

Senate Bill Proposes to Expand Paycheck Protection Program to Businesses in Bankruptcy—But with a Significant Catch

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Late last month, Senators Marco Rubio (R-Fla.) and Susan Collins (R-Maine) introduced Senate Bill 4321 (S-4321), titled “Continuing Small Business Recovery and Paycheck Protection Program Act” (Bankruptcy Access Bill), which, if enacted, would permit businesses in bankruptcy to qualify for Paycheck Protection Program (PPP) loans. Unfortunately, as currently drafted, the Bankruptcy Access Bill appears to be of limited practical use, since participation in the PPP by debtors in bankruptcy would be subject to the Small Business Administration’s (SBA) acceptance of their PPP loan applications, which is far from likely.

The PPP and the Bankruptcy Exclusion

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) created the PPP under Section 7(a) of the Small Business Act, which authorizes the SBA to guarantee loans to qualified small businesses, with the goal of helping them keep their employees working during the pandemic. While the CARES Act eliminated for the PPP the 7(a) loan requirement that a business demonstrate it was unable to obtain credit from commercial sources, in favor of a good-faith representation that “the current economic uncertainty makes the PPP loan request necessary to support its ongoing operations” absent statutory direction to the contrary, the SBA treated the PPP like any other 7(a) loan by requiring an applicant to not be “presently involved in any bankruptcy” (Bankruptcy Exclusion). In support of the Bankruptcy Exclusion, the SBA argues that permitting debtors in bankruptcy to qualify for PPP loans would create unnecessary risk, which would limit the salability of PPP loans on the secondary market. This argument is significantly undercut given that, as created, PPP loans are to be forgiven to the extent the loan proceeds are used to pay payroll and other operating expenses of the business. Indeed, when the \$350 billion PPP was created, it was thought that more than half of the aggregate principal amount of all PPP loans would be forgiven. Recent statutory changes to the PPP are likely to result in a greater percentage of the now \$660 billion PPP being forgiven.

The Bankruptcy Access Bill was likely precipitated, at least in part, by the entry of numerous conflicting court orders regarding the

enforceability of the Bankruptcy Exclusion. (See our related alert [here](#).)

The Super-Priority PPP Loan

In an attempt to eliminate the above-mentioned confusion, the Bankruptcy Access Bill would amend the Bankruptcy Code to expressly authorize bankruptcy courts to allow debtors to obtain PPP loans. Specifically, a new provision, Subsection (g) of 11 U.S.C. § 364, would provide that bankruptcy courts,

after notice and a hearing, may authorize a debtor in possession or a trustee that is authorized to operate the business to obtain a [PPP loan], and such loan shall be treated as a debt to the extent the loan is not forgiven, with priority [over administrative claims].

If the PPP loan is not entirely forgiven, the Bankruptcy Access Bill would grant the remaining principal amount of the PPP loan super-priority administrative claim status and thereby place the remaining PPP loan ahead of the claims of most unsecured creditors, including any other administrative claims.

Unfortunately, the foregoing Bankruptcy Code amendments would not be effective on enactment of the Bankruptcy Access Bill. Rather, the effectiveness of the Bankruptcy Code amendments would be entirely contingent on the SBA's agreement to process such PPP loan applications. In other words, the availability of PPP funds to bankruptcy debtors hinges on the cooperation of the very entity that created and has sought to enforce the Bankruptcy Exclusion.

It is not clear why the SBA would favor the potential marketability of PPP loans to third-party investors over the need of small businesses to gain access to funds to keep their employees employed and the business operating during this severe economic dislocation. Indeed, it can be argued that debtors in bankruptcy, particularly those seeking bankruptcy protection during the pandemic, would have a greater need than other qualified small businesses for the PPP, and the oversight of the bankruptcy court and the bankruptcy trustee would ensure proper use of PPP proceeds to keep the business operating and the employees on the job—the principal goal of the PPP in the first instance.

The Takeaway: Plenty to Extol, but Questions Remain

While debtors may view the Bankruptcy Access Bill with a sense of optimism, the bill falls short of its lofty goals of expanding PPP access to bankruptcy debtors. As the SBA has spent the better part of four months seeking to enforce the Bankruptcy Exclusion in courts across the country, it is uncertain whether the SBA will soften its stance and accept PPP loan applications from debtors were the bill to be enacted. At a minimum, passage of the bill would telegraph to the SBA Congress's express intent to permit bankruptcy debtors to benefit from the PPP. However, desperate times call for bold action. The Bankruptcy Access Bill would be more effective were the bill to side with the needs of struggling businesses over those of the fledging secondary trading market for PPP loans by eliminating the SBA's buy-in requirement and instead instructing the SBA to accept PPP loan applications from bankruptcy debtors.