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New Mexico Court Enjoins SBA from Denying PPP Relief to Debtor in Bankruptcy

Court Finds PPP Qualification Rules Contrary to CARES Act

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On May 1, 2020, the United States Bankruptcy Court for the District of New Mexico ruled in favor of the Roman Catholic Church of the Archdiocese of Santa Fe (Archdiocese) granting a temporary injunction against the Small Business Administration (SBA) that had rejected the Archdiocese's application for a Paycheck Protection Program (PPP) Loan under the CARES Act. The case sheds light on how courts may view other SBA rulemaking regarding eligibility for PPP Loans, including the recently announced requirement that PPP applicants and recipients first exhaust other sources of liquidity, or give back funds by May 14, 2020.

In 2018, the Archdiocese filed for Chapter 11 bankruptcy and had been operating as a debtor-in-possession. On March 23, 2020, in response to COVID-19 pandemic the New Mexico Department of Health issued a “stay-at-home” order, prohibiting mass gatherings and requiring all non-essential businesses to cease in-person operations. Due to the stay-at-home orders, the Archdiocese was losing about \$300,000 a month in revenue it otherwise would realize from normal operations.

The economic hardship brought on by COVID-19 and the stay-at-home orders led the Archdiocese to file an application for a PPP Loan on April 20, 2020. Not long after the Archdiocese filed its application, the SBA issued a second interim final rule which purported to disqualify bankruptcy debtors from a PPP Loan.

“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.”

The Archdiocese's PPP Loan application was promptly denied after this interim final rule was issued by the SBA. In response, the Archdiocese filed an adversary proceeding against the SBA.

Other debtors in similar positions as the Archdiocese have instituted adversary proceedings against the SBA challenging its rejection of PPP

Loan applications with differing results. For example, in *Hidalgo County Emergency Services Foundation v. Jovita Carranza*, Hidalgo County Emergency Services Foundation Hidalgo commenced an adversary proceeding before the United States Bankruptcy Court for the Southern District of Texas against the SBA, seeking a temporary and preliminary injunction against the SBA's barring of PPP Loan applicants in bankruptcy. Judge David Jones on April 25, 2020 granted Hidalgo's request for a temporary restraining order against the SBA enjoining the SBA from denying Hidalgo's PPP Loan application on the basis of being a debtor in bankruptcy. In *Cosi Inc. v. Small Business Administration et al.*, Cosi, Inc. Cosi commenced an adversary proceeding against the SBA for a temporary restraining order to bar the SBA from disqualifying it from applying for a PPP Loan. Contrary to the results in Hidalgo, U.S. Bankruptcy Judge Brendan L. Shannon denied Cosi's bid for the temporary restraining order. Judge Shannon commented that although he disagreed with the SBA's decision to preclude bankruptcy debtors from receiving PPP Loans, he would defer to the SBA's recent directives as to how loan funds are to be disbursed.

The Archdiocese succeeded in its application for a temporary injunction. The Court found the SBA's decision to exclude bankruptcy debtors from a PPP Loan (i) was arbitrary and capricious, (ii) exceeded the SBA's authority under the CARES Act, and (iii) constituted discriminatory treatment.

Arbitrary and Capricious

The Court found that while a borrower's bankruptcy status is relevant for a typical loan program, a PPP Loan is not atypical loan, but is instead a grant or support program. The Court also held that the CARES Act's eligibility requirements do not include creditworthiness, instead, the PPP Loans are available regardless of financial distress. Given the obvious purpose of PPP Loans, the Court found it arbitrary and capricious for the SBA to add a creditworthiness test to the eligibility requirements for a PPP Loan.

Exceeded SBA's Authority

The Court also found that the SBA was tasked only with issuing "regulations to carry out this title..." and had exceeded its authority under this direction by rewriting the eligibility requirements and prohibiting bankruptcy debtors from obtaining PPP Loans.

Discriminatory Treatment

11 U.S.C. § 525(a) provides protection against a governmental unit denying or discriminating against a person that is or has been a debtor under the Bankruptcy Act in applying for a license, permit, charter, franchise, or other similar grant. The Court found that a PPP Loan is not a typical loan but is instead a government grant or support program. Denying the Archdiocese access to a PPP Loan solely because it is a debtor in bankruptcy was a clear violation of the discrimination protections afforded under § 525(a).

The result of this decision is a clear signal to the SBA as well as lenders administering PPP Loans that applicants should not be barred from

receiving PPP Loans only because it has filed for bankruptcy. The same analysis of the SBA's overstepping in the instant case potentially could be applied to other rules implemented by the SBA that arguably run counter to the language and stated intent of the CARES Act PPP program.

The SBA has promised additional guidance concerning PPP Loan eligibility before its stated May 14 Safe Harbor period expires. What this will mean for applicants in bankruptcy as well as the original PPP Loan qualifications outlined in the CARES Act is yet to be determined.

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