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Introduction

During the COVID-19 pandemic, Congress enacted the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), which established the Paycheck Protection Program ("PPP").[1] Under the PPP, the United States Small Business Administration ("SBA") declared small businesses—including nonprofits, veterans' organizations, and tribal enterprises that employ 500 people or less—as potential eligible borrowers.[2] A borrower can use a PPP loan for a variety of purposes, such as general business costs like payroll and rent, or payments toward preexisting debts.[3]

However, there has been some debate as to whether a debtor in a case under title 11 of the United States Code (the "Bankruptcy Code") is eligible for PPP loans.[4] Until the SBA

[1] CARES Act, § 1102, amending Small Business Act, 15 U.S.C. 636(a) (2020).
[2] *Id.*
[3] *Id.* at § 1102(F) (listing the permitted uses for PPP loans).
[4] *See, e.g.*, *In re* Roman Catholic Church of the Archdiocese of Santa Fe, 615 B.R. 644, 649–50 (Bankr. D.N.M. 2020).

declares that bankruptcy status is not an automatic disqualification for a PPP loan, it appears that a debtor under the Bankruptcy Code is not eligible.[5]

Part I of this memorandum explores a recent amendment to the CARES Act, which addresses debtor eligibility for PPP loans. Part II is divided into two sections describing the case law on PPP loan eligibility. First, Part II explains the analysis known as the *Chevron* doctrine, on which some courts have relied when assessing the SBA's determination of PPP loan eligibility. Next, it examines the conflicting case law where courts have come to different conclusions about debtor eligibility.

Discussion

I. CARES Act Amendment and Debtor Eligibility

In April 2020, the SBA published its Interim Final Rule ("IFR") on the CARES Act in the Federal Register.[6] The IFR was a formal, written notice of intent to implement the PPP, and provided interested parties the opportunity to comment on the SBA's PPP proposed regulations.[7] The IFR did not expressly state that debtors were ineligible for PPP loans.[8] Subsequently, on December 27, 2020, Congress passed the Consolidated Appropriations Act ("CAA"), which amended provisions of the Bankruptcy Code and attempted to codify debtor accessibility to PPP loans.[9] Specifically, Title X of the CAA states that a "person may not be denied relief under . . . the CARES Act . . . because the person is or has been a debtor under this title."[10] This provision, however, does not supersede the SBA's authority.[11]

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[5] Consolidated Appropriations Act, Pub. L. No. 116-260 (2020).
[6] 13 C.F.R. § 120 (2020).
[7] *Id.*
[8] *Id.*
[9] Consolidated Appropriations Act, Pub. L. No. 116-260 (2020).
[10] *Id.* at § 1001.
[11] *Id.* at § 320(f)(1)(A).

According to the CAA, Title X is not effective until the SBA submits a written notice of approval to the Director of the Executive Office for United States Trustees.[12] In response to the Title X amendment, the SBA issued another IFR in January 2021, where it clearly stated that bankruptcy debtors are not eligible for PPP loans.[13] Furthermore, if the debtor becomes a petitioner for relief under the Bankruptcy Code subsequently to filing a PPP loan application, it is the responsibility of the applicant to notify the SBA so the application can be withdrawn.[14]

II. Case Law on Debtor Eligibility and PPP Loans

A. Chevron *and the "Arbitrary and Capricious" Standard*

Section 706(2)(a) of the Administrative Procedure Act ("APA") provides that a "reviewing court shall . . . [among other things] hold unlawful and set aside agency action, findings, and conclusions found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law . . . ."[15] In *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, the United States Supreme Court created the legal standard by which courts review an agency's actions under its statutorily delegated authority.[16] There, the Court held that the EPA did not abuse its statutorily delegated authority when it interpreted an amendment to the Clean Air Act which did not define "source."[17]

