

RHODE ISLAND Lawyers Weekly

Federal judge declines to rule on PPP loan eligibility

By: Eric T. Berkman August 20, 2021

A nonprofit organization operating under a non-liquidating state receivership could not seek a declaratory judgment that it was eligible for a loan it received under the Paycheck Protection Program, a U.S. District Court judge has ruled.

The entity in question, substance abuse treatment provider Phoenix House, was struggling financially due to the COVID-19 pandemic and sought and received equitable non-liquidation protection under the Superior Court's COVID-19 Business Recovery Plan. While under receivership, Phoenix House also sought and received a PPP loan.

When questions arose as to whether a non-liquidating state receivership might be treated as a bankruptcy, which would be disqualifying under the PPP, Phoenix House's court-appointed special master, plaintiff Jonathan N. Savage, sought clarification from the U.S. Small Business Administration.

SBA officials, however, apparently were unwilling or unable to provide such clarification, referring the plaintiffs instead to PPP rules and "Frequently Asked Questions" on the SBA website to make the determination for themselves.

When Savage and W. Mark Russo, program coordinator for the COVID-19 Business Recovery Plan, sought a declaratory judgment in U.S. District Court stating that Phoenix House was, in fact, an eligible PPP recipient, the SBA argued that any purported harm Phoenix House was suffering — namely uncertainty as to whether it could potentially face an adverse eligibility determination after having spent the loan funds — was insufficient to confer standing to bring such an action.



Judge Mary S. McElroy agreed with the SBA.

"There is no statute or rule deeming entities in a state non-liquidating receivership program ineligible for PPP loans," McElroy wrote in dismissing the complaint. "Although the SBA's District Director 'indicated' that he was not 'sure' whether entities in the BRP were ineligible, there are no allegations that it is 'sufficiently imminent' that the SBA will take any administrative action making this so."

The 15-page decision is *Savage, et al. v. United States Small Business Administration, et al.*, Lawyers Weekly No. 52-084-21. The full text of the ruling can be found [here](https://rilawyersweekly.com/blog/2021/08/20/federal-judge-declines-to-rule-on-ppp-loan-eligibility/).



“Although the court found that we did not have standing, the action was filed from our perspective to establish that participation in the COVID-19 Business Recovery Plan does not equate to being involved in a bankruptcy proceeding, which would prevent an entity from seeking or utilizing PPP funding,” said Russo, a Providence attorney.



Along those lines, Russo continued, it was encouraging that the judge noted in the decision that Phoenix House was not, in fact, involved in bankruptcy, which the SBA did not dispute.

Similarly, he said, the judge noted that nothing in the federal Coronavirus Aid, Relief and Economic Security (CARES) Act, the PPP or the SBA’s final interim rules for the PPP states that a participant in a state court non-liquidating special mastership is either disqualified as an eligible entity or is in “bankruptcy.”

Spokespeople for the U.S. Department of Justice, which represented the SBA, did not respond to requests for comment.

Unclear answers

The PPP was created under the CARES Act in March 2020 as an emergency measure to combat economic damage from the COVID-19 pandemic. The SBA was given rulemaking power and directed to issue regulations.

Under the act, the PPP was designed to give loans to eligible businesses that could be forgiven so long as the funds were used for certain types of expenses, such as payroll costs, mortgage interest payments and rent.

At the same time, not all permissible uses of the funds would result in the loans being forgiven. The lender would determine based on the rules if a particular borrower was entitled to forgiveness of some or all the money borrowed. Once the lender requested payment for amounts that were forgiven, the SBA would make a final determination.

Phoenix House, struggling financially from the pandemic, sought non-liquidating protection from the COVID-19 Business Recovery Plan, a receivership program created by the Superior Court to supervise entities that, but for the pandemic, were paying their debts as they became due in the usual course of business.

The program utilized the appointment of a court-supervised fiduciary tasked with overseeing a business’s operations under a court-approved operating plan while protecting the business from lawsuits for pre-Business Recovery Plan debts.

