WRITTEN DECISION - NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT

SOUTHERN DISTRICT OF CALIFORNIA

In re Vestavia Hills, Ltd dba Mount Royal Towers, Debtor.	Bankruptcy No. 20-00018-LA11 Adversary No. 20-90073-LA
Vestavia Hills, Ltd., dba Mount Royal Towers, Plaintiff, v. The U.S. Small Business Administration, and Jovita Carranza, solely as the Administrator of The U.S. Small Business Administration, Defendant.	MEMORANDUM DECISION

I.

INTRODUCTION

On June 25, 2020, the Court held a hearing on the emergency motion of plaintiff, Vestavia Hills, Ltd. ("Plaintiff" or "Debtor") for a preliminary injunction against defendants, The United States Small Business Administration ("SBA") and Jovita Carranza, solely in her capacity as the Administrator of the SBA (collectively the "SBA"). The SBA has opposed the motion. For the reasons more fully stated herein, the motion is GRANTED.

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II.

PROCEDURAL BACKGROUND

On May 27, 2020, Plaintiff commenced this adversary proceeding against the SBA for injunctive relief and a declaratory judgment. A few days later it filed an emergency motion for a temporary restraining order ("TRO") and for a preliminary and permanent injunction. Like many other debtors across the nation, Plaintiff filed this action and the emergency motion because the SBA denied its application to obtain funding under the Paycheck Protection Program ("PPP") of the Coronavirus Aid Relief, and Economic Security Act (the "CARES Act")[1] solely because it is a debtor in a pending bankruptcy case.

The complaint pleads a claim for a preliminary and permanent injunction, and a claim for declaratory relief. The claims are two-fold. Plaintiff alleges that:

(1) It has the legal right to apply for a PPP loan and have its application considered on the same terms as other applicants without regard to its status as a chapter 11 debtor, as set forth in 11 U.S.C. § 525(a); and

(2) The SBA's First and Fourth Interim Final Rules ("First IFR; Fourth IFR") and subsequent denial of its application were "arbitrary and capricious" in violation of 5 U.S.C. § 706(2)(A) and exceeded the SBA's authority under the CARES Act in violation of 5 U.S.C. § 706(2)(C).

Specifically, the complaint and emergency motion seek a preliminary and permanent injunction,[2] directing the SBA to change the PPP application form for Plaintiff to remove all questions about its status as a debtor in a bankruptcy case; and prohibiting use of the Plaintiff's status as a chapter 11 debtor as a reason to reject its PPP application if it is otherwise qualified as a business eligible for the PPP funds. The emergency motion argues

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[1] *See* CARES Act, P.L. 116-136, 134, Stat. 281 (enacted March 27, 2020), § 1102, amending the SBA's existing Section 7(a) loan program, as codified in 15 U.S.C. § 636(a), by adding new paragraph (36) creating the PPP loan program in the Small Business Act.

[2] Plaintiff's initial request for a temporary restraining order was merged into its request for a preliminary injunction upon stipulation with the SBA permitting additional time for briefing. [ECF No. 18]

that expedited relief is necessary because applications for PPP funding will cease to be considered after June 30, 2020.

The parties agreed that in light of their earlier stipulation to set aside the PPP funds, the June 25, 2020 hearing would proceed as a hearing on Plaintiff's motion for preliminary injunction.

III.

FACTUAL BACKGROUND

A. Plaintiff's Chapter 11 Case and Need for Postpetition Funding.

The Plaintiff, Vestavia Hills, Ltd., doing business as Mount Royal Towers, is the fee owner of real property located at 300 Royal Tower Drive, Vestavia Hills, Alabama 35209 ("Mt. Royal Towers Facility" or "Facility"), at which it has operated a senior housing community for nearly thirty years. The Facility includes a 143-bed skilled nursing facility, a 98-bed assisted living facility, a 113-bed specialty care assisted living facility and a 150-bed independent living facility. Currently, it houses approximately 148 residents and employs approximately 150 people to care for the residents and maintain the Facility.

