The Changing Landscape of PPP Loans - Debtors’ Access and What Does Forgiveness Look Like?

Presenters

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The Payroll Protection Program

- A well-known part of the CARES Act is the Payroll Protection Program (PPP), which establishes a new SBA loan that can be forgiven if done properly.
- Generally, businesses with less than 500 employees are eligible, also certain businesses with less than 500 employees per location – no collateral or personal guarantees are required.

PPP – Maximum Loan Amount

- *Maximum Loan Amount*

  - The maximum loan amount is the lesser of:
    - The average total monthly payroll payments made in the one-year period before the loan is made multiplied by 2.5;
    - PLUS the outstanding amount of a loan made under the SBA's Disaster Loan Program between January 31, 2020 and the date on which such loan may be refinanced as part of this new SBA loan program;

PPP – Maximum Loan Amount

OR

Upon request, and only for businesses that were not in business during the period from February 15, 2019 to June 30, 2019:

- The average total monthly payroll payments from January 1, 2020 to February 29, 2020 multiplied by 2.5;
- PLUS the outstanding amount of a loan made under the SBA's Disaster Loan Program between January 31, 2020 and the date on which such loan may be refinanced as part of this new SBA loan program;
- Or $10 million

PPP – Use of Loan Proceeds

- The Loan Proceeds can be used for the following:
- Payroll costs, including employee salaries, commissions or similar compensation, allowance for separation or dismissal; vacation and other paid leave, group health benefits (including insurance premiums), retirement benefits, state and local payroll taxes and compensation to sole proprietors or independent contractors (including commission-based compensation) up to $100,000 in 1 year, prorated for the covered period. Payroll costs under this program specifically **exclude** individual employee compensation above $100,000 per year, as prorated for the covered period; taxes under chapters 21, 22 and 23 of the Internal Revenue Code; compensation to employees whose principal place of residence is outside of the US; and qualified sick leave wages and family leave wages for which a credit is allowed under the Families First Coronavirus Act;

PPP – Use of Loan Proceeds

- Payments of interest (not principal) on mortgage obligations;
- Rent/lease agreement payments (for real and personal property);
- Utilities; and
- Interest on any other debt obligations incurred before the covered period.

PPP – The Rules Keep Changing

- Initially, an applicant for a PPP loan had to certify “that the uncertainty of current economic conditions makes necessary to loan request to support the ongoing obligations.
- Guidance changed and companies who could obtain a loan, may not be eligible.

PPP – The Rules Keep Changing

- In FAQ #31, the SBA gave additional guidance:
  - Before submitting a PPP application, all borrowers should review carefully the required certification that "[c]urrent economic uncertainty makes this loan necessary to support the ongoing operations of the Applicant." Borrowers must make this certification in good faith, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.

PPP – The Rules Keep Changing

- FAQ #31 went on to say that it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith.
- Large companies (Shake Shack) gave the money back. $436 million of the $1.3 billion that went to public companies was returned.
- First bucket of $350 billion was exhausted with 2 weeks.
- Second bucket, there over $100 billion still available

The PPP Application, Question 1

Is the applicant or any owner of the applicant **presently suspended, debarred**, proposed for debarment, declared in eligible, voluntarily excluded from participation in this transaction by any federal department or agency, **or presently involved in any bankruptcy**?

What is Suspension and Debarment (S&D)?

The debarment and suspension procedures are intended to prevent waste, fraud and abuse in Federal procurement and non-procurement actions. Debarment or suspension of an organization or individual excludes that company or individual from doing business with the Federal Government. These exclusions are intended to ensure that only responsible companies or individuals participate in contracts and financial assistance awards with the Federal government.

What are the causes for Suspension or Debarment?

- **Commission of fraud, embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, tax evasion, violating Federal criminal laws, receiving stolen property, an unfair trade practice**
- Violation of antitrust statutes
- Willful, or a history of, failure to perform
- Violation of the Drug-Free Workplace Act
- Delinquent Federal taxes (more than $3,000)
- Knowing failure to disclose violation of criminal law
- Any other cause that affects present responsibility
- https://www.gsa.gov/policy-regulations/policy/acquisition-policy/office-of-acquisition-policy/gsa-acq-policy-integrity-workforce/suspension-debarment-division/suspension-debarment/frequently-asked-questions-suspension-debarment

Wait- what??

