otherwise qualified for loan forgiveness under the PPP provisions, is saddled with an unforgiven debt only because the debtor filed for bankruptcy. This latest approach comes on the heels of the numerous hurdles the SBA has already thrown up to limit access to these funds available to a certain group of distressed borrowers.

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[1] The author of this article is currently concluding his two-year clerkship for Hon. Daniel P. Collins of the U.S. Bankruptcy Court for the District of Arizona. The opinions herein are the author's alone and do not represent the opinion of Judge Collins or the District of Arizona. Nothing in this article should be construed as legal advice, nor should it be interpreted to represent the opinion of Judge Collins or the District of Arizona.

[2] For a review of this initial phase of litigation, interested readers can review "This DIP Loan Should Be Brought to You by Someone Who CARES, Part I" and "This DIP Loan Should Be Brought to You by Someone Who CARES, Part II," written by Thomas Salerno, Gerald Weidner, Chris Simpson and Susan Ebner, *available at* https://connect.abi.org/l/107412/2020-03-31/4gvq3z and https://connect.abi.org/l/107412/2020-04-27/4jv57x, respectively.

[3] *See* discussion of the "SBA Tango" in "Reports of a 'Debtor Bar' for PPP Loans Have Been Exaggerated," written by Thomas Salerno on July 2, 2020, *available at* https://abi-org.s3.amazonaws.com/Newsroom/ABI_Brief/SBATangoArticle.pdf.

**The CARES Act**

As discussed at great length in the suits seeking to enjoin the SBA from prohibiting access to PPP loans based solely on an applicant's filing for bankruptcy, the CARES Act's PPP provisions never once mention the word "bankruptcy." Section 1106 of the CARES Act details the requirements for a PPP loan to be forgiven. Section 1106(b) states that a PPP loan recipient is eligible for forgiveness of a PPP loan provided that the loan was used on payroll costs, any payment of interest on any covered mortgage obligation, any payment on any covered rent obligation and any covered utility payment. Section 1106(e) outlines what is required to be included in an application. Nowhere in any of these sections is an event of default mentioned or defined.

***Ipso Facto* Clauses**

Events of default based on a borrower filing for bankruptcy are common in financing agreements. So-called *ipso facto* clauses also have a long history in bankruptcy. The Fourth Circuit defines an *ipso facto* clause as a contractual provision that causes a debtor to immediately default under the terms of a contract upon filing for bankruptcy protection.[4] Bankruptcy courts generally disfavor *ipso facto* clauses.[5] The origins of the Bankruptcy Code's disapproval of *ipso facto* clauses are found in 11 U.S.C. §§ 541(c) and 365(e)(1).[6]

**Possible Solutions**

Debtors whose applications for loan forgiveness are rejected by a PPP lender based solely on a bankruptcy *ipso facto* clause may have a couple of procedural mechanisms at their disposal. Debtors could object to the lender's claim. Debtors could also consider initiating an adversary proceeding and seeking declaratory relief that the *ipso facto* clause is unenforceable. Under either of these options, debtors may consider relying on § 525's anti-discrimination provisions or alternatively argue that the *ipso facto* clause is unenforceable based on public policy.

Debtors who choose to argue that the lender's refusal to process the loan-forgiveness application based on a bankruptcy filing violates § 525's anti-discrimination provisions may be aided by Treasury Secretary Steven Mnuchin's recent comments before the House Small Business Committee. On July 17, 2020, Treasury Secretary Mnuchin suggested that the Trump administration would support a proposal from U.S. banks that the paycheck protection program should see loans under $150,000 automatically converted into grants.[7] As those who followed

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[4] *In re Jones*, 591 F.3d 308, 312 (4th Cir. 2010).