On January 3, 2020, Plaintiff filed a voluntary chapter 11 bankruptcy case and continues to operate its business as a debtor in possession. Plaintiff's first day motions included a request for authority to obtain postpetition unsecured financing from its limited partners ("DIP Loan"). [Main Case ECF No. 15] Plaintiff's stated goal in filing this reorganization case was to sell substantially all of its assets (the Facility) as a going concern in order to yield the highest and best price. Plaintiff had historically operated at a monthly cash deficit and did not foresee that changing during this case. Plaintiff needed the DIP Loan to preserve its going concern value and operate while it solicited and obtained a buyer for the Facility and closed the sale. Further, it explained that closing its sale and transferring ownership would not occur immediately upon sale because the successful bidder at the auction sale was required to obtain regulatory licenses and approvals to operate the Facility.

Plaintiff would need DIP funds to continue to operate the Facility until closing. The Court approved the DIP loan.

In early March, Plaintiff obtained approval of its stalking horse bidder and auction procedures for its § 363 sale and set the motion to approve the sale for mid-May 2020. Then COVID-19 hit. This worldwide pandemic severely impacted Plaintiff's business by diminishing its ability to accept new residents, impacting its workforce, increasing the costs of doing business due to mandatory social distancing and stay at home orders, and prohibiting outside visitors. The pandemic also affected the progress of its § 363 sale. Plaintiff requested and the Court has granted its mid-May request to amend its auction procedures and delay the auction sale until late July because of the challenges posed by attempting to market and sell a Facility that no one can physically inspect. This delay has imposed additional demand for DIP funding by the limited partners.

On May 4, 2020, Plaintiff applied to Comerica Bank for a PPP loan in the amount of $1,138,100. Plaintiff intended to use the PPP loan to pay its payroll costs, utilities, and mortgage interest expenses as allowed by the PPP; and, upon maturity, to apply for forgiveness as a grant. Plaintiff submits it has ample qualifying expenses to qualify for full loan forgiveness. Plaintiff needs to use the PPP loan for these permissible expenses to avoid drawing down further on its diminishing DIP funding so it can move forward and close its sale. However, on May 6, 2020 Comerica Bank rejected Plaintiff's PPP loan application. The sole reason Comerica gave for Plaintiff's rejection was that Plaintiff truthfully answered "yes" to the question on the PPP application, asking if Plaintiff was presently involved in a chapter 11 bankruptcy. [ECF No. 5-2 (Moriarty Decl. ¶ 20)] This adversary proceeding and emergency motion followed.

B. <u>The CARES Act and PPP Loan Program</u>

In response to the COVID-19 pandemic, Congress enacted, and the President signed into law on March 27, 2020, the CARES Act. Section 1102, of the CARES Act created the PPP by amending "Section 7(a) of the Small Business Act (15 U.S.C. § 636(a))" to add new

subparagraph (36). *See* CARES Act § 1102; 15 U.S.C. § 636(a)(36). The PPP provides that an eligible small business may obtain a guaranteed loan to cover certain expenses, including "payroll costs," "interest on any mortgage obligation," "rent," and "utilities." CARES Act § 1102(a)(2); 15 U.S.C. § 636(a)(36)(F)(i). Plaintiff has stated without contradiction that it intends to use the PPP funding precisely for these purposes. To obtain a PPP loan, the borrower must certify that: (i) economic uncertainty makes the loan necessary, (ii) the funds will be used for payroll and other authorized uses; (iii) the applicant does not have a duplicative application pending; and (iv) the applicant has not already received a PPP loan. CARES Act § 1102(a)(2); 15 U.S.C. § 636(a)(36)(G).

The CARES Act provides that PPP loans may be forgiven under certain circumstances, but forgiveness is not automatic. CARES Act § 1106. To receive forgiveness of a PPP loan, the borrower must submit an "application" for forgiveness to the lender servicing the PPP loan along with certain certifications regarding how PPP funds were spent. CARES Act § 1106; 15 U.S.C. § 9005(e).

The CARES Act also granted to the SBA, "emergency rulemaking authority" over the PPP, directing the Administrator to issue regulations to carry out the program without regard to typical notice requirements. CARES Act § 1114; 15 U.S.C. § 9012; *see also* 15 U.S.C. §§ 633(a), (b)(1)(7)(placing management of the SBA in the hands of the Administrator); *see also* 15 U.S.C. § 633(d)(the SBA shall "establish general policies … which shall govern the granting and denial of application for financial assistance by the SBA.").

