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PPP Loans: Creative Solutions that Helped Us Navigate the Federal Stimulus Program



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While the headlines have been replete with coverage of the Coronavirus Aid, Relief and Economic Security (CARES) Act and its Paycheck Protection Program (PPP) loans,¹ the same cannot be said about the impact of the program on the interests of unsecured creditors of PPP borrowers. This lack of attention is unfortunate, as the PPP loan program had a meaningful effect on the creditor experience, as well as borrowers' balance sheets.

On May 4, 2021, and within a few weeks of the intended expiration of the program, the SBA advised that of the \$292 billion allocated to the current round of PPP loans, almost all of the funds had been spent. As a result, no new applications for general PPP borrowing were being accepted. Since the beginning of the PPP lending program, more than \$780 billion was dispersed in response to more than 10.7 million applications.²

In a bankruptcy context, if a debtor had been able to procure access to PPP funds, (1) a debtor's secured lenders might not have the same leverage and control over case goals or its milestones; (2) going-concern sales are more likely to occur than liquidation sales; (3) a PPP loan was treated only as a pre-petition unsecured claim that can be

repaid pursuant to a plan alongside other similarly situated creditors;³ and (4) if the debtor is able to navigate the PPP requirements, the obligations incurred by borrowing PPP funds might be forgiven entirely, bringing meaningful liquidity to an estate without a repayment obligation.

Unsecured creditors should have been enthusiastic about PPP borrowings in a bankruptcy context, as PPP-created liquidity had a positive impact on both the debtor's and creditor's bottom line. While a debtor, seeking to have PPP borrowings forgiven by the SBA, had to use such funds only to meet payroll, utility or rent obligations, access to PPP funds even on such a restricted basis created immediate liquidity to assist with the funding of a debtor's overall operations. Payroll, utilities and rent are major expenses for almost every business. With those expenses covered by a PPP loan, debtors would have newfound liquidity to meet their other obligations: repaying past-due invoices, purchasing new inventory, paying suppliers and equipment vendors, retaining independent contractors, satisfying insurance obligations without the necessity of financing and/or paying professionals to assist with the debtor's economic distress, or otherwise simply providing optionality to exit the restructuring process. A debtor could use its liquid, non-PPP funds to directly continue its business operations.

While the PPP loan program was designed to cover payroll and other ongoing expenses, there was

¹ As has been well covered, on March 27, 2020, the CARES Act was enacted, establishing, among other things, the PPP, which was to be administered by the Small Business Administration (SBA). The CARES Act established minimal rules through which small businesses could obtain unsecured loans in an amount up to the lesser of \$10 million or 2.5 times the applicant's average monthly payroll to fund payroll, mortgages, rent and PPP utilities. The PPP loans did not have fees attached, and the interest and principal obligations on the loans were deferred for six months. It was also possible that the full amount of PPP loans would be forgiven if the small business borrower maintained its pre-COVID levels of employment and wage levels, and if the small business borrower managed to follow all of the rules that would be fully fleshed out after the money was gone.

² Stacy Cowley, "The Paycheck Protection Program Is Out of Money," *New York Times* (May 4, 2021), available at [nytimes.com/2021/05/04/business/paycheck-protection-program-closes.html](https://www.nytimes.com/2021/05/04/business/paycheck-protection-program-closes.html) (last visited May 6, 2021).

³ *But see* Order Authorizing the Debtors to Obtain Post-Petition Unsecured, Forgivable Loan Pursuant to the Paycheck Protection Program, *In re Alpha Media Holdings*, Case No. 21-30209 (Bankr. E.D. Va. April 23, 2021) (Docket No. 491) (authorizing PPP borrowing by debtor but requiring administrative-priority treatment for borrowed funds that are not forgiven by SBA; following effective date of debtor's plan, authorizing that unpaid borrowings shall be treated as unsecured obligation of emerging debtor entity).

no such limitation on the actual utilization of such funds. A bold debtor, unconcerned with loan forgiveness, could seek to use its newfound liquidity to fund a plan and its distributions to creditors. This is because the statutory limitations on the use of PPP funds (payroll, rent and utilities) were tied only to loan forgiveness. Further, a well-prepared debtor knew that the portion of a PPP loan that is not forgiven will bear interest at 1 percent and will not need to be repaid for five years. Those repayment terms were not offered by any other lender in the marketplace during or after the exhaustion of PPP loan funds.