In its assessment, the Court set forth a two-part test. First, the reviewing court must determine whether Congress has expressly addressed the issue in the statute that delegates authority to the agency.[18] If so, the agency must follow the express terms.[19] Next, if the statute is

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[12] *Id.*
[13] *See* Business Loan Program Temporary Changes; Paycheck Protection Program as Amended by Economic Aid Act, SBA No. SBA-2021-0001, 26 (Jan. 6, 2021).
[14] *Id.* at 26–27.
[15] 5 U.S.C. § 706 (explaining the judicial scope of review over agency decisions).
[16] *Chevron*, 104 S.Ct. 2778, 2778 (1984).
[17] *Id.* at 2781.
[18] *Id.*
[19] *Id.*

ambiguous, the court must decide "whether the agency's answer is a permissible construction of the statute."[20] The Court then established what is known as the *Chevron* deference when it clarified that if Congress "left a gap for the agency to fill," the agency will be afforded deference for its interpretation of the statute "unless [it is] arbitrary, capricious, or manifestly contrary to the statute."[21] Thus, because Congress did not express a specific intent regarding the definition of "source," it was acceptable for the EPA to employ its agency expertise regarding pollution sources in this case.[22]

B. PPP Loan Case Law

Courts have adopted the *Chevron* analysis to assess whether debtors are eligible for PPP loans.[23] In *In re Roman Catholic Church*, a New Mexico bankruptcy court reviewed the SBA's denial of a PPP loan to the church because of its bankruptcy status and held that bankruptcy does not preclude PPP loan eligibility.[24] There, the court applied the two-part *Chevron* test, and determined that the SBA "exceeded its authority by trying to prohibit bankruptcy debtors from getting PPP funds . . . [and thus, was] not entitled to *Chevron* deference."[25] Specifically, the court noted that if Congress meant to exclude debtors from these loans, it would not have enacted a separate statute for loans to mid-size businesses wherein it listed bankruptcy debtors as ineligible.[26] To the court, this was a direct "usurpation of Congressional authority,"[27] and "arbitrary and capricious" under APA § 706(2)(a), which gives the court the authority to overrule

[20] *Id.* at 2781–82.
[21] *Id.* at 2782.
[22] *Id.* at 2783.
[23] *See In re* Roman Catholic Church of the Archdiocese of Santa Fe, 615 B.R. 644, 654 (Bankr. D.N.M. 2020); Skefos v. Carranza (*In re* Skefos), 2020 Bankr. LEXIS 1479 (Bankr. W.D.Tenn. 2020); USF Fed. Credit Union v. Gateway Radiology Consultants, P.A. (*In re* Gateway Radiology Consultants, P.A.), 983 F.3d 1239 (11th Cir. 2020).
[24] 615 B.R. at 654.
[25] *Id.* at 655.
[26] *Id.* at 656.
[27] *Id.*

and agency decision.[28] As such, the SBA's decision was reversed, and the church was awarded entitlement to the PPP loan it requested, as well as the option to pursue compensatory and punitive damages if the loan was not granted by the SBA.[29]

Similarly, in *In re Skefos*, a Tennessee bankruptcy court held that the SBA acted "arbitrarily and capriciously in excluding applicants whose owners are debtors in bankruptcy from the PPP."[30] There, a daycare was denied a PPP loan because the president of the daycare was a bankruptcy debtor.[31] The SBA argued that it included a preliminary question regarding bankruptcy status on its PPP loan application because this was an efficient way to avoid individual credit checks for all applicants.[32] Adopting the *Chevron* analysis, the court asserted that "the exclusion of entities whose owner is 'presently involved in a bankruptcy' is even further removed from Congress's expressed intent of providing payroll support to struggling Americans."[33] Furthermore, the bankruptcy court stressed that Congress intended the PPP to be more akin to a grant where creditworthiness is immaterial, and where business owner can get a "fresh start."[34] Subsequently, the court granted an injunction to prohibit the SBA from future denials based on debtor status.[35]