The goal of the BRP was to enable the entity to ultimately exit its protections with support of its creditors.

In February 2021, Phoenix House, through Savage, its special master, applied for a second draw PPP loan. The first question on the SBA’s application form asked whether the applicant was “presently involved in any bankruptcy,” and Phoenix House answered in the negative.

On March 5, 2021, Savage’s counsel spoke by phone with SBA Rhode Island District Director Mark Hayward because he had questions about the calculation of gross receipts.

During the call, Savage’s counsel mentioned that Phoenix House was a participant in the COVID-19 Business Recovery Plan.

In response, Hayward allegedly indicated that he believed there might be an “issue” regarding Phoenix House’s eligibility based on such participation.

Afterward, Hayward sent the counsel two emails quoting from the SBA’s FAQs, which stated that borrowers in a bankruptcy proceeding are ineligible for the PPP and that he was “just not sure that receivership is covered as well.”

CASE: Savage, et al. v. United States Small Business Administration, et al., Lawyers Weekly No. 52-084-21

COURT: U.S. District Court

ISSUE: Could a nonprofit organization operating under a non-liquidating state

Savage’s counsel responded that the FAQ could have included state receivership proceedings as disqualifying but did not do so, which indicated that they should not be considered disqualifying. He also pointed out that the Business Recovery Plan — unlike most bankruptcy proceedings — did not affect creditor priority status of the federal government.

receivership seek a declaratory judgment as to whether it was eligible for a loan it had received under the Paycheck Protection Program?

DECISION: No

The attorney additionally requested an advisory opinion as to whether Phoenix House was eligible for the loan despite its participation in the COVID-19 Business Recovery Plan.



“Although the court found that we did not have standing, the action was filed to establish that participation in the COVID-19 Business Recovery Plan does not equate to being involved in a bankruptcy proceeding, which would prevent an entity from seeking or utilizing PPP funding.”

— W. Mark Russo, BRP program coordinator

That request ultimately reached the general counsel’s office at SBA headquarters, which responded that the SBA did not provide eligibility determinations for specific applicants or borrowers and directed Phoenix House to the SBA website, where it could find the PPP program rules and applicable forms and make its own determination.

Unsatisfied with that response, the plaintiffs filed a complaint in U.S. District Court seeking a declaration that Phoenix House was in fact, an eligible PPP recipient. The SBA moved to dismiss for lack of standing.

No standing

Addressing the motion, McElroy noted that because Phoenix House received the money in question, the real issue was uncertainty surrounding loan forgiveness created by Hayward’s alleged ambivalence, which the SBA had not clarified.

“The plaintiffs claim that because they cannot be certain if Phoenix House’s loan will be forgiven, the Special Master faces the ‘Hobson’s choice’ of permitting Phoenix House to spend the loan funds with the possibility of ‘an adverse eligibility determination down the road’ or face liquidation and closure by not spending the money,” she wrote. “It is thus conceivably possible that at some later date the SBA could take administrative action that would specifically address whether entities in non-liquidating state receiverships are eligible entities under the PPP and could do so in a way that negatively impacts Phoenix House’s ability to achieve loan forgiveness.”

However, that possible “threatened injury” did not rise to the level of a harm that is “certainly pending” absent any statute, rule or other guidance providing that state non-liquidating special masterships constitute bankruptcy for PPP eligibility purposes, McElroy said.

Similarly, McElroy found no showing of “substantial risk” of harm.

“There is nothing before the Court to suggest a substantial likelihood that the SBA will take some future action to include what it currently does not include: that entities in state nonliquidating special masterships are ‘presently involved in any bankruptcy,’” the judge said.

While conceding that the SBA caused uncertainty by refusing to answer specific inquiries regarding PPP eligibility, McElroy concluded that with no showing of a “certainly impending” injury or “substantial risk” of harm, the plaintiffs could not show an injury of fact and thus had no standing to proceed.

Issue: AUG. 23 2021 ISSUE

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