[5] *In re EBCI Inc.*, 356 B.R. 631, 640 (Bankr. D. Del. 2006) (citing *In re James Cable Partners L.P.*, 154 B.R. 813, 816 (M.D. Ga. 1993); *In re Hutchins*, 99 B.R. 56, 57 (Bankr. D. Colo. 1989)). *See also In re Heward Bros.*, 210 B.R. 475, 479 (Bankr. D. Idaho 1997) (stating that "[g]enerally, a prepetition agreement to waive a benefit of bankruptcy is void as against public policy"); *In re James Cable Partners L.P.*, 154 B.R. 813, 816 (M.D. Ga. 1993), *aff'd*, 27 F.3d 534 (11th Cir. 1994) (referring to "a basic bankruptcy policy that abhors the operation of so-called '*ipso facto*' clauses[,] … which trigger a default … upon the happenstance of bankruptcy"); *In re Hutchins*, 99 B.R. 56, 57 (Bankr. D. Colo. 1989) (stating that "[b]ankruptcy default clauses are not favored and are generally unenforceable under the Bankruptcy Code"); *In re Perry*, 25 B.R. 817, 820 (Bankr. D. Md. 1982) (enforcement of "bankruptcy clauses … would result in forfeitures contrary to the spirit of the Code, a result which courts of equity strain to avoid").

[6] Both §§ 541(c) and 365(e)(1) expressly prohibit the enforcement of *ipso facto* clauses in the context of determining what constitutes property of the estate and executory contracts.

[7] Ryan Tracy, "Mnuchin Calls for Forgiving PPP Loans to Smallest Businesses," *Wall St. J.* (July 17, 2020), *available at* https://www.wsj.com/articles/mnuchin-suggests-automatic-forgiveness-of-paycheck-protection-program-loans-11595000522.

the litigation between debtors and the SBA will recall, the classification of PPP money as "loans" or "grants" was determinative for many courts in holding that § 525 did not apply. Those courts determined that § 525's anti-discrimination provisions did not apply because § 525(a) only prohibits a governmental unit from discriminating against debtors in denying a "license, permit, charter, franchise, or other similar ***grant***" (emphasis added).

Treasury Secretary Mnuchin's recent suggestion provides debtors with ammunition for the argument that money provided for under the PPP provisions is in fact a "grant." Treasury Secretary Mnuchin's comments are consistent with comments previously made by Sen. Marco Rubio (R-Fla.).[8] Although § 525(a) only applies to a governmental unit and not to private lenders who made these loans, lenders will have a difficult time arguing that the *ipso facto* default provisions contained in their loan documents were the result of rules promulgated by the SBA.

As to the public policy argument, debtors have ample case law supporting bankruptcy courts' tendency to look to public policy to refuse to enforce *ipso facto* clauses.[9] Not only do *ipso facto* clauses arguably contradict the fresh-start policy of the Bankruptcy Code, they also go against the intent to provide forgivable loans to small businesses adversely impacted by the pandemic.

**Conclusion**

The hypothetical presented above is a novel issue for debtors and differs from the SBA's prohibition against debtors having access to the PPP loans in the first place. To begin with, in this hypothetical it is the lender bank who is arguably violating the Bankruptcy Code, not the SBA. Unlike the situation in which the SBA enforced rules prohibiting access to PPP loans based on an applicant's status as a debtor in bankruptcy, the lender bank is refusing to process loan-forgiveness applications. Furthermore, although the SBA arguably had the rule-making authority as an agency to promulgate and enforce such rules it deemed necessary to carry out legislative intent, the lenders do not have the benefit of courts applying the *Chevron* deference. While some courts justifiably deferred to the SBA and refused to enjoin the agency from enforcing rules that prohibited debtors from accessing the funds, lenders will not enjoy the same deference. Lenders will have to argue that these *ipso facto* clauses are enforceable and that they do not violate the Bankruptcy Code or public policy.

As debtors have already learned, although the PPP provisions seemingly provided much-needed relief in times of unparalleled economic uncertainty, there is no such thing as a free lunch. Whether it is the SBA or the private lenders creating the hurdles, debtors seem to end up somewhere they have already been: being denied forgiveness of loans seemingly intended to serve as a lifeline in trying times.

[8] Yuka Hayashi, "Demand for Small-Business Loans Cools," *Wall St. J.* (May 8, 2020), *available at* https://www.wsj.com/articles/demand-for-small-business-loans-cools-11588930201.
[9] *See* fn. 5, *supra*.