Why is the honest but unfortunate debtor lumped into the category of those who have committed fraud… embezzlement… theft… forgery… bribery… falsification or destruction of records… making false statements… tax evasion… violating Federal criminal laws… receiving stolen property… and unfair trade practice?

The PPP Application, Question 1

Is the applicant or any owner of the applicant **presently suspended, debarred**, proposed for debarment, declared in eligible, voluntarily excluded from participation in this transaction by any federal department or agency, **or presently involved in any bankruptcy**?

How did persons availing themselves of relief offered under the federal statutes in Title 11 get placed into the same exclusion from the Paycheck Protection Program as the persons above?

- A fundamental goal of the federal bankruptcy laws enacted by Congress is to give debtors a financial "fresh start" from burdensome debts. The Supreme Court made this point about the purpose of the bankruptcy law in a 1934 decision:
- [I]t gives to the honest but unfortunate debtor…a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.
- *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934). This goal is accomplished through the bankruptcy discharge, which releases debtors from personal liability from specific debts and prohibits creditors from ever taking any action against the debtor to collect those debts.
- https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/process-bankruptcy-basics
-

- **The Case of St. Alexius Hospital**
- Located in an economically depressed area in St. Louis, MO in a zip code with 28,000 residents whose annual median household income is less than $33,000. Hospital has served the St. Louis community since 1869.
- Hospital offers an emergency department, intensive care unit, and radiology, cardiology, therapy, and psychiatric services as well as a senior care center.
- Hospital employs over 350 people most of whom live paycheck to paycheck.
- Hospital treats a higher portion of uninsured patients, and patients who rely on Medicare and Medicaid.
- Closure of the Hospital "would be devastating… both from a patient health and economic perspective." (Doc. No. 166, p. 13 ¶ 33).
- Chapter 11 Trustee was appointed to oversee the Hospital, divesting the prior operator of control.

Paycheck Protection Program
Borrower Application Form

OMB Control No.: 3245-0407
Expiration Date: 09/30/2020

Check One: ☐ Sole proprietor ☐ Partnership ☐ C-Corp ■ S-Corp ☐ LLC ☐ Independent contractor ☐ Eligible self-employed individual ☐ 501(c)(3) nonprofit ☐ 501(c)(19) veterans organization ☐ Tribal business (sec. 31(b)(2)(C) of Small Business Act) ☐ Other	**DBA or Tradename if Applicable** St. Alexius Hospital		
Business Legal Name			
St. Alexius Hospital Corporation #1			
Business Address	**Business TIN (EIN, SSN)**	**Business Phone**	
3933 S. Broadway, St. Louis, MO 63118	[redacted]	314-865-7000	
	Primary Contact	**Email Address**	
	Carol Fox	cfox@glassratner.com	

Average Monthly Payroll:	$ $2,042,388	x 2.5 + EIDL, Net of Advance (if Applicable) Equals Loan Request:	$ $5,105,971	Number of Employees:	360
Purpose of the loan (select more than one):	■ Payroll ☐ Lease / Mortgage Interest ☐ Utilities ☐ Other (explain):				

Applicant Ownership

List all owners of 20% or more of the equity of the Applicant. Attach a separate sheet if necessary.

Owner Name	Title	Ownership %	TIN (EIN, SSN)	Address
See attached declaration.				

If questions (1) or (2) below are answered "Yes," the loan will not be approved.

Question	Yes	No
1. Is the Applicant or any owner of the Applicant presently suspended, debarred, proposed for debarment, declared ineligible, voluntarily excluded from participation in this transaction by any Federal department or agency, or presently involved in any bankruptcy?	■	☐

https://apply.usbank.com/applications/business/LoanDetails/Estimate

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About your business

3 Loan detail

4 Finalize and submit

Loan details

Maximum eligible loan amount

$5,105,971

Loan term:

24 months

The loan will have a maximum maturity of up to two years from the date the borrower applies for loan forgiveness.

Interest rate:

1%

You will not have to make any payments for six months following the date of disbursement of the loan. However, interest will continue to accrue on PPP loans during this six-month deferment.

Next

Have questions?

We can help.

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5/4/2020

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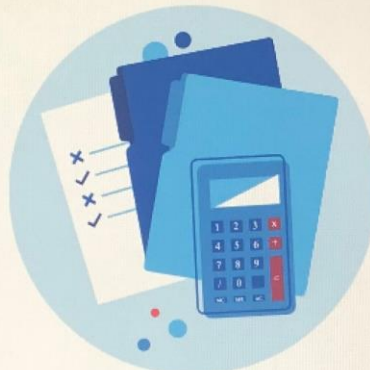
usbank.