Although the PPP is part of the SBA's Section 7(a) loan program, a PPP loan differs from other Section 7(a) loans in certain respects. *See* CARES Act § 1102(a)(2); 15 U.S.C. § 636(a)(36)(D)-(R). For example, a PPP loan can be made to "any [small] business concern," non-profit organization and other organization or business concern that qualifies as small under industry-specific rules. *See* 15 U.S.C. § 636(a)(36)(D)(i).

The PPP loan underwriting criteria also differs. For regular Section 7(a) loans, the SBA "will consider" several factors to reasonably assure payment, including credit history, strength of business, ability to repay the loan, and even bankruptcy history. 13 C.F.R. § 120.150. *See e.g.,* SOP 50-10-5 K, p. 180 (available at www.sba.gov/document/sop-50-10-5-lender-development-company-loan-programs). However, in administering the PPP, the SBA eliminated Section 7(a)'s typical underwriting guidelines, including a creditworthiness check. *See* First Interim Final Rule ("First IFR"), 85 Fed. Reg. 20811-01 at Art. III § 1 (April 15, 2020)(stating the PPP lending procedures are "streamlined" so the "SBA will not require lenders to comply with [13 C.F.R. §], 120.150," which sets forth SBA underwriting requirements such as a creditworthiness check, necessary to ensure "sound value"); see also First IFR at Art. III § 2(a)-(c); Art. III § 2(t); and Art. III § 3(b) (collectively these sections confirm the typical SBA underwriting guidelines, including a creditworthiness check, do not apply to a PPP loan). Further, the CARES Act expressly waives Section 7(a) of the Small Business Act's requirement for collateral or a personal guarantee to obtain the PPP loan. CARES Act § 1102(a)(2); 15 U.S.C. § 636(a)(36)(J).

At the time Plaintiff applied for the PPP loan, the SBA had issued four interim final rules ("IFR") for the PPP. The First IFR, described above, addresses PPP eligibility and the minimal lending requirements for a PPP loan. It does not address the topic of bankruptcy, but requires the applicant to "submit SBA Form 2438 (Paycheck Protection Program Application Form)." That form requires a borrower to certify, among other things, that the applicant is not "presently involved in any bankruptcy." 85 Fed. Reg. 20811, Art. III. § 2(q). There is no explanation for the certification requirement in the First IFR.

The Second and Third IFRs explain other rules and procedures, but they do not address the topic of bankruptcy. See 85 Fed. Reg. 20817 (April 15, 2020); 85 Fed. Reg. 21747-1 (April 20, 2020). The Fourth IFR was issued on April 24, 2020 and, for the first time, bankruptcy is addressed. The Fourth IFR provides:

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4. Eligibility of Businesses Presently Involved in Bankruptcy Proceedings

Will I be approved for a PPP loan if my business 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 any time before the loan is disbursed, the applicant is ineligible to receive a PPP loan ….

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 ….

85 Fed. Reg. 23450, Art. III § 4 (April 28, 2020). Therefore, the Fourth IFR explicitly provides that a borrower presently involved in a bankruptcy proceeding is "ineligible" to participate in the PPP.

If a PPP loan is approved, the lending institution and applicant must execute a promissory note, and the PPP funds are disbursed by the lending institution. The SBA does not directly loan the funds; it is the loan guarantor. A separate loan forgiveness application must be submitted to the lender for forgiveness.

The CARES Act initially allocated $349 billion to the PPP, but these funds were promptly exhausted. Thereafter, Congress passed, and the President signed into law, the Paycheck Protection Program and Health Care Enhancement Act ("CARES Act II") that allocated another $310 billion for PPP loans. See P.L. No. 116-139, 134 Stat. 620 (enacted April 24, 2020), § 101(a)(1). The Debtor applied for the PPP funds allocated by the CARES Act II, which are also available on a first come first serve basis.

IV.

JURISDICTION

Pursuant to 28 U.S.C. § 1334(b) and the district court's order of reference, this Court has subject matter jurisdiction over all civil proceedings arising under title 11 or arising in

or related to cases under title 11. Subject to Constitutional limits, this Court can enter a final order on "core" bankruptcy claims. 28 U.S.C § 157(b). For "non-core" claims, the Court cannot enter a final order unless all parties consent. 28 U.S.C. § 157(c).

The complaint pleads that the SBA, by declaring the Debtor ineligible for PPP funds solely because it is in a chapter 11 bankruptcy, has violated 11 U.S.C. § 525(a); and it violated §§ 706(2)(A) and (C) of the Administrative Procedures Act ("APA"). The § 525(a) claim arises under title 11 and is "core." There is no doubt that the Court can enter a final order on this claim.