While there was great potential for PPP funds to impact debtors and their creditors positively, the ability to capture such benefits was complicated because, at the outset of the program, the CARES Act failed to make clear whether a soon-to-be debtor or a current debtor could borrow PPP funds. This initial confusion was eliminated, to some extent, by the SBA pursuant to an “Interim Final Rule” issued on April 28, 2020, that states that a PPP loan applicant is ineligible for a PPP loan if it is “the debtor in a bankruptcy proceeding, either at the time it submits its application or any time before the loan is disbursed.”⁴ While at first this interpretation was a stinging loss to the bankruptcy process, not all bankruptcy courts followed the SBA’s guidance.⁵ As time passed, the Interim Final Rule became a challenge in search of solutions.

The Response to Confusion from the Program’s Start

When PPP loan funds were first authorized, some debtors that had filed for bankruptcy in advance of the CARES Act or after the SBA Interim Final Rule dismissed their pending bankruptcy cases, then later refiled or sought reinstated their cases.⁶ After the issuance of the Interim Final Rule, debtors determined that they needed to apply for and receive their PPP loan in advance of the bankruptcy petition filing.⁷

Round Two: The Confusion Continues

On Oct. 2, 2020, the SBA issued additional guidance with regard to PPP loans for borrowers that engaged in a “change in ownership” transaction after disbursement of PPP loan funds. The SBA Procedural Notice defined a change in ownership as follows:

When (1) at least 20 percent of the common stock or other ownership interest of a PPP borrower (including a publicly traded entity) is sold or otherwise transferred, whether in one or more transactions, including to an affiliate or an existing owner of the entity,

(2) the PPP borrower sells or otherwise transfers at least 50 percent of its assets (measured at fair market value), whether in one or more transactions, or (3) a PPP borrower is merged with another entity.⁸

The SBA Procedural Notice states:

Regardless of any change of ownership, the PPP borrower remains responsible for (1) [the] performance of all obligations under the PPP loan, (2) the certifications made in connection with the PPP loan application, including the certification of economic necessity, and (3) compliance with all other PPP requirements. Additionally, the PPP borrower remains responsible for obtaining, preparing, and retaining all required PPP forms and the supporting documentation and providing those forms and supporting documentation to the PPP lender or lender servicing the PPP loan ... or to [the] SBA upon request.⁹

The SBA Procedural Notice also indicates that “prior to the closing of any change in ownership transaction, the PPP borrower must notify the PPP lender in writing.”¹⁰ This notification requirement is in place because the PPP lender and/or the SBA by the Procedural Notice have (1) imposed numerous restrictions on the use of funds post-change-in-ownership transaction, (2) a right to seek to delay the closing of the proposed transaction, and (3) the right to require the escrow of funds equal to the amount of the PPP borrowing.¹¹

Whether the requirements of the SBA Procedural Notice provisions are held to be consistent with the application of the Bankruptcy Code is unknown. The escrow requirement in the SBA Procedural Notice seems particularly problematic when considered in the context of the Bankruptcy Code’s established principles. As previously stated, PPP loans are to be treated as pre-petition unsecured claims. The escrow requirement in the SBA Procedural Notice, if enforced, elevates the PPP repayment obligation above even the priority and treatment of secured creditors of a debtor.

The Final Guidance?