PAYCHECK PROTECTION PROGRAM

Thanks for considering U.S. Bank

Unfortunately, your business is not eligible for the Paycheck Protection Program through U.S. Bank at this time.



Have questions?

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5/4/2020

Adversary Proceeding – Three Counts

Count I – Preliminary and Permanent Injunctive Relief (Fed. R. Bankr. P. 7065)

- enjoining SBA and the relevant commercial lender (U.S. Bank) from denying the Hospital's PPP application on the basis that the applicant is a debtor in bankruptcy requiring Hospital's application be considered without the words "or presently involved in any bankruptcy"
- enjoining SBA from issuing loan guaranties or approving PPP applications in an amount that would leave insufficient funds for Hospital until the Debtor's claims in the Complaint are resolved.

Count II – Declaratory Judgment (28 U.S.C. § 2201 and Fed. R. Bankr. P. 7001(9))

- Neither the CARES Act nor the Small Business Act prohibit disbursements under PPP to the Hospital merely because it is a Debtor.

- The Hospital has a right to apply for funds under PPP and to have its Application considered on the same terms as other applicants without regard the fact that it is in a Chapter 11 case.

- The Administrator exceeded her statutory authority by prohibiting U.S. Bank from processing the Hospital's Application and by prohibiting disbursements to debtors.

- The Hospital is entitled to a declaratory judgment that the CARES Act requires its Application to be considered on the same terms as other qualified businesses that are not presently debtors.

Count III - (11 U.S.C. § 525(a))

- Section 525(a) prohibits the federal government from discriminating against a person based on that person’s status as a debtor with respect to a “license, permit, charter, franchise, **or other similar grant**[.]”
- The Hospital is a debtor in a case under chapter 11 of the Bankruptcy Code.
- PPP is a federal program within the meaning of § 525(a); the program provides forgivable loans to qualified businesses akin to grants.
- The Hospital is a small business within the meaning of the CARES Act and is eligible to participate in funding of forgivable loans, which are functionally grants, under PPP.
- The Hospital sized its PPP funding request to be forgivable and, if for any reason the Hospital’s use of funds did not qualify for forgiveness, the Hospital would repay them.

As necessary, the Hospital filed a Motion for a Temporary Restraining Order which dovetailed with its request for injunctive relief.

Elements required for an award of injunctive relief:

- Likelihood of success on the merits
- Irreparable harm
- Balance of Hardships
- Effect on the Public Interest

Sooo… what happened??

The Bankruptcy Court for the Eastern District of Kentucky (Chief Judge Schaaf) held a hearing on May 7, and entered a TRO on May 8 setting a further hearing on the request for a preliminary injunction on May 21.

The TRO gave the Hospital the right to reapply for the PPP without regard to the Hospital's status as a Chapter 11 debtor

Likelihood of success on the merits

- The likelihood of success is not guaranteed to either side, but initially the balance favors the Plaintiff. The Administrator is starting at a disadvantage.
- Several courts have recently required the relief requested by the Plaintiff. *See Springfield Hosp. Inc. v. Carranza (In re Springfield Hosp. Inc.)*, Case No. 19-10283, Adv. No. 20-1003, 2020 WL 2125881 (Bankr. D. Vt. May 4, 2020); *Roman Catholic Church of the Archdiocese of Santa Fe v. United States of America Small Business Administration (In re Roman Catholic Church of the Archdiocese of Santa Fe)*, Case No. 18-13027 t11, Adv No. 20-1026 t, 2020 WL 2096113 (Bankr. D.N.M. May 1, 2020); *Calais Reg'l. Hosp. v. Carranza (In re: Calais Reg'l Hosp.)*, Case No. 19-10486, 2020 WL 2201947 (Bankr. D. Me., May 1, 2020); *Penobscott Valley Hosp. v. Carranza (In re Penobscot Valley Hosp.)*, Case No. 19-10034, 2020 WL 2201943 (Bankr. D. Me., May 1, 2020); *Hidalgo Cty. Emergency Serv. Found. v. Jovita Carranza (In re Hidalgo Cty Emergency Serv. Found.)*, Case No. 19-20497; Adv No. 20-2006, (Bankr. S.D. Tex.).
- During argument at the May 7 hearing, the only distinction made was that these cases were wrongly decided.
- At this point, the Plaintiff has met its burden to show a likelihood of success on the merits. There is no doubt more information is required to reach a definitive conclusion.

