

Church Successfully Challenges SBA's Legislation of PPP by Regulation; More to Follow?

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The Small Business Administration (SBA) violated federal law by imposing conditions for loans under the [Paycheck Protection Program](#) (PPP) that were not enacted in the Coronavirus Aid, Relief, and Economic Security Act, H.R. 748, P.L. 115-136 (CARES Act), Judge David Thuma has held. [Roman Catholic Church of the Archdiocese of Santa Fe v. United States of America Small Business Administration](#), No. 20-1026-t (Bankr. D.N.M. May 1, 2020) [D.I. 15].

Does this portend the outcome of future litigation challenging the SBA's post-statutory rulemaking in connection with PPP?

Background

Roman Catholic Church involved a catholic archdiocese that had been a debtor in possession under Chapter 11 of the U.S. Bankruptcy Code since 2018.

Like most states, New Mexico has issued a "stay at home" order, prohibiting mass gatherings and requiring all non-essential businesses to cease in-person operations. As churches, among other institutions, are currently closed to parishioners and the public, the archdiocese (which collects the bulk of its revenue from church collections) claimed the lockdown has resulted in a loss of monthly revenue of approximately \$300,000. Seeking the "fresh start" intended by the PPP, the archdiocese applied for a \$900,000 PPP loan on April 20, 2020. The archdiocese's application for a PPP loan was denied due to its bankruptcy status.

As the court noted, "[t]he PPP has very few eligibility requirements." A borrower must be a qualifying entity (a small business concern or any business concern, nonprofit organization, veterans organization, or Tribal business concern described in section 31(b)(2)(C) of the Small Business Act); have fewer than 500 employees (or satisfy other SBA criteria); have been in operation on February 15, 2020; and have had employees to whom the applicant pays salaries and payroll taxes. The court further noted the archdiocese "clearly met all eligibility requirements under the CARES Act."

The template application for PPP loans issued by SBA on April 2, 2020, provided that an applicant currently involved in a bankruptcy proceeding is ineligible for a PPP loan and the fourth [interim final rule](#) (Promissory Notes, Authorizations, Affiliation, and Eligibility), effective April 28, 2020, (Fourth Rule) similarly provides that bankruptcy debtors (like the archdiocese) are ineligible for a PPP loan.

The Fourth Rule provides:

Will I be approved for a PPP loan if my business is 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 at 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 for an unauthorized use of funds or non-repayment of unforgiven loans.

The archdiocese challenged the denial of its PPP loan application under the Administrative Procedure Act, 5 U.S.C. § 701 *et seq.* (APA). In pertinent part, the APA instructs a reviewing court to “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” or “in excess of statutory jurisdiction, authority, or limitations, or short of statutory right.”

Holding

The court found that the SBA’s adoption of the Fourth Rule was not entitled to the deference typically afforded agency actions because it was “taken without statutory authority.” *Util. Air Regulatory Group v. E.P.A.*, 573 U.S. 302, 321 (2014).

Absent such deference, the court found the SBA’s decision to exclude bankruptcy debtors from the PPP was arbitrary and capricious, because: (a) the PPP “is not a loan program at all. It is a grant or support program”; (b) the statutory eligibility requirements do not include creditworthiness; and (c) the CARES Act makes PPP money available regardless of financial distress.

Accordingly, the court held, “[I]t was arbitrary and capricious for [SBA] to engraft a creditworthiness test where none belonged.” The court described SBA’s articulated justification for the bankruptcy disqualification in the Fourth Rule (that bankruptcy debtors “present an unacceptably high risk for an unauthorized use of funds or non-repayment of unforgiven loans”) as “completely frivolous.”

The court further held that SBA’s exclusion of debtors from PPP eligibility exceeded the agency’s authority under the CARES Act in violation of the APA, 5 U.S.C. § 706(2)(C). The CARES Act “directly addresses the PPP eligibility requirements.” However, the court continued, while SBA was authorized to issue “regulations to carry out this title” (CARES Act, § 1114), SBA had “no authority under this charge to change the eligibility requirements.”

The court concluded that SBA’s “trying to prohibit bankruptcy debtors from getting PPP funds” was a clear “usurpation of Congressional authority to determine which business are eligible for PPP funds.”

The court issued an order compelling the SBA to act on the archdiocese’s PPP application without regard to their status as a bankruptcy debtor. It also ordered that the archdiocese may file an adversary proceeding for compensatory and, if appropriate, punitive damages if it does not obtain the loan requested.

Implications

Other litigation challenging the SBA’s PPP rulemaking likely will follow. The bankruptcy exclusion at issue in *Roman Catholic Church* is just one example of the SBA adding restrictions and limitations on PPP loans that are not present in the CARES Act.

Other examples include:

- The enhanced certification requirements for eligibility for a PPP loan;
- The requirement that 75% of the loan proceeds be used for payroll costs and the requirement that not more than 25% of the loan forgiveness amount be attributable to non-payroll costs;
- The rule that hedge funds and private equity firms are ineligible to receive PPP loans because “they are primarily engaged in investment or speculation”;
- The requirement that businesses part of a single corporate group may not receive more than \$20 million of PPP loans in the aggregate; and
- The maturity date on a PPP loan must be two years.

Considering the court’s well-reasoned opinion in *Roman Catholic Church*, and the many examples of SBA’s expansive PPP rulemaking, additional litigation will follow, particularly concerning eligibility for the PPP loans and the denial of loan forgiveness.

Jackson Lewis attorneys will continue to monitor this evolving area of law.

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