The APA claims are also statutorily "core" per 28 U.S.C. §§ 157(2)(A), (D) and (O). These APA claims fall within the Court's "arising in" jurisdiction, over which the Court may enter a final order, because these particular APA claims involve a dispute that could not have arisen but for Plaintiff's bankruptcy case. *See Harkey v. Grobstein (In re Pointe Center Financial, Inc.)*, 957 F.3d 990, 998 (9th Cir. 2020)(citing *Stern v Marshall*, 564 U.S. 462, 473-74 (2011)).

V.

LEGAL ANALYSIS

A. Sovereign Immunity

The Court must first consider a threshold issue as to whether the SBA enjoys sovereign immunity or whether the agency can be enjoined.

When Congress created the SBA, it narrowed its sovereign immunity, permitting the SBA to "sue and be sued." 15 U.S.C. § 634(b)(1). However, Congress carved out a caveat to the "sue and be sued" language, which provided that "no attachment, *injunction*, garnishment, or other similar process ... shall be issued against the Administrator." *Id.* (emphasis added). Section 634(b) is not as unambiguous as it may initially seem. In fact, courts are split over the scope of the "no injunction" language. Some courts hold that § 634(b)(1) bars injunctions in all circumstances;[3] while other courts hold that the statute

[3] *See*, e.g., *Hidalgo County Emergency Service Foundation v. Jovita Carranza, U.S. Small Business Administration (In re Hidalgo County Emergency Service Foundation)*, 2020 WL 3411190, at *1-2 (5th Cir. June 22, 2020)(recognizing

does not bar a court from enjoining an agency that exceeded its statutory authority. *In re Gateway Radiology Consultants, P.A.*, Adv. No. 8:20-ap-00330-MGW, 2020 WL 3048197, at *7-9 (Bankr. M.D. Fla. June 8, 2020)(citing *DV Diamond Club of Flint, LLC v. U.S. SBA*, No. 20-cv-10899, 2020 WL 2315880, at *3-4 (E.D. Mich. May 11, 2020) ("Court is persuaded that injunctive relief is available to Plaintiffs [because] ... Plaintiffs here seek only to 'set aside unlawful agency action'."); *Camelot Banquet Rooms, Inc. v. U.S. SBA*, Nos. 20-C-0601, 20-C-634, 2020 WL 2088637, at *3-4 (E.D. Wis. May 1, 2020). Still, most courts recognize that an injunction may not be issued against a governmental unit, where doing so interferes with agency functioning. See *Gateway Radiology*, 2020 WL 3048197, at *8-9 (citing *Ulstein Maritime, Ltd. v U.S.*, 833 F.2d 1052, 1056 (1st Cir. 1987)(recognizing that Congress added the "no attachment" language in § 634(b)(2) to bar "other interference with agency functioning," not to broaden the SBA's immunity)). To date, the Ninth Circuit Court of Appeals has no binding precedent addressing this issue.

This Court adopts the latter view that the SBA cannot invoke sovereign immunity to avoid judicial review of unlawful agency actions. Enjoining the SBA for exceeding its statutory authority or acting arbitrarily and capriciously in its administration of the PPP does not interfere with agency functioning. It merely requires the SBA to function within the parameters created for it by Congress.

B. Standard for Preliminary Injunctions

A preliminary injunction is an "extraordinary and drastic remedy" that "may only be awarded upon a clear showing that the plaintiff is entitled to such relief." *Winter v. Nat. Res. Def. Council, Inc.*, 555 U.S. 7, 22 (2008); *Garcia v. Google, Inc.*, 786 F.3d 733, 740 (9th Cir. 2015). To obtain a preliminary injunction, the plaintiff must show that: (1) it is likely to succeed on the merits; (2) it is likely to suffer irreparable harm in the absence of preliminary relief; (3) the balance of equities, tips in its favor; and (4) that an injunction is in the public

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that the Fifth Circuit has "concluded that all injunctive relief directed at the SBA is *absolutely prohibited*"(emphasis in original).

interest. *Garcia,* 786 F.3d at 740. The last two factors "merge when the Government is the opposing party." *Nken v.* Holdeer, 556 U.S. 418, 535 (2009).