Further guidance for potential borrowers came from the SBA on April 6, 2021, in the form of the answer to FAQ 67 on the SBA’s website.¹² There, the SBA attempts to interpret the phrase “presently involved in any bankruptcy” and create distinctions therefrom. This new guidance, read in conjunction with the April 28, 2020, Interim Final Rule, suggests that on and after April 6, 2021, a debtor with a confirmed plan can borrow PPP funds. By this analysis, a debtor with a confirmed plan is no longer a prohibited borrower pursuant to the still-in-force Interim Final Rule, which plainly prohibited debtors from borrowing PPP funds.

4 85 Fed. Reg. 23,450 (April 28, 2020).

5 *In re Gateway Radiology Consultants PA v. Carranza* (*In re Gateway Radiology Consultants PA*), Case Nos. 19-04971; 20-0330; 2020 Bankr. Lexis 1508 (Bankr. M.D. Fla. June 8, 2020), *rev’d*, 983 F.3d 1239 (11th Cir. 2020); *In re United States of Am. Rugby Football Union Ltd.*, Case No. 20-10738 (Bankr. D. Del.); *In re Vestavia Hills Ltd.*, 2020 WL 2621186 (Bankr. S.D. Cal. June 26, 2020); *Springfield Hosp. Inc. v. Carranza* (*In re Springfield Hosp. Inc.*), Case No. 20-01003 (Bankr. D. Vt. June 22, 2020); *Roman Catholic Church of Archdiocese of Santa Fe v. U.S.* (*In re Roman Catholic Church of Archdiocese of Santa Fe*), Case No. 20-1026 (Bankr. D.N.M. May 1, 2020); *Emergency Serv. Found. v. Carranza* (*In re Hidalgo Cnty. Emergency Serv. Found.*), 20-02006 (Bankr. S.D. Tex. April 25, 2020).

6 *In re Advanced Power Techs. LLC*, Case No. 20-13304 (Bankr. S.D. Fla. 2020) (first case dismissed April 24, 2020; reinstated on May 12, 2020); *In re Starplex Corp.*, Case No. 20-02208 (Bankr. D. Ariz. 2020); *In re Eastern Niagara Hosp.*, Case No. 20-10903 (Bankr. W.D.N.Y. 2020).

7 See *In re Barfly Ventures LLC, et al.*, Case No. 20-01947 (Bankr. W.D. Mich.); *In re TooJay’s LLC*, Case No. 20-14792 (Bankr. S.D. Fla. April 29, 2020).

8 SBA Procedural Notice, Control No. 5000-20057, Oct. 2, 2020 (footnote omitted).

9 *Id.*

10 *Id.*

11 *See id.*

12 The SBA stated that three conditions terminate involvement in a bankruptcy case: (1) once a discharge order is entered in an individual chapter 7 bankruptcy; (2) if the applicant (or 20 percent owner) has been a debtor in a case under chapter 11, 12 or 13, and the applicant is no longer “presently involved in any bankruptcy,” once an order confirming a plan has been entered; and (3) under any bankruptcy chapter, once an order dismissing the case is entered. See SBA FAQ 67, p. 30, available at home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf (last visited April 27, 2021), which might be subject to further revisions in accordance with the American Rescue Plan Act of 2021.

On April 6, 2021, Alpha Media Holdings LLC filed an adversary proceeding against the SBA in its bankruptcy case pending in the Eastern District of Virginia seeking to enjoin the SBA administrator from interfering with Alpha Media's application to borrow \$10 million in PPP funds while still a chapter 11 debtor.¹³ On April 23, 2021, the bankruptcy court entered an order granting the debtors' later-filed motion seeking authorization to access PPP funds despite its debtor status and because Alpha Media had a confirmed, but not yet effective, plan.¹⁴ The Alpha Media debtors' motion specifically referenced the guidance in FAQ 67 as a basis for the request.¹⁵ The Alpha Media PPP loan, per the court order, will be treated as an administrative expense under the Bankruptcy Code, but it will be subordinate to superpriority debtor-in-possession claims in the case. Following the plan's effective date, to the extent that the PPP loan is not forgiven, it will be treated as an unsecured obligation. The court's order provides further that the court is not undertaking the role of determining whether the PPP loan is subject to forgiveness.