# This DIP Loan Brought To You By Someone Who CARES! (Or "I'm From The Government And I'm Here To Help You")

## PART ONE

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"No social stability without individual stability."
Aldous Huxley, *Brave New World*

Our world has undeniably changed, and will remain so for the foreseeable future. In an attempt to soften the inevitable economic blow that accompanies this global pandemic and its epic adverse impact on the U.S. economy, on March 27, 2020, Congress passed (and the President quickly signed) the "Coronavirus Aid, Relief, and Economic Security (CARES) Act" into law. The CARES Act is reported to be "twice as large as any relief ever signed"[2] and will provide $2.2 trillion in relief to U.S. families, workers and businesses. This is the third piece of legislation[3] passed to address this problem.

While bankruptcy lawyers are aware that CARES expanded the debt limitations for eligibility for the "Small Business Reorganization Act of 2019" (which became effective on Feb. 19, 2020) from a little over $2.7 million to $7.5 million (thereby opening up the streamlined restructuring capabilities for materially more financially distressed business),[4] the authors believe that there could be another substantial implication for the brave new bankruptcy world: a new potential source of DIP financing.

There is something for almost everyone in the CARES Act. CARES has approximately $377 billion allocated for financing "small businesses" (under 500 employees or the standard size established by the SBA for the businesses industry,

1 The authors are part of the multidisciplinary Coronavirus Task Force at Stinson, LLP.

2 For a more in-depth and expanded analysis of the CARES Act, see Ebner, Weidner, Wheeler, Sheahan, Salerno, Simpson, Tews, Fenske, Araujo & Respeliers, "Coronavirus Aid, Relief, and Economic Security (CARES) Act Signed into Law: Overview of Key Provisions," Stinson Client Alert (March 30, 2020).

3 The CARES Act is the "latest in a series of legislative packages addressing the COVID-19 pandemic. Two bills have already been enacted into law: the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020 (P.L. 116-123) and the Families First Coronavirus Response Act (P.L. 116-127)." https://crsreports.congress.gov/product/pdf/R/R46279.

4 While not directly relevant to this article, the CARES Act also amended the Code to provide that debtors who have experienced a material financial hardship due to COVID-19 will be allowed to modify a plan under chapter 13, but only if the modified plan does not provide payments more than seven years after the first payment was due under the original chapter 13 plan (and the modification otherwise meets the requirements of §§ 1322(a)-(c) and 1325(a).

the "Small Business Provisions")[5] and a program called Emergency Relief Direct Loans to Employers (the "Larger Business Provisions"), as well as a $500 billion "Specified Industry Loan Program" (SILP)[6]. The Larger Business Provisions and SILP will be the subject of Part Two of this briefing.

We are all aware that Bankruptcy Code § 364 provides the vehicle to obtain post-petition financing on either a secured or unsecured basis (DIP financing). It is in this context that the CARES financing provisions become particularly interesting. Also of interest, the CARES Act does not expressly preclude application of some of these programs in a bankruptcy proceeding (and wisely so, since it is anticipated that the economic upheaval of COVID-19 will lead to more chapter 11 filings).

The authors recognize that there are established underwriting guidelines for Small Business Administration (SBA) loans. Moreover, there are new regulations (and undoubtedly future regulations as this plays out) that will come into play with these loans.[7] As such, while there is no express prohibition for some of the loans referenced herein from being accessed in a chapter 11 proceeding,[8] the *de facto* prohibition may come from underwriting guidelines.[9]

The foregoing notwithstanding, if the overarching purpose of the CARES Act is to assist businesses in weathering the economic storm while the COVID-19 virus ravages the economy, it is not unreasonable to suggest that such underwriting guidelines can and will be loosened in order to allow the application of some of these programs in a chapter 11 proceeding (whose aim will be to stabilize the business such that jobs can be retained, taxes paid in the future, etc.). In other words, the stimulus funds will be used where they can be most effectively deployed.[10] The chapter 11 into which the funds are lent will not have as its purpose the goal of wiping out the SBA loans discussed herein.[11]

Any prudent advisor to a financially distressed business enterprise[12] should consider the implications of the CARES Act and its financing provisions as part of a restructuring analysis. This briefing summarizes some of the major CARES Act provisions that could come into play in the bankruptcy/restructuring arena.