Irreparable harm / Balance of Hardships:

- The Plaintiff contends that closure of the Hospital and its other properties would be devastating both from a patient health and an economic perspective. The record bears out the fact that the Plaintiff will suffer irreparable harm if relief is not granted.
- The Plaintiff is in urgent need of the funds provided under the PPP to pay nurses, physicians, and other clinical personnel critical to the safe and secure operations of its properties, and the treatment and care of patients, including those with the COVID-19 virus. The PPP funds are critical to the Plaintiff's payroll obligations at this unprecedented historical time created by COVID-19.
- But the PPP funds available are finite and diminishing. The money available for the first round of financing was gone quickly, although the argument suggested there are funds in a second tranche. No doubt, those funds will go quickly and will not survive until this dispute is fully litigated. So there is an urgent need to apply for the funds now.
- In comparison, the Defendant will suffer little harm by the issuance of 14-day restraining order. Allowing the Plaintiff to file an application does not guarantee loan approval or that funds will be immediately distributed or used.
- The Administrator suggests a ruling in favor of the Plaintiff would interfere with the difficult process of administering the PPP loan program. That argument is without merit. This Order only applies to the Plaintiff. Further, the initial analysis suggests the Administrator has overstepped her authority and possibly endorsed discrimination. So any hardship is brought on by the administration's own actions.

Effect on the Public Interest

- Lack of this source of liquidity risks the Plaintiff's survival and the health and treatment of patients. The Plaintiff needs the PPP loan to shore up the Hospital's finances and keep it a viable health care provider in an underserved and depressed community. This service is particularly critical as the nation and the local community come out of pandemic-driven closures.
- The continued gainful employment of the Plaintiff's approximately 300 healthcare employees also benefits the community and the public interest as a whole. The Plaintiff operates a "front line" health care business that is vitally important, even in normal times, and even more so now. It is important to maintain a responsible and knowledgeable team capable of serving the depressed Missouri region in which the hospital businesses reside. The public interest is clearly served by the Plaintiff's ability to take steps to maintain 100% of its usual staffing levels in the midst of the COVID-19 pandemic.

What happened next?

The Hospital immediately applied (reapplied) for funding under the PPP program with US Bank…

OMB Control No.: 3245-0407
Expiration Date: 09/30/2020

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Borrower Application Form

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St. Alexius Hospital Corporation #1	**Business TIN (EIN, SSN)**	**Business Phone**
Business Address	[redacted]	314-865-7000
3933 S. Broadway, St. Louis, MO 63118	**Primary Contact**	**Email Address**
	Carol Fox	cfox@glassratner.com

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	Question	Yes	No
1.	Is the Applicant or any owner of the Applicant presently suspended, debarred, proposed for debarment, declared ineligible, voluntarily excluded from participation in this transaction by any Federal department or agency, or presently involved in any bankruptcy?	☒	☐
		☐	☒

- Between the time of the entry of the TRO (May 8) and the upcoming hearing for further injunctive relief, a few other courts which had entered TROs in favor of the Debtor entered orders denying the requests for injunctive relief…

- The hearing on the preliminary injunction was rapidly approaching on May 21…

- Less than 48 hours prior to the hearing on the preliminary and permanent injunction, the Hospital received a deposit of exactly what it had requested, $5,105, 971 into its account with US Bank. The Trustee immediately moved these funds into a DIP account.

- Okay… we got the money… so now what?

On May 20 (one day prior to the hearing to consider preliminary and permanent injunctive relief) the Hospital withdrew the Motion for Preliminary Injunction.

On May 22, the Hospital filed a Notice of Dismissal of the Adversary Proceeding.

But wait—there's more!

In re Gateway Radiology Consultants, PA, 8:19-bk-04971-MGW; Adv. Pro. No. 8:20-ap-00330-MGW

- A chapter 11 case pending before Judge Williamson, Judge Williamson and entered an order dated June 24, 2020 granting a motion filed by the debtor for approval to borrow a paycheck protection program loan.
- In the motion, the debtor alleged it would use 75% of the PPP loan proceeds for payroll and the remaining 25% for rent, health insurance, and utilities, which would make the PPP loan eligible for forgiveness.
- The SBA objected based on its fourth interim final rule which disqualified debtors from participating in the PPP. Judge Williamson determined that the fourth interim rule was unenforceable to the extent it disqualified the radiology group from participating in the PPP.