The Ninth Circuit also employs a "serious questions" approach that weighs the first two factors on a sliding scale. See *Alliance For The Wild Rockies v. Cottrell*, 632 F.3d 1127, 1134-35 (9th Cir. 2011)(explaining that a preliminary injunction may issue where the plaintiff shows there are: "serious questions going to the merits" and the balance of hardships tips sharply in its favor, provided the other elements are also met). However, the "serious questions" approach is unworkable where (as here) the plaintiff is seeking a mandatory injunction -- *i.e.,* an order directing the defendant to act, as opposed to preserving the status quo. The Ninth Circuit has instructed that a plaintiff seeking a mandatory injunction must show a *clear* likelihood to succeed on the merits, not just that it is likely to succeed. *Garcia*, 786 F.3d at 740; *P.P. v. Compton Unified Sch. Dist.*, 135 Supp. 3d 1126, 1135 (C.D. Cal. 2015).

C. Likelihood of Success on Merits

Plaintiff asserts three grounds to support its request for a preliminary injunction. First, Plaintiff states that the SBA Administrator exceeded her authority in promulgating the First and Fourth IFR. Second, Plaintiff states that the SBA's promulgation of First and Fourth IFR is arbitrary and capricious. Lastly, Plaintiff states that the First and Fourth IFR violate 11 U.S.C. § 525(a). The Plaintiff has demonstrated a *clear* likelihood of success on the first two grounds, but will not clearly succeed on the third ground regarding a violation of 11 U.S.C. § 525(a).

1. The SBA's First and Fourth IFR exceeded its authority, in violation of § 706(2)(C) of the APA.

Section 706(2)(C) of the APA requires a court "hold unlawful and set aside agency action, findings, and conclusions found to be ... in excess of statutory jurisdiction, authority, or limitations." 5 U.S.C. § 706(2)(C). The Ninth Circuit set out a three-step inquiry for reviewing an agency's interpretation of a statute that the agency is entrusted to administer:

(1) Whether Congress intended the agency be able to speak with the force of law when it addresses ambiguity in the statute.

(2) Whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter, and the Court and agency must give effect to the unambiguous intent of Congress.

(3) However, if the statute is silent or ambiguous as to the issue at hand, the court defers to the agency's reading so long as its interpretation is reasonable.

See Alaska Wilderness League v. Jewell, 788 F.3d 1212, 1217 (9th Cir. 2015)(recognizing that the inquiry is narrow, and a court should not substitute its own judgment for that of the agency). The multi-step inquiry is known as *Chevron* deference. *Bahr v. U.S. Environmental Protection Agency*, 836 F.3d 1218, 1229-30 (9th Cir. 2018).

However, not all statutory interpretations are entitled to *Chevron* deference. The Supreme Court has recognized that in "extraordinary cases," courts should not assume that Congress implicitly delegated authority to the agency to fill in the statutory gaps." *See In re Gateway Radiology*, 2020 WL 3048197, at *10 (citing to *King v. Burwell*, 135 S. Ct. 2480, 2488 (2015), as an example of when the court need not apply *Chevron* deference to the agency's interpretation to fill in gaps).

In *King v. Burwell*, the Supreme Court considered a challenge to the Affordable Care Act, which provided tax credits to taxpayers to buy insurance plans. *King*, 135 S. Ct. at 2488-89. The Supreme Court ultimately found that whether credits were available on federal exchanges was a "question of deep 'economic and political significance' that [was] central to [the] statutory scheme" because the availability of credits involved billions of dollars in spending each year and affected the price of health insurance for millions of people. *Id.* at 2489. Because of this, the Supreme Court concluded that *King* was one of those "extraordinary cases" where it would decline to give the IRS's statutory interpretation *Chevron* deference. *Id.* at 2489. It stated that "had Congress wished to assign that question to an agency, it surely would have done so expressly." *Id.*

Likewise, the PPP involves billions of dollars in loans to assist millions of small businesses, and their employees, in financial distress due to the COVID-19 pandemic. This Court agrees with the analysis and conclusion in *Gateway Radiology* that it is not likely Congress intended to delegate interpretation of the PPP's eligibility requirements to the SBA, given the program's "economic and political significance." *Gateway Radiology*, 2020 WL 3048197, at *11. Therefore, the CARES Act presents an "extraordinary case" where courts may determine the correct reading of the statute. *Id.*