**Small Business Provisions[13]**

There are at least three areas of the CARES Act totaling in excess of $376.5 billion for small businesses that come into play here: the $10.562 billion Emergency Economic Injury Disaster Loan and Grants (EIDL) Program, the $349 billion Paycheck Protection Program (PPP) provisions, and the $17 billion in Subsidies for Certain Other Small Business Loan Payments. *There is no express prohibition in the CARES Act that precludes these small business provisions' application in a chapter 11 bankruptcy proceeding.*[14]

**1. EIDL Provisions**

There are two CARES Act provisions that come into play here for smaller businesses.

5 While the CARES Act does not say anything about how the number of employees is calculated, Section 3 of the Small Business Act will likely apply. That provision says that size (based on employment) is measured by the average employment based on employment during each of the manufacturing concern's pay periods for the preceding 12 months. That would be consistent with the methodology for determining whether a reduction in the forgiveness is made due to a reduction in the workforce.

6 Yes, that is "billions." To put this into historical perspective, 12 years ago the Emergency Economic Stabilization Act of 2008, which authorized the expenditure of economic stimulus federal money by the Troubled Asset Relief Program (known simply as TARP), created in reaction to the capital markets meltdown in 2008), was a quaint *$700 billio*n in its entirety. A few billion here, a few billion there; it starts to add up to real money eventually.

7 For example, the Treasury Department recently issued some guidance on payroll support to air carriers and contractors, and procedures and minimum requirements for loans to air carriers and eligible businesses and national security businesses. For anyone who may be interested, a link to the website where those are available is below. There does not yet appear to be any guidance on the PPP loans or other SBA relief. See: https://home.treasury.gov/news/press-releases/sm960.

8 CARES does have a certification requirement. The CARES loans discussed herein require a certification "acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments." Accordingly, as long as the loan proceeds are used strictly for this purpose, it is a proper use of DIP financing monies and in compliance with the CARES Act. Attorneys' fees and other costs of administration would need to be paid from a different source of funds (not all that dissimilar to a restriction by a lender on the use of its cash collateral, for example).

9 The underwriting guidelines require that the owner have reasonable equity to invest and guarantee rates on regular Section 7 loans ranging from 50% to 90%, so the borrower would need to satisfy the lender's underwriting standards as the lender retains some risk of loss. The SBA maintains a Lender Guide, and there are some parts of the SBA website that can only be accessed by lenders with a password. The following materials on the SBA website generally discuss underwriting considerations and borrower requirements:
- https://www.sba.gov/partners/lenders/7a-loan-program/terms-conditions-eligibility;
- https://www.sba.gov/sites/default/files/articles/Chapter_4_Credit_Standards_Chart-1B.pdf;
- https://www.sba.gov/sites/default/files/SDOLoanFactSheet_Oct_2011.pdf; and
- https://www.sba7a.loans/eligibility-and-qualifications-for-the-sba-7a-loan.

10 Put another way, if the loans discussed herein are made before the chapter 11 filing of a distressed business, and because the loans are, in reality, more of a Band-Aid than a real overall cure for the existing economic malaise, then the loans will be subject to be altered, reduced or otherwise diminished in a subsequent chapter 11 proceeding. That benefits no one and indeed directly undermines the remedial goal of the CARES Act program.

11 As a practical matter, these loans, as DIP loans, will at a minimum have administrative expense priority such that, absent a meltdown of the entire case, they must be repaid as part of the confirmation of any chapter 11 plan.

12 At the risk of sounding callous, the new reality is that there are two kinds of business enterprises out there: those that are in financial distress, and those that are lying about being in financial distress. Such is the brave new world in which we currently live.

13 *See Small Business Owner's Guide to the CARES Ac*t (March 30, 2020), available at https://www.sfnr.com/wp-content/uploads/2020/03/JTB-CARES-Act-SBA-Business-Owner-Guide.pdf.

14 As contrasted with the Larger Business Provisions, the subject of Part II of this series.

***Emergency Economic Injury Disaster Loans (EIDLs)***:[15] The Act appropriates an *additional $562 million for Small Business Administration (SBA) disaster loans, including EIDLs.* For the covered period of *Jan. 31, 2020, through Dec. 31, 2020,* EIDL eligibility is expanded to include sole proprietors, independent contractors, cooperatives, ESOPs and tribal businesses with less than 500 employees.

