Reports of a "Debtor Bar" for PPP Loans Have Been "Exaggerated"

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

In my learned colleague Bill Rochelle's June 24 *Rochelle's 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 been reporting the same thing. Yet as my good colleague acknowledged, the headline (while certainly eye-catching, as headlines are wont to be) 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) was set to expire 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 voted on July 1 to approve the extension to Aug. 8.[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 participating 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 in question) 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."[2]

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" in the June 2020 *ABI Journal*, injunctive relief was an early procedural mechanism used to force the SBA to strike the SBA Bankruptcy Rule from the approval process for debtors 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-

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[1] *See* "$130 Billion Left at Paycheck Program Deadline, but Senate Acts to Extend It," *New York Times* (June 30, 2020).

[2] *Hidalgo Community Emergency Service Foundation v. Carranza*, No. 20-40368 (June 22, 2020) (Docket No. 0051546181).

Hidalgo. In its place, debtors are instead now seeking declaratory relief, requesting an adjudication that the SBA Bankruptcy Rule is discriminatory in violation of Bankruptcy Code § 525 and that 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 sources 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 dance 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 (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 gets 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-19 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.