The Court's analysis must begin with the language of the CARES Act itself. If the language is clear and unambiguous, it must enforce the statute according to its terms. *Id.* at *11; *see also Bahr v. U.S. Environmental Protection Agency*, 836 F.3d 1218, 1230 (9th Cir. 2016). This Court finds the analysis in *Gateway Radiology* compelling. That court examined: The context of the CARES Act; the PPP's place in the overall statutory scheme; and the language of the CARES Act itself. *Gateway Radiology*, at *11. After a careful examination, that court concluded that a plain reading of the CARES Act, and the PPP therein, does not preclude debtors in bankruptcy from participation in the PPP. *Id.* at *12.

There is nothing in the PPP insisting that lenders determine whether a borrower is in bankruptcy before approving a PPP loan, or requiring a borrower to certify it is not involved in a bankruptcy proceeding to obtain a PPP loan. The Court agrees that Congress' silence ought to be conclusive that it did not intend to exclude an entire class of small businesses – chapter 11 debtors – from participating in the PPP. *Id.*

The SBA argues that Congress' silence about bankruptcy in the PPP justifies adding this additional eligibility to the PPP. It points out that Congress enacted the PPP, not as an entirely new loan program, but by adding the PPP to the SBA's preexisting § 7(a) loan program which considers a debtor's bankruptcy filing history as an underwriting requirement. The SBA's argument is not convincing because the SBA itself states in its First IFR that it "will not require the lenders to comply with section 120.150['s]," typical underwriting requirements. Instead, the SBA stated it will "allow lenders to rely on

certification of the borrower in order to determine eligibility." *See* 85 Fed. Reg. 20811, Art. III § 3(c); *see also* Art. III § 3(b)(listing only five actions a lender must take to underwrite a PPP loan, none of which consider bankruptcy history or require a determination of creditworthiness).

Had Congress intended to disqualify a debtor in bankruptcy from eligibility for a PPP loan, it knew how to do so expressly. This is evident because the CARES Act expressly disqualifies a debtor in bankruptcy from "eligibility" to participate in a different loan program for "mid-sized businesses" operated by the Treasury Department, created under title IV of the CARES Act. See CARES Act § 4003(c)(3)(D)(V).[4] Congress' silence respecting PPP loans -- which are forgivable -- is telling.

The Court concludes that the SBA's exclusion of debtors in bankruptcy from eligibility for a PPP loan is contrary to the plain language of the PPP, and Congress' clear intent in enacting the program. It is clear the SBA exceeded its authority in promulgating the First and Fourth IFR.

2. The SBA acted arbitrarily and capriciously when it promulgated the First and Fourth IFR, in violation of § 706(2)(A) of the APA.

Section 706(2)(A) of the APA requires a court set aside agency action, findings, and conclusions found to be arbitrary and capricious. 5 U.S.C. § 706(2)(A). An agency rule is "arbitrary and capricious" if (i) the agency relied on factors Congress did not intend it to consider; (ii) the agency failed to consider an important aspect of the problem; (iii) the agency's explanation runs counter to the evidence before it; and (iv) the agency's explanation is so implausible that it could not be ascribed to a difference in view or the product of agency expertise. *Motor Vehicles Mfrs. Ass'n of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). Typically, this standard is deferential to the agency; however, no such deference is given to an action taken without statutory authority. See *In re*

[4] This "mid-size business" program is a true loan program because these loans cannot be forgiven. *See Gateway Radiology*, at *12; *see also* CARES Act § 1106 (confirming only the PPP loan can qualify for loan forgiveness). Thus, it makes sense that Congress would require a borrower to certify it is not in bankruptcy to be eligible for a true loan. *Id.*at *12.

Roman Catholic Church of the Archdiocese of Santa Fe, Adv. No. 20-1026 t, 2020 WL 2096113, *5 (Bankr. D. N.M. May, 1 2020)(citing *Util. Air. Regulatory Group v. E.P.A.*, 573 U.S. 302, 321 (2014); see also *In re Gateway Radiology*, 2020 WL 3048197, at *13.