For EIDLs of less than $200,000, *the personal guaranty requirement is waived for the covered period*. Federally declared emergencies also now qualify as a trigger for the EIDL program, making *EIDLs available nationwide.*

During the covered period, the SBA can approve EIDLs based solely on the credit score of the applicant or an alternative method appropriate for determining creditworthiness; the "time in business" and "credit elsewhere" test requirements have been waived for the covered period.

***Emergency Economic Injury Grants:*** The Act also includes *$10 billion for emergency EIDL grants (EIDL Grants)*, to be provided by the SBA *through December 31, 2020.* Emergency EIDL grants are *$10,000 advances to small businesses* applying for the EIDL program. The $10,000 advance will be *provided within three days of the business applying for the EIDL.* Businesses *will not be required to pay back the advance*, even if they are ultimately denied the EIDL grant.

***Subsidies for Certain Other Small Business Loan Payments:*** *$17 billion is appropriated for the payment of certain other small business loans.* For loans in regular service, whether or not on deferment, made under 7(a) of the Small Business Act, Title V of the Small Business Investment Act, and loans under 7(m) of the Small Business Act made by an intermediary before enactment of the Act, the SBA will pay the principal, interest and fees owed for the six-month period commencing with the first payment due following the date of enactment (March 27, 2020) or, for loans on deferment, commencing with the next payment due after the deferment period. *The SBA shall also pay the first six months of principal, interest and fees owed on any such loans made during the period beginning on March 27, 2020, and ending on the date that is six months after the date of enactment (Sept. 27, 2020).*

The Act waives the maximum loan maturity limits for those loans under deferment, and also extends the lender site visit requirement to within 60 days of a non-default adverse event and 90 days for a default adverse event.

***State Trade Expansion Program:*** Federal grant funds appropriated for the State Trade Expansion Program (STEP) from fiscal years 2018 and 2019 will remain available to provide grants through the end of fiscal year 2021.

***Entrepreneurial Development:*** The Act appropriates $275 million toward funding and resources to small business development centers, women's business centers and minority business centers. These centers must use the funds to provide education, training and advising on surviving the COVID-19 crisis to covered small businesses, especially those in impoverished or rural areas.

***Resources and Services in Languages Other than English:*** Notably, the Act requires that SBA resources and services relating to the Act's relief provisions be provided in the 10 most commonly spoken languages, other than English, in the U.S., including Mandarin, Cantonese, Japanese and Korean.

**2. PPP Provisions**

The CARES Act includes specific and detailed provisions expanding the authority of the Small Business Administration (SBA) to insure loans to help small businesses cope with the COVID-19 pandemic.[16] The SBA currently provides partial guarantees of loans made under the SBA's Section 7(a) loan program, including loans for disaster assistance. Under the CARES Act, the SBA is authorized to guarantee a new category of loans originated under the Act's Paycheck Protection Program (PPP). PPP loans are intended to help small businesses fund certain payroll, loan interest, rent and utility expenses.

15 Emergency Injury Disaster Loans under Section 7(b)(2) of the Small Business Act. The CARES Act expanded the SBA's authority under Section 7(b)(2).

16 The PPP loan rules are an addition to Section 7 of the Small Business Act. Those rules contain specific provisions relating to eligible borrowers, maximum loan amounts, how loan size is determined, maximum interest rate, maximum maturity, the criteria for qualifying for a loan, and the formula for calculating the amount of the loan to be forgiven. It is the statutory framework for the SBA to guarantee these loans. Despite these specifics, questions about the size, affiliation and number of employees are some of the areas where greater guidance would be useful.

In contrast, the section of the CARES Act that deals with the program for the Larger Business Provisions (to be discussed in Part Two of this briefing) merely says the Treasury will endeavor to seek the implementation of a loan program that provides financing for banks and other lenders to make loans to organizations with an annualized interest rate not higher than 2% per annum where no principal or interest will be payable for the first six months or such longer period as is determined by the Secretary. It then lists 10 certifications the borrowers are to make. The statute refers to eligible businesses, but does not define them other than by an employee size range.

Demand for PPP loans will be high, so time is of the essence when applying for PPP loans.