Adv. Pro. No. 8:20-ap-00330-MGW, Doc. No. 14, June 8

- *Memorandum Opinion on Debtor's Eligibility for the Paycheck Protection Program (46 pages)*

Case No. 8:19-bk-04971-MGW, Doc. No. 266, June 24

- *Order Granting Debtor's Motion for Approval to Borrow Paycheck Protection Program Loan*

Judge Williamson's Conclusions:

The Court concludes that the SBA Administrator exceeded her authority when she promulgated the rule disqualifying Gateway Radiology from the PPP.

Even if the SBA Administrator had not exceeded her authority, the rule disqualifying Gateway Radiology from participating in the PPP is arbitrary and capricious because:

- the SBA Administrator considered factors Congress did not intend her to consider (i.e., collectability);
- the SBA Administrator failed to consider an important aspect of the problem (i.e., how the bankruptcy process promotes the same public policy as the CARES Act and how it makes it unlikely a chapter 11 debtor will use a PPP "loan" for noncovered expenses); and
- the SBA Administrator's explanation for her rule is contrary to the evidence before her (i.e., chapter 11 debtors are less likely to use PPP "loans" for noncovered expenses and more likely to repay PPP "loans").

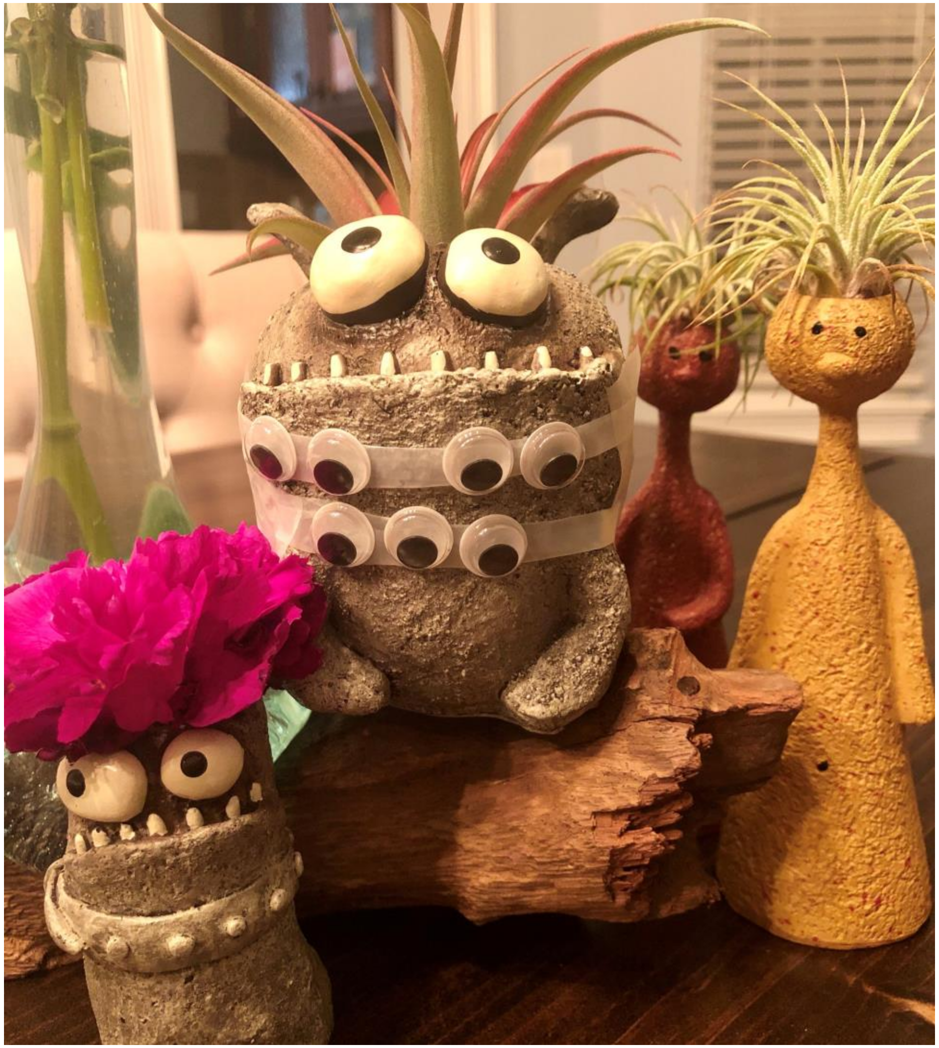
The Court enjoined the SBA Administrator from disqualifying Gateway Radiology from participating in the PPP.