The Supreme Court recently reiterated its holding in *Motor Vehicles Mfrs. Ass'n of the U.S.*, and shed additional light on the "arbitrary and capricious" standard, recognizing that the agency must provide a reasoned explanation for the manner in which it administers a program. *See Department of Homeland Security v. Regents of The Univ. of Cal.*, _ S.Ct. _, 2020 WL 3271746, *3 (June 18, 2020)(recognizing that an agency is not required to consider all policy alternatives in reaching its decision but should consider "reliance interests").

Here, the SBA appears to base its "bankruptcy exclusion" decision on the notion that debtors in bankruptcy present an unacceptably high risk of using funds for non-covered expenses or nonpayment of unforgiven loans. The SBA relies on the "sound value" requirement of § 636(a)(6) of the Small Business Act to warrant that decision. 15 U.S.C. § 636(a)(6)(requiring "such sound value ... as reasonably to assure repayment."). However, in doing so, the SBA relies on a factor Congress did not intend it to consider (collectability); and ignores the very purpose of the PPP program.

Congress requires no collateral or a personal guarantee to obtain a PPP loan, and Congress structured the PPP loans to be completely forgivable so long as the borrower uses the loan proceeds for covered expenses and provides documentation of such to its lender. Further, Congress delineated only two underwriting factors that SBA lenders should consider when making PPP loans, neither of which concern collectability: (1) Was the borrower operating on February 15, 2020; and (2) Did the borrower have employees for whom it paid salaries and payroll taxes, or independent contractors. *See* CARES Act § 1102(a)(2); 15 U.S.C. § 636(F)(ii)(II). At no point has Congress directed the SBA or SBA lenders to consider collectability, or more specifically, whether a borrower is in bankruptcy. In considering collectability, the SBA considered a factor that Congress did not intend it to

consider. Therefore, the SBA's preclusion of debtors in bankruptcy from PPP participation is arbitrary and capricious.

It is worth noting that the SBA's § 636(a)(6) argument contradicts its own regulations. The SBA's First IFR excuses lenders from complying with 13 C.F.R. § 120.150, thereby eliminating the typical underwriting requirements, including creditworthiness checks, under § 7(a) of the Small Business Act. *See* 85 Fed. Reg. 20811, Art. III § 3(b)(iv)(II)("Each lender's underwriting obligation under the PPP is limited to the items [in this IFR] and reviewing the "Paycheck Protection Application Form."). In fact, the First IFR specifically defines parties eligible to participate in the PPP and at no point disqualifies debtors in bankruptcy from eligibility. It is not until the Fourth IFR that the SBA disqualifies debtors in bankruptcy from participation in the PPP. The SBA's reliance on § 636(a)(6) appears to be an after-the-fact justification for its arbitrary and capricious rule.

Not only did the SBA consider a factor it should not have considered (collectability), it failed to consider a factor it should have considered: The protections afforded by the chapter 11 bankruptcy process. A debtor in chapter 11 bankruptcy must give notice to interested parties where it intends to borrow money outside the ordinary course of business. If the bankruptcy court permits the debtor to borrow money, the court can impose conditions on the debtor's doing so such as restricting use of the loan proceeds. Moreover, debtors are required to file monthly operating reports detailing the debtor's receipts and disbursements. Those reports are carefully examined by professionals at the U.S. Trustee's Office and are typically available for creditors to scrutinize. The foregoing reduces the risk that a chapter 11 debtor will use PPP proceeds for non-covered expenses. In contrast, there is an utter lack of safeguards for PPP loans to borrowers not in bankruptcy, further underscoring the flimsiness of the SBA's *ad hoc* justification for excluding chapter 11 debtors from participation in the PPP.

Given the foregoing, the SBA's exclusion of Plaintiff from participation in the PPP is clearly illogical and arbitrary and capricious.

3. The PPP is a loan; it does not qualify as an "other similar grant" protected from discrimination under 11 U.S.C § 525(a).

Bankruptcy Code § 525(a) provides, in relevant part, that a "governmental unit may not deny ... a license, permit, charter, franchise, or other similar grant to" a bankruptcy debtor. The only consideration then is whether PPP disbursements qualify as a "similar grant," protected from discrimination under § 525(a).