Without question, the improvements born of the response to FAQ 67 and the Alpha Media court's interpretation thereof will help debtors now permitted to emerge from bankruptcy with the benefit of a PPP loan. This development is of direct assistance to creditors as well, as creditors have greater assurance of feasibility of this soon to emerge debtor entity.

Other Ways Restructuring Professionals Took Advantage of the Opportunities

Recently, in a standard asset sale and exit from chapter 11, an opportunity for a nondebtor PPP borrower presented itself. On March 31, 2021, in *In re Punch Bowl*,¹⁶ a series of nondebtor affiliate shell limited liability companies of the debtors were sold to the purchaser in exchange for withdrawal of the purchaser's claim against the debtors, among other considerations to the estates. The purchaser then sought PPP funds in order to mobilize operations, complete unfinished construction projects and wrap up certain work in progress that was otherwise abandoned by the cash-strapped debtor.

The PPP program funds provided an opportunity for a company that was on life support and was unlikely to survive the pandemic but now could have new life outside of bankruptcy. These purchasers were able to maximize the opportunity presented by the availability of PPP loans in order to fund their new business. As a result, unsecured creditors still have an opportunity to continue their business relationship with this newly emerged customer.

What's Next?

The COVID-19 pandemic presented the bankruptcy community with new and interesting legal issues in the form of PPP loans. With the exhaustion of funds on May 4, 2021, it is unclear whether these cases and examples are bound for a time capsule with all of our other pandemic memories, or whether they can be drawn upon again by another extension of the program.¹⁷ **abi**

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¹³ *Alpha Media LLC v. Isabella Casillas Guzman, in her capacity as Administrator for U.S. Small Business Administration (In re Alpha Media Holdings LLC)*, Case No. 21-30209 (Bankr. E.D. Va. 2021) (Docket No. 393); Debtors' Motion for Authority to Obtain Post-Petition Unsecured, Forgivable Grant Funding Pursuant to the Paycheck Protection Program, Case No. 21-30209 (Bankr. E.D. Va. April 19, 2021) (Docket No. 406).

¹⁴ See Order Authorizing the Debtors to Obtain Post-Petition Unsecured, Forgivable Loan Pursuant to the Paycheck Protection Program, *In re Alpha Media Holdings LLC*, Case No. 21-30209 (Bankr. E.D. Va. April 23, 2021) (Docket No. 421); see also Order Confirming the Second Amended Joint Plan of Reorganization of Alpha Media Holdings LLC and Its Debtor Affiliates Under Chapter 11 of the Bankruptcy Code, Case No. 21-30209 (Bankr. E.D. Va. April 1, 2021) (Docket No. 382).

¹⁵ See Debtors' Motion for Authority to Obtain Post-Petition Unsecured, Forgivable Grant Funding Pursuant to the Paycheck Protection Program, Case No. 21-30209 (Bankr. E.D. Va. April 19, 2021) (Docket No. 406).

¹⁶ See *In re PBS Brand Co. LLC, et al. (In re Punch Bowl Social Inc.)*, Case No. 20-13157 (Bankr. D. Del. March 31, 2021) (Docket No. 461).

¹⁷ In the midst of these myriad, undulating regulations of the program, on Dec. 27, 2020, the Consolidated Appropriations Act provided an update to the CARES Act, and it is anticipated that further regulation will be forthcoming if additional PPP funds are authorized. The December 2020 modifications provide additional hope for the use of PPP funds in a bankruptcy context. However, the changes are subject to forthcoming SBA authorization. Following SBA authorization, subchapter V debtors, family farmers, family fishermen and individuals already in bankruptcy will be eligible PPP loan borrowers, with a right to repay PPP loans over time (as opposed to on the effective date with other administrative-priority claims).