The Act requires the Treasury Secretary to implement regulations for administration of the PPP,[17] which will include loan terms and conditions, interest rates, underwriting standards and the SBA guarantee percentage. While the PPP provisions suggest that the guarantee percentage will be 100% and the SBA will reimburse lenders for any forgiven loan amounts, the final guarantee percentage will be established by regulation. *Businesses should expect delays while the Treasury Secretary promulgates rules for PPP loans*. Borrowers who may be interested should immediately take steps to pull together their payroll and other financial information and seek out a lender participating in the PPP program to determine eligibility.

***Key Takeaways:*** The Act commits $349 billion to the (PPP), which will provide *loans of up to $10 million to eligible small businesses to cover qualified costs. Loan amounts equal to up to eight weeks of payroll and other qualified costs may be forgiven if the business retains its employees and maintains compensation levels during the period covered by the Act.* All SBA loan fees also will be waived for PPP loans. All PPP loans will be nonrecourse to individual shareholders, members and partners of a borrower so long as the loan proceeds are used for permissible purposes. Moreover, PPP loan payments can be deferred for at least six months and up to one year.

Unlike traditional SBA loans, *applicants need not show that credit is unavailable elsewhere, nor will they have to provide personal guarantees or collateral to receive a PPP loan.*

***Who Is Eligible for PPP Loans?*** Businesses that have already qualified as "small business concerns" under the Small Business Act, 501(c)(3) nonprofit entities, and businesses, veterans' organizations and tribal businesses that employ no more than the greater of either (1) 500 employees or (2) the standard size established by the SBA for their industry are all eligible for PPP loans. *Sole proprietors, independent contractors and self-employed individuals are also eligible for PPP loans.* In addition, certain businesses with more than one physical location that have been assigned a North American Industry Classification System (NAICS) code beginning with 72 and that have 500 or fewer employees per location are eligible for PPP loans. The number of employees employed by a business's affiliate(s) will be counted toward its total number of employees for small business size calculation in most cases. In addition, the borrower's business *must have been in operation as of Feb. 15, 2020,* to be eligible to apply for and receive these loans. Lastly, businesses applying for a loan must also *certify that they have been negatively affected by the current economic conditions.*

As stated, the number of employees employed by a business's affiliate(s) will be counted toward its total number of employees for small business size calculation in most cases. However, in determining eligibility for PPP loans, the Act waives the affiliation rules under 13 C.F.R. 121.103 for businesses of 500 employees or less that are in the accommodation and food services industry, franchises assigned a franchise-identified NAICS code, and businesses receiving financing through the Small Business Investment Company Act.

***What Are PPP Loan Dollar Amounts and Payment Terms?*** The *maximum PPP loan amount* is the lesser of (1) *$10 million or* (2) *2.5 times the average monthly payroll for the prior one-year period* (or, for certain seasonal businesses, the average monthly payroll for certain periods specified in the Act).[18] *The interest rate on PPP loans is not to exceed 4%.* Loan amounts not forgiven (as discussed below) will have a *loan maturity not to exceed 10 years*.

Payroll costs that may be covered by the loan include salaries, wages, commissions, payments for certain other benefits such as vacation, health insurance and retirement benefits, and state and local employment taxes. *Payroll costs can include certain compensation or other income to a sole proprietor or independent contractor.*

Payroll costs *excluded* from the loan are certain compensation in excess of $100,000 per year, taxes under the Federal

17 Section (F)(iii) of Section 36 of the Small Business Act (as added by Section 1102) provides as follows: "The authority to make loans under this paragraph shall be extended to additional lenders determined by the Administrator and the Secretary of the Treasury to have the necessary qualifications to process, close, disburse and service loans made with the guarantee of the Administration." Section 1109 of the Act provides for the establishment of guidance and rules and refers to the Secretary of the Treasury.

18 The CARES Act specifically permits sole proprietors and self-employed businesses to participate. The benefits may not be as great when there are no employees. The maximum loan amount is determined by the average monthly payroll amount, which will be less for a sole proprietor. Note that payroll costs include "the sum of payments of any compensation to or income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment or similar compensation" (based on annual compensation of up to $100,000 per year). In addition, the loan-forgiveness concept in the CARES Act calculates the loan-forgiveness amount to include payroll costs (as well as certain interest payments, rent and utility costs), so the forgiven amount would not be as great where there are no employees.

For some businesses with very few employees (including single-employee businesses), the EIDL grants, in conjunction with the PPA loans, will provide some relief. There is nothing that prohibits a single-employee business from applying for both an EIDL grant and a PPP loan; however, if both are given, the amount of loan forgiveness under the PPP loan will be reduced by the EIDL grant amount.

Insurance Contributions Act, Railroad Retirement Tax and Unemployment Taxes, compensation for employees residing outside the U.S., certain qualified sick leave wages, and certain qualified family leave wages.

***Circumstances Under Which PPP Loans May Be Forgiven:*** *The SBA will forgive PPP loan amounts equal to up to eight weeks of qualified costs of the business, including payroll costs, interest payable on secured debt incurred before Feb. 15, 2020, rent due on leases in place before Feb. 15, 2020, and utility payments for service that began before Feb. 15, 2020.* The amount of PPP loan forgiveness that a business is eligible for cannot exceed the loan principal. Additionally, the amount of loan forgiveness will be reduced proportionally by the reduction in number of employees compared to the prior year and by the reduction in pay of any employee beyond 25% of their compensation the year prior.

*A business that has already laid off employees or reduced salaries due to COVID-19 may still be eligible for PPP loan forgiveness if the business re-hires its employees and/or eliminates the salary reductions by June 30, 2020.* PPP loan debt forgiveness will not be included in the borrower's taxable income; however, businesses that have PPP loan debt forgiven will not be eligible for the payroll tax deferment provided under Section 2303 of the Act. Any PPP loan balance not forgiven will have a maximum maturity date of 10 years.

***Where Can Businesses Obtain PPP Loans?*** *In order to cut down on processing time, the Act eliminates the need to apply through the SBA and provides for delegating the authority to make and approve PPP loans to qualified lenders.* For eligibility purposes, the Act limits a lender's consideration only to whether the business was in operation as of Feb. 15, 2020, and had employees to whom it paid salaries and payroll taxes, or paid independent contractors.

***Who Is a Qualified Lender?*** *All existing SBA lenders and other lenders approved by the SBA are eligible to issue PPP loans.* Existing SBA loans (other than PPP loans) made between Jan. 31, 2020, and the date PPP loans become available under the CARES Act may be refinanced with PPP loan proceeds. The SBA will reimburse lenders for processing fees associated with issuing PPP loans (rates vary by loan amount).

*PPP loans are guaranteed by the SBA and may be sold in the secondary market.* The SBA will reimburse lenders for any loan amount that is forgiven within 90 days of the date the amount of forgiveness is determined. The SBA may (and indeed is likely to) issue guidance requiring lenders to prioritize loans to businesses in underserved and rural markets.

**Conclusion**

As we embark on this journey into the great unknown together, as restructuring professionals we must continue to explore avenues of opportunity that open for our clients (existing and future). As they say, when one door closes, another opens.

**Stay tuned for Part II: Larger Business Provisions and Specified Industry Loan Program provisions.**

# Faculty

**Hon. Daniel P. Collins** is a Bankruptcy Judge for the U.S. Bankruptcy Court for the District of Arizona in Phoenix, appointed on Jan. 18, 2013. He served as chief judge from 2014-18. Previously, he was a shareholder with the law firm of Collins, May, Potenza, Baran & Gillespie, P.C. in downtown Phoenix, practicing primarily in the areas of bankruptcy, commercial litigation and commercial transactions. Judge Collins served on the State Bar of Arizona's Subcommittee on the Uniform Fraudulent Transfer Act. He also served as chairman of the Bankruptcy Section of the State of Arizona and was a lawyer representative to the Ninth Circuit Court of Appeals. He was granted the St. Thomas More Award in 2017. Judge Collins is presently an At Large Governor of the National Conference of Bankruptcy Judges, a member of ABI's Board of Directors, on the board of the Phoenix Chapter of the Federal Bar Association and a member of the University of Arizona Law School's Board of Visitors. He is also a member of the Arizona Bankruptcy American Inn of Court, State Bar of Arizona and Maricopa County Bar. Judge Collins received both his B.S. in finance and accounting in 1980 and his J.D. in 1983 from the University of Arizona.