The words "license," "permit," "charter," and "franchise" are not defined in the Bankruptcy Code. The critical terms must be evaluated in light of their meanings when used in the governmental context. *In re Penobscot Valley Hospital*, Adv. Nos. 20-1005, 20-1006, 2020 WL 3032939, at *10 (Bankr. D. Me. June 3, 2020). "Each of the enumerated [terms] is a type of grant from a governmental actor that involves some permission of the holder of the grant to act in a particular way." *Penobscot Valley*, 2020 WL 3032939, *10 (recognizing a driver's license is a permission to operate a motor vehicle on public roads). Although the term "grant" is not defined in the statute, the use of the word "similar" limits the universe of grants to which § 525(a) applies. *Id.* at *12. In other words, the phrase "or other similar grant," is limited to grants bearing a family resemblance to licenses, permits, charters, and franchises. *Id.* While several courts have struggled to define "grants" in this context, the ultimate purpose of § 525(a) is to prohibit the government from erecting barriers to the realization of a debtor's fresh start solely because the debtor entered bankruptcy. *Id.* at *11; *see also Schuessler v. United States Small Business Administration*, Adv. Nos. 20-02065-bhl, 20-02068-bhl, 20-02069-bhl, 2020 WL 2621186, at *8 (Bankr. E.D. Wis. May 22, 2020)(recognizing that three of the four circuits that have decided the issue have narrowly interpreted the application of § 525(a) and found that it does not apply to government loan programs). This section does not apply to a loan because, "in general, a party cannot be forced to make a loan to a debtor" in bankruptcy. *Penobscot Valley*, at *11.

Here, Plaintiff contends that because the PPP loan is fully forgivable, it operates as a "grant." That is an incorrect interpretation of the statute because the term "grant" under § 525(a) does not refer to an "economic grant."[5] Rather, the phrase "or other similar grant" refers to the family of terms listed under § 525(a). Moreover, it cannot be said that denial of access to PPP disbursements inhibits the Debtor's access to a fresh start in the same manner contemplated by § 525(a)(*e.g.*, by limiting access to employment or a driver's license only obtainable from the government). The Court concludes that this claim is not likely to succeed.

D. Irreparable Harm and Balance of the Equities

This requirement is met. The deadline to apply for PPP funding is June 30, 2020, after which Plaintiff's application for a PPP loan will no longer be considered. Plaintiff operates an elderly resident care center and employs about 150 people to provide essential services for the population residing at its Facility. The crux of Plaintiff's bankruptcy is completion of a 11 U.S.C. § 363 sale of the Facility as a going concern. However, the effects of COVID-19 have required Plaintiff to delay that sale, consequently causing Plaintiff to incur the additional costs to continue operating until the extended sale date and delayed closing date. Plaintiff cannot continue to operate or provide essential services to its at-risk population without the PPP funds.

In contrast, enjoining the SBA to delete its preclusion of debtors in bankruptcy from its IRFs simply requires the SBA to act within its statutory authority. The Court can identify no harm that may befall the SBA by requiring it to operate within its statutory authority.

E. Public Interest

This requirement is met. While the public has an interest in allowing agencies to exercise statutory authority in administering governmental programs, the expectation is that the agency operate *within* that statutory authority. As discussed above, the SBA has

[5] *C.f.* 11 U.S.C. § 525(c)(barring discrimination by governmental agencies for economic grants that operate as "a student grant or student loan program"). There would be no need for subsection (c) if economic grants are already covered by subsection (a).

improperly exceeded its statutory authority in precluding Plaintiff, and other debtors in bankruptcy, from participating in the PPP. Enjoining the SBA from continuing to preclude the Debtor's participation only furthers Congress' objective in passing the CARES Act: To provide emergency assistance for financially distressed businesses affected by the COVID-19 pandemic.

VI.

CONCLUSION

The Plaintiff has met its heightened burden of establishing entitlement to a preliminary injunction on the APA claims. When an administrative agency sets policy, it must provide a reasoned and weighed explanation for its action that is in line with Congressional intent. The SBA's reasoning here was anything but reasoned. Instead, its exclusion of chapter 11 debtor's from participation in the PPP is arbitrary and capricious and it runs counter to clear Congressional intent, in excess of the SBA's statutory authority and in violation of 5 U.S.C. §§ 706(2)(A) and (C).

This Court enjoins the SBA from enforcing its IFRs to the extent that they preclude Plaintiff from participation in the PPP on the sole basis of its status as a chapter 11 debtor in bankruptcy. The Court will enter its own preliminary injunction order.

DATED: JUN 26 2020

Louise DeCarl Adler

LOUISE DE CARL ADLER, JUDGE
United States Bankruptcy Court

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