Likewise, in *In re Gateway Radiology Consultants, P.A.*, the Eleventh Circuit employed the *Chevron* analysis, yet came to a different conclusion.[36] There, the court held in favor of the SBA's decision to exclude a bankruptcy debtor from a PPP loan.[37] The debtor falsely claimed that it was not involved in a bankruptcy proceeding when it filled out the SBA's PPP application,

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[28] 5 U.S.C. § 706(2)(a).
[29] 615 B.R. at 657.
[30] 2020 Bankr. LEXIS 1479, at *36.
[31] *Id.* at *21.
[32] *Id.* at *27.
[33] *Id.* at *30.
[34] *Id.* at *41.
[35] *Id.* at *44.
[36] 983 F.3d 1239, at *1247.
[37] *Id.*

and as a result, was preliminarily approved.[38] However, as required by the Bankruptcy Code, the debtor needed approval from the bankruptcy court before receiving the loan.[39] The SBA objected to the debtor's motion for approval when it discovered that the debtor was in Chapter 11.[40] In its *Chevron* analysis, the Eleventh Circuit reasoned that because Congress did not explicitly address debtor eligibility, it gave discretion to the SBA on how to implement the PPP.[41] In response to the debtor's claim that the PPP is a grant, which implies forgiveness and debtor eligibility, the court emphasized that PPP loans are only forgiven for certain "allowable uses."[42] Furthermore, not all "allowable uses" are forgiven; therefore, the SBA acted reasonably in considering debtor status and the ability to pay back a PPP loan.[43]

In *In re Hidalgo Cty. Emergency Serv. Found.*, the Fifth Circuit did not rely on *Chevron*, but it ultimately deferred to the SBA.[44] As with the previous cases, the debtor was denied a PPP loan because it filed for relief under Chapter 11 of the Bankruptcy Code.[45] Instead of addressing the nature of the SBA's PPP rulemaking and eligibility decisions, the court simply stated that injunctions against the SBA are prohibited under Fifth Circuit precedent.[46] Thus, the injunction previously issued by the bankruptcy court against the SBA and in favor of the debtor was reversed.[47]

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[38] *Id.* at *1246.
[39] *Id.*
[40] *Id.*
[41] *Id.* at *1256.
[42] *Id.* at *1261.
[43] *Id.* at *1261–62.
[44] Hidalgo Cty. Emergency Serv. Found. v. Carranza (*In re* Hidalgo Cty. Emergency Serv. Found.), 962 F.3d 838, 841 (5th Cir. 2020).
[45] *Id.* at 840.
[46] *Id.* at 841 (citing Teague v. City of Flower Mound, 179 F.3d 377, 383 (5th Cir. 1999)).
[47] *Id.* at 841.

Conclusion

Prior to the CAA, the case law regarding PPP loan availability to debtors was split. However, the regulations are clear – debtors are not eligible for PPP loans.[48] Title X of the CAA is an attempt to expand PPP loan eligibility to debtors; however, the SBA retains the authority to reject this amendment.[49] As of its IFR issued January 2021, the SBA has not withdrawn its stance that anyone currently part of a bankruptcy case, or who has become a bankruptcy debtor after submitting its loan application, is not eligible for a PPP loan.[50] No matter the courts' opinions thus far, until the SBA submits its written approval of the Title X amendment, debtors are statutorily ineligible for a PPP loan.[51]

[48] *See* Business Loan Program Temporary Changes; Paycheck Protection Program as Amended by Economic Aid Act, SBA No. SBA-2021-0001, 26 (Jan. 6, 2021).
[49] Consolidated Appropriations Act, Pub. L. No. 116-260, § 320 (f)(1)(A) (2020).
[50] *See* SBA No. SBA-2021-0001, 26 (Jan. 6, 2021).
[51] *See* Consolidated Appropriations Act, Pub. L. No. 116-260, § 320 (f)(1)(A) (2020).