The SBA's meager justification for the Supplemental Rule's new eligibility requirement was that debtors are more likely to use a PPP Loan for noncovered expenses and less likely to be able to repay an unforgiven 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 rule excluding Debtors is "illogical on its own terms." When agency action is "illogical on its own terms," as is the case here, the agency action is arbitrary and capricious.

- Because Gateway Radiology is in bankruptcy, however, there will be, as one court aptly put it, a hundred-eyed Argus watching how Gateway Radiology uses the money.



In Greek Mythology, Argus Panoptes (Ἄργος Πανόπτης), was a primordial giant. The meaning of P*anoptes is* "all-seeing", and led to Argus being described with multiple, often one hundred, eyes.

https://en.wikipedia.org/wiki/Argus_Panoptes

Dismissal and Reinstatement (maybe)

- Some Debtors have sought to dismiss their case for the sole purpose of applying for a PPP loan and not having to check the bankruptcy box.
- *In re Advanced Power Technologies, LLC*, Case No. 20-13304 (S.D. of FL). The Debtor moved to dismiss its case. There was little opposition to the dismissal. Judge Hyman dismissed the case and was very open to reinstatement of the case if necessary.
- Debtor obtained a PPP loan and then moved for reinstatement. Case was reinstated.

Dismissal and Reinstatement (maybe)

- *In re Capital Restaurant Group, LLC*, Case No. 19-65910-WLH, N.D. Ga.
  - Case filed on October 4, 2019.
  - Debtor owned and operated 24 Burger King restaurants
  - On April 4, 2020 Debtor moved to dismiss its case so that it could apply for a PPP loan.
  - Burger King Corporation objected to dismissal.
  - Dismissal was granted with prejudice.
  - Debtor cannot file for 365 days.

Dismissal and Reinstatement (maybe)

- *In re Blue Ice Investments, LLC*, 2:20-bk-02208-DPC, District of Arizona
  - Debtor filed on March 4, 2020
  - Debtor sought a preliminary injunction and was denied
  - Court invited a motion to dismiss
  - Debtor seeks dismissal so it can get a PPP loan
  - On June 1, 2020, Debtor receives over $1,500,000 in PPP loan proceeds
  - On June 5, 2020 Debtor moved to reinstate its case.
  - No objections filed and case was reinstated

Forgiveness - What it looks like under the PPP Flexibility Act

- At least 60% of the loan proceeds must be used for payroll expenses. This is a reduction from the 75% that was established in an IFR issued by the SBA
- 40% of the loan proceeds can be used for other eligible expenses (no change from PPP as to what is an eligible expense)
  - Businesses continue to lobby to include inventory, personal protection equipment, expenses related to remote working and other expenses

Forgiveness - what it looks like under the PPP Flexibility Act

- Time period to use funds is extended from 8 weeks to 24 weeks, the end of 2020.
    - Allows businesses that cannot fully reopen due to government restrictions, to conserve the funds.
- Deadline to rehire is pushed back from June 30th to December 31, 2020.
    - This extension should ensure 100% forgiveness requirements.

Forgiveness - what it looks like under the PPP Flexibility Act

- Rehire requirements eased.
  - 2 signification changes to the rehire requirements
    - The date to rehire is extended to December 31, 2020
    - Additional exceptions to the head count requirements
      - A business can still receive forgiveness on payroll if:
        - It is unable to rehire an individual that was an employee on February 15, 2020.
        - It can demonstrate it was unable to hire a similarly qualified employee(s) on or before December 31, 2020; or
        - It can demonstrate it was unable to return to the same level of business activity as such business was operating at prior to February 15, 2020.

Forgiveness - what it looks like under the PPP Flexibility Act

- Repayment terms extended for certain loans
  - All loan approved by SBA after June 5, 2020 have a 5 year maturity
  - Loans made prior to June 5, 2020 have a 2 year maturity, but the lender can agree to extend the maturity up to an additional 3 years