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Are Bankrupt Companies Eligible for a PPP Loan?

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Should a company in Bankruptcy be eligible for a PPP Loan? A Texas Bankruptcy Judge says, "Yes." Bankruptcy Judge David R. Jones from the Southern District of Texas ruled recently that so long as the company otherwise qualifies for such loans, the Small Business Administration cannot exclude a Chapter 11 company from participating in the PayCheck Protection Program ("PPP") a part of the CARES Act recently enacted into law by Congress as a relief measure for businesses and individuals affected by the COVID-19 pandemic.

Hidalgo County Emergency Service Foundation ("Hidalgo") filed for protection under Chapter 11 on October 11, 2019. Hidalgo is a company with 250 employees providing emergency medical transportation services to residents of South Texas, benefiting the public interest as a "front line" health care provider. The debtor in possession claimed to have lost approximately 30% of its business as a result of the coronavirus. In April of this year, Hidalgo filed a complaint and a temporary restraining order seeking injunctive relief. Judge Jones issued a TRO on April 25, finding that the Debtor could file an application for a PPP loan and directing the SBA and the participating Bank to review the application without regard for whether the applicant had filed for protection under the Bankruptcy Code.

Judge Jones reasoned that the funds provided by Congress under the CARES Act and the PPP were not really loans, but rather a "support program" since the applicant need not pay the loan back if used for the proper purposes. It is clear from the SBA's website that a PPP loan is "fully forgiven" if at least 75% of the proceeds are spent on payroll and the remainder used for qualifying expenses. The CARES Act includes no language excluding companies in bankruptcy from receiving PPP loans. However, the SBA application form requires a company to indicate whether it is "presently involved in a bankruptcy" and goes on to state that an applicant in bankruptcy is disqualified from participating in the program. Judge Jones found that Hidalgo had met its burden of establishing the grounds for a TRO and indicated that the government did not establish any "legitimate authority for including the language in the form" and presumably using the response to exclude otherwise qualified applicants who were currently involved in a bankruptcy proceeding.

To be clear, the ruling did not direct the SBA to approve the application as the Court indicated that the Debtor must otherwise qualify for the loan. The Government argued that the Bankruptcy Court had no authority to enjoin the SBA and issue an injunction, but Judge Jones indicated that though he did not have the authority to direct the SBA and the participating bank to approve the loan, he did have the authority to prevent discrimination against parties in Bankruptcy.

The case is *Hidalgo County Emergency Service Foundation v. Carranza (In re Hidalgo County Emergency Service Foundation), 20-02006 (Bankr. S.D.Tex. April 25, 2020).* A hearing on the Motion for a Preliminary Injunction is scheduled for May 8, 2020.