

Bankruptcy and the New Year - Impact of the Newly-Adopted Spending Bill (Consolidated Appropriations Act of 2021)

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The focus of 2020 has been the COVID-19 pandemic. Most recently, Congress demonstrated its continued response to the impact on the economy by passing the Consolidated Appropriations Act of 2021 ("CAA 2021") which President Trump signed into law on December 27, 2020. Our clients should be aware of these developments.

First, well before the outbreak of the pandemic, President Trump signed into law the Small Business Reorganization Act of 2019 ("SBRA"), which became effective in February 2020. SBRA provided Subchapter V Chapter 11 ("Subchapter V") relief to small business debtors with debts less than \$2,725,625.

Secondly, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") became effective on March 27, 2020. Among other provisions, the CARES Act raised the qualifying amount to file a Subchapter V under SBRA to \$7.5 million. This increased qualifying amount under SBRA is in effect until March 27, 2021. For further discussion of the SBRA and the CARES Act, please see a prior alert at <https://www.cullenllp.com/blog/cares-act-expands-bankruptcy-protections-for-small-businesses/>.

One of the key provisions of the CARES Act was the Paycheck Protection Program ("PPP"). PPP loans are forgivable so long as they are used to keep employees working on payroll and enable the business to stay afloat. However, shortly after the passage of the CARES Act, bankruptcy debtors seeking PPP loans began to realize their business may not be eligible for PPP loans due to the nature of such business or on account of the company's status as a Chapter 11 debtor. This has resulted in litigation throughout the country as the Small Business Administration ("SBA") has refused certain debtor's applications for PPP loans in many instances.

In a decision out of the Western District of New York this past June, District Judge Lawrence Vilaro noted that courts are split on whether eligibility requirements imposed by the SBA for PPP loans (which effectively prohibited certain Chapter 11 debtor from qualifying for PPP loans) contradicted the language of the CARES Act. In *Pharaohs GC, Inc. v. U.S. Small Bus. Admin.*, 20-CV-665, 2020 WL 3489404 (W.D.N.Y. June 26, 2020), Judge Vilaro noted that some courts find the exclusion of certain businesses runs contrary to the Congressional intent of the CARES Act, whereas other courts hold that the SBA does "not exceed its authority in barring certain organizations from obtaining PPP loans." 2020 WL 3489404, at *3. Judge Vilaro agreed with the latter courts and found, in interpreting provision of the CARES Act which makes "any business concern . . ." eligible to receive a PPP loan, that Congress did not intend for "any" business to mean "all" businesses so broadly, noting that a broader interpretation would lead to illogical results such as including illegal businesses. *Id.* at *4-5. Further, Judge Vilaro concluded that the SBA offered a reasonable explanation to exclude the debtor's business (an adult-entertainment club) from eligibility for PPP loans. *Id.* at *6.

Conversely, in *DV Diamond Club of Flint, LLC v. U.S. Small Bus. Admin.*, 459 F. Supp. 3d 943 (E.D. Mich. 2020), District Judge Matthew Leitman determined that "the plain language of the PPP makes clear that any business concern is eligible for a PPP loan if it employed the requisite number of Americans during the covered period," and the SBA could not exclude the plaintiffs from receiving PPP loans. 459 F. Supp. 3d 943, 958.

Recently, on December 22, 2020, the Eleventh Circuit ruled that Chapter 11 debtors were ineligible for PPP loans and the SBA has the authority to deny such loans. See *USF Fed. Credit Union v. Gateway Radiology Consultants, P.A.*, No. 20-13462, 2020 WL 7579338, *16 (11th Cir. Dec. 22, 2020) ("The SBA did not exceed its authority in adopting the non-bankruptcy rule for PPP eligibility. That rule does not violate the CARES Act, is based on a reasonable interpretation of the Act, and the SBA did not act arbitrarily and capriciously in adopting the rule."). By this ruling, the Eleventh Circuit joined the Fifth Circuit, which found that a bankruptcy court exceeded its authority by ordering the SBA to consider debtor's PPP loan application without consideration of its ongoing bankruptcy case. See *Hidalgo Cnty. Emergency Servs. Found. v. Carranza (In re Hidalgo Cnty. Emergency Servs. Found.)*, 962 F.3d 838 (5th Cir. 2020).

Unfortunately, while the recent CAA 2021 addresses PPP loans, it does not seem to resolve the confusion surrounding bankruptcy debtors' eligibility for PPP loans. While it remains to be seen how courts will rule on the issue of a debtor's eligibility for PPP loans and the new provisions in the CAA 2021, that law appears to provide the SBA more discretion to approve PPP loans to certain debtors. CAA 2021 allows the SBA to submit a written determination to the Director of the Executive Office for the U.S. Trustee regarding the debtor's eligibility for PPP.

Our clients should be aware of the differing views of whether the nature of a business will render it ineligible for PPP loans or whether the business will be disqualified from receiving PPP loans if it is a Chapter 11 debtor.

In addition to the PPP provision referenced above, the CAA 2021 amends and expands upon prior COVID-19 legislation and it addresses many issues brought to the courts' attention this year. Most of the CAA 2021 amendments to the Bankruptcy Code will expire in either one or two years after its enactment. Among the highlights of the CAA 2021 are the following:

Allowing businesses to deduct from taxable income expenses funded with the proceeds of PPP loans, such as payroll costs, covered operations expenses, payment on rent or mortgage, utility payments, and supplier costs. Expanding PPP assistance to businesses and allowing certain entities employing 300 or fewer employees (500 or fewer for "accommodation and food service employers"), to apply for PPP second draw loans ("PPP2") if there was at least a 25% reduction in gross receipts in any quarter of 2020 compared to that same quarter in 2019, and if the business already used the full amount of the original PPP prior to the disbursement of the PPP2.

Exempting certain coronavirus relief payments from being treated as "property of the estate" pursuant to Section 541 of the Bankruptcy Code.

Providing for certain creditor claims arising out of forbearance agreements set forth by the CARES Act, which amends Sections 501, 502 and 1329 of the Bankruptcy Code.

Amending "preferential transfers" pursuant to Section 547 of the Bankruptcy Code to prevent payments deferred by a debtor on or after March 13, 2020 from being recovered, so long as the deferred payments do not exceed an amount the debtor would have owed without the deferral.

As these are relatively new issues which continue to evolve in these unprecedented times of the COVID-19 pandemic, we expect that future case law will address many of the issues discussed above. We will continue to follow the progress of how the law advances and issue future alerts on relevant developments.

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