**Tiffany Payne Geyer** is a partner with BakerHostetler in Orlando, Fla., and practices primarily in the areas of bankruptcy and creditors' rights. She has represented both corporate and individual debtors in chapter 11 cases and individuals in chapter 7 cases, and her clients include health care businesses and medical professionals, investment bankers and financial advisors. She has also represented clients in the hospitality sectors, and has assisted in representing debtors in the energy sectors. Ms. Geyer has negotiated multiple settlements of guarantor liability and has experience with assignments for the benefit of creditors. She has also represented secured creditors, unsecured creditors, landlords and panel trustees. Ms. Geyer has been listed in *Chambers USA* for Bankruptcy/Restructuring in Florida and in *The Best Lawyers in America* in 2020 for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law, and she is a member of the Central Florida Bankruptcy Law Association (CFBLA), Federal Bar Association, American Bar Association and the International Women's Insolvency & Restructuring Confederation (IWIRC). She received her B.A. with honors in political science and public administration in 1998 from the University of Central Florida, and her J.D. in 2000 from the University of Florida Levin College of Law, where she received the Book Award for Legal Drafting and was a member of a trial competition team.

**Andrew C. Helman** is a business, workout, and restructuring attorney with Murray Plumb & Murray in Portland, Maine, and works with all types of businesses, including those in the health care sector, to help them protect their assets. A large part of his work is focused on helping debtors and creditors, and he represents clients in distressed and nondistressed transactions, business litigation and preference actions. Mr. Helman has been involved in some of the most significant chapter 11 cases in Maine and New Hampshire in recent years, including the representation of the debtor-in-possession in the largest health care bankruptcy case in Maine's history. In that same case, he subsequently represented a liquidating trustee under a confirmed chapter 11 plan and successfully resolved about 50 preference actions with an estimated value exceeding $3 million. Mr. Helman frequently writes articles for national insolvency publications and teaches seminars on bankruptcy and fraudulent-transfer law. He was selected by his peers for inclusion in the 2015-17 issues of *Super Lawyers* as a "Rising Star" and

was one of 40 attorneys nationally to participate in the National Conference of Bankruptcy Judges' 2016 NextGen Program.

**Thomas J. Salerno** is a partner in the Bankruptcy and Creditors' Rights practice at Stinson LLP in Phoenix, where he represents distressed companies, acquirers and creditors in financial restructurings and bankruptcy proceedings, pre- and post-bankruptcy workouts, and corporate recapitalizations. He works with clients from an array of industries, including casinos, resort hotels, sports teams, real estate, high-tech manufacturing, electricity generation, agribusiness, construction, health care, airlines and franchised fast-food operations. Mr. Salerno has represented parties in insolvency proceedings in 30 states and five countries. He has been involved in restructurings in the U.S., U.K., Germany, France, Switzerland, and the Czech and Slovak Republics. In addition, Mr. Salerno taught comparative international insolvency at the University of Salzburg and Gray's Inn School of Law in London, and is an adjunct professor at the Sandra Day O'Connor School of Law at Arizona State University, teaching bankruptcy litigation and advanced chapter 11 bankruptcy. He is also a regular guest lecturer at the Eller MBA Program for the University of Arizona. Mr. Salerno has served as an expert witness on U.S. insolvency law in litigation in Germany, and represented Coyote Hockey LLC, the owners of the Phoenix Coyotes of the National Hockey League (NHL), in historic bankruptcy proceedings that resulted in an unprecedented solution: the NHL purchasing one of its own teams for the first time in the league's 90-year history. He headed the U.S. delegation to the Czech Republic in advising the Czech Government in the historic revamping of its bankruptcy law, which took effect in January 2008, and he has also advised on revamping insolvency laws in the Dominican Republic and Costa Rica. Mr. Salerno is a member of the UNCITRAL working group on its Insolvency Law Reform Project, completed in early 2007. He is a former ABI Board and Executive Committee member, a past director of the American Board of Certification, a Fellow of the American College of Bankruptcy, and a member of the Plan Issues Advisory Subcommittee for ABI's landmark Bankruptcy Review Commission. Mr. Salerno received his B.A. *summa cum laude* from Rutgers University and his J.D. *cum laude* from Notre Dame Law School, where he served as an editor of the *Notre Dame Law Review*.