

Bankruptcy and Creditor's Rights Department

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Notice to Clients and Friends

PPP's Bankruptcy Exclusion Rule

In response to the COVID-19 pandemic, Congress enacted the Coronavirus Aid Relief and Economic Security (CARES) Act. Section 1102 of the CARES Act created the Paycheck Protection Program, or PPP, as a convertible loan program under section 7(a) of the Small Business Act, intended to help businesses preserve their operations by providing funds to cover certain key operating expenses such as labor, utilities, and rent. The loans are made by the SBA's participating banks and guaranteed by the SBA itself." *Id.* Section 1106 of the CARES Act provides that the loans will be forgiven with the SBA paying the lender the forgiven amount to the extent the borrower uses the funds for certain specific purposes. 15 U.S.C. § 9005. Congress initially appropriated \$349 billion for the PPP program and then appropriated an additional \$310 billion in April 2020.

Section 1114 of the CARES Act granted the SBA emergency rulemaking powers to administer the PPP. One of those rules, requires the applicant to answer whether it or its owner is a debtor in a bankruptcy proceeding at the time it submits the application or at any time before the loan is disbursed. The applicant is then automatically disqualified if it answers it in the affirmative. The reason is "that providing PPP loans to debtors in bankruptcy would present an unacceptably high risk of unauthorized use of funds or non-repayment of unforgiven loans." Business Loan Program Temporary Changes; Paycheck Protection Program—Requirements—Promissory Notes, Authorizations, Affiliation, and Eligibility, 85 FR 23450-01.

The bankruptcy exclusion rule has been the object of numerous cases where bankrupt debtors have sought temporary restraining orders or preliminary injunctions against the SBA to enjoin enforcement of the rule. Debtors argued that the SBA has not imposed similar restrictions to other section 7(a) loans in which bankruptcy is only one factor to be considered. Debtors also argue that the alleged risk for those applicants who have sought bankruptcy protection because the SBA does not require any comparable oversight, and does not require personal guarantees or collateral for the loans. Further, debtors assert that the bankruptcy exclusion rules violates section 525(a) of the Bankruptcy Code, which provides that "a governmental unit may not deny ... a license, permit, charter, franchise, or other similar grant to ... a person that is or has been a debtor under this title ... solely because such ... debtor is or has been a debtor under this title[.]" 11 U.S.C. § 525(a). Accordingly, debtors claim that the SBA's rule violates section 525(a) and should be set aside according to the Administrative Procedure Act or APA, as arbitrary and capricious, of exceeding the statutory authority granted to the SBA.

The controversy has been litigated nationwide, and the courts are divided on it. Some recent cases from bankruptcy courts within the First Circuit show this split. In In re Organic Power LLC, No. 19-01789-EAG11, 2020 WL 4728084 (Bankr. D.P.R. July 24, 2020), the bankruptcy court granted the debtors request for a TRO based on both section 525(a) and APA claims. By contrast, in In re Breda, No. 18-10140, 2020 WL 2373597 (Bankr. D. Me. May 11, 2020), the bankruptcy court denied the TRO, finding the debtor had failed to show irreparable harm. While it had originally granting TROs in the consolidated proceedings in Penobscot Valley Hosp., 20-ap-01005 and Calais Reg'l Hosp., 20-ap-01006 (Bankr. D. Me.), the bankruptcy court issued joint proposed findings of fact and conclusions of law in favor of the SBA on both the debtors' APA and § 525(a) claims.

Courts within the Eleventh Circuit are also divided. In NRP Lease Holdings, LLC, 20-ap-00055 (Bankr. M.D. Fla May 27, 2020), granted the debtors' request for preliminary injunction based on their APA claims, and was silent on the plaintiff's section 525(a) claims. In In re Gateway Radiology Consultants, P.A., 616 B.R. 833 (Bankr. M.D. Fla. 2020), the court found the plaintiff showed a substantial likelihood of success on the merits of its APA claims, and thus declined to address the plaintiff's § 525(a) claim on a preliminary basis in the remaining proceeding. In Matter of Henry Anesthesia Assocs. LLC, No. AP 20-06084-LRC, 2020 WL 3002124 (Bankr.

N.D. Ga. June 4, 2020), the court denied debtor's request for a preliminary injunction on both its § 525(a) and APA claims.

A review of the recent case law shows similar trends in other circuits. We note, however, that the cases are highly fact-specific and vary due to the balancing test required for preliminary injunction. Some commentators have noted some trends arising, such as that hospitals or emergency medical service providers have been more successful in obtaining their requests.

As the SBA's exclusion requirements continue to be litigated, Congress continues working on new projects to extend the PPP loans. For example, the Payroll Protection Program Second Draw Loan bill, introduced on July 27, 2020, S. 4321 (the "proposed PPP III legislation"), sought to reverse the previous exclusions, but has